1244 stock. If the cost of organizing corporation W amounted to $1,000 and constituted paid-in surplus or a contribution to capital, such amount must be taken into account in determining the amount that may be received under the plan, with the result that only $499,000 may be so received.

Example 2. On December 1, 1958, Corporation X, a newly formed corporation, adopts a plan to issue common stock for an amount (determined under subparagraph (1) of this paragraph (c)) not in excess of $500,000 during a period ending not later than November 30, 1960. By January 1, 1960, the corporation has, pursuant to the plan, issued at par, stock having an aggregate par value of $400,000, $200,000 of which was issued for $200,000 cash, and $200,000 of which was issued for property (other than stock or securities) having a basis to the corporation of $100,000 and a fair market value of $200,000. The corporation may, prior to November 30, 1960, issue stock for an amount not in excess of $200,000 cash or property having a basis to it not in excess of $200,000. Stock issued for any payment which, alone or together with any payments received after January 1, 1960, exceeds such $200,000 amount would not qualify as section 1244 stock because it would not be issued pursuant to the plan.

Example 3. Assume that on December 1, 1958, Corporation Y, a newly formed corporation, adopts a plan to issue common stock for an amount (determined under subparagraph (1) of this paragraph (c)) not in excess of $500,000 during a period ending not later than November 30, 1960. By January 1960 the corporation has received $400,000 cash for stock issued pursuant to the plan, but due to business successes the equity capital of the corporation exceeds $1,000,000. Since the equity capital test is made as of the date that the plan is adopted, the corporation may still, prior to November 30, 1960, issue section 1244 stock pursuant to the plan until the full amount specified in the plan has been received.

Example 4. Subsequent to June 30, 1958, Corporation Z receives a total of $600,000 cash on the issuance of its stock. In 1960 Corporation Z redeems shares of its stock for the total amount of $300,000 and the redemptions reduce Corporation Z's capital to substantially less than $500,000. Notwithstanding the redemptions, pre-November 1978 stock subsequently issued by Corporation Z will not qualify as section 1244 stock because the $500,000 limitation has been previously exceeded.

[T.D. 7779, 46 FR 29470, June 2, 1981, as amended by T.D. 7837, 47 FR 42729, Sept. 29, 1982; 60 FR 16575, Mar. 31, 1995]

§ 1.1244(d)–1 Contributions of property having basis in excess of value.

(a) *In general.* (1) Section 1244(d)(1)(A) provides a special rule which limits the amount of loss on section 1244 stock that may be treated as an ordinary loss. This rule applies only when section 1244 stock is issued by a corporation in exchange for property that, immediately before the exchange, has an adjusted basis (for determining loss) in excess of its fair market value. If section 1244 stock is issued in exchange for such property and the basis of such stock in the hands of the taxpayer is determined by reference to the basis of such property, then for purposes of section 1244, the basis of such stock shall be reduced by an amount equal to the excess, at the time of the exchange, of the adjusted basis of the property over its fair market value.

(2) The provisions of section 1244(d)(1)(A) do not affect the basis of stock for purposes other than section 1244. Such provisions are to be used only in determining the portion of the total loss sustained that may be treated as an ordinary loss pursuant to section 1244.

(b) *Transfer of more than one item.* If a taxpayer exchanges several items of property for stock in a single transaction so that the basis of the property transferred is allocated evenly among the shares of stock received, the computation under this section should be made by reference to the aggregate fair market value and the aggregate basis of the property transferred.

(c) *Examples.* The provisions of this section may be illustrated by the following examples:

Example 1. B transfers property with an adjusted basis of $1,000 and a fair market value of $250 to a corporation for 10 shares of section 1244 stock in an exchange that qualifies under section 351. The basis of B's stock is $1,000 ($100 per share), but, solely for purposes of section 1244, the total basis of the stock must be reduced by $750, the excess of the adjusted basis of the property exchanged over its fair market value. Thus, the basis of such stock for purposes of section 1244 is $250 and the basis of each share for such purposes is $25. If B sells his 10 shares for $250, he will recognize a loss of $750, all of which must be treated as a capital loss. If he sells the 10 shares for $200, then $50 of his total loss of $800 will be treated as an ordinary loss under section 1244, assuming the various requirements of such section are satisfied, and the remaining $750 will be a capital loss.

Example 2. B owns property with a basis of $20,000. The fair market value of the property unencumbered is $15,000 but the property is subject to a $2,000 mortgage. B transfers the encumbered property to a corporation for 100 shares of section 1244 stock in an exchange that qualifies under section 351. The basis of the shares, determined in accordance with section 358, is $18,000 or $180 per share, but solely for purposes of section 1244 the basis is $13,000 ($130 per share), which is its basis for purposes other than section 1244, reduced by $5,000, the excess of the adjusted basis, immediately before the exchange, of the property transferred over its fair market value.

Example 3. C transfers business assets to a corporation for 100 shares of section 1244 stock in an exchange that qualifies under section 351. The assets transferred are as follows:

	Basis	Fair market value
Cash	$10,000	$10,000
Inventory	15,000	30,000
Depreciable property	50,000	20,000
Land	25,000	10,000
	100,000	70,000

The basis for the shares received by C is $100,000, which is applied $1,000 to each share. However, the basis of the shares for purposes of section 1244 is $70,000 ($700 per share), the basis for general purposes reduced by $30,000, the excess of the aggregate adjusted basis of the property transferred over the aggregate fair market value of such property.

[T.D. 6495, 25 FR 9679, Oct. 8, 1960]

§ 1.1244(d)–2 Increases in basis of section 1244 stock.

(a) *In general.* If subsequent to the time of its issuance there is for any reason, including the operation of section 1376(a), an increase in the basis of section 1244 stock, such increase shall be treated as allocable to stock which is not section 1244 stock. Therefore, a loss on stock, the basis of which has been increased subsequent to its issuance, must be apportioned between the part that qualifies as section 1244 stock and the part that does not so qualify. Only the loss apportioned to the part that so qualifies may be treated as an ordinary loss pursuant to section 1244. The amount of loss apportioned to the part that qualifies is the amount which bears the same ratio to the total loss as the basis of the stock which is treated as allocated to section 1244 stock bears to the total basis of the stock.

(b) *Example.* The provisions of paragraph (a) of this section may be illustrated by the following example:

Example: For $10,000 a corporation issues 100 shares of section 1244 stock to X. X later contributes $2,000 to the capital of the corporation and this increases the total basis of his 100 shares to $12,000. Subsequently, he sells the 100 shares for $9,000. Of the $3,000 loss, $2,500 is allocated to the portion of the stock that qualifies as section 1244 stock ($10,000/$12,000 of $3,000), and the remaining $500 is allocated to the portion of the stock that does not so qualify. Therefore, to the extent of $2,500, the loss may be treated as an ordinary loss assuming the various requirements of section 1244 stock are satisfied. However, the remaining $500 loss must be treated as a capital loss.

[T.D. 6495, 25 FR 9680, Oct. 8, 1960]

§ 1.1244(d)–3 Stock dividend, recapitalizations, changes in name, etc.

(a) *In general.* Section 1244(c)(1) provides that stock may not qualify for the benefits of section 1244 unless it is issued to the taxpayer for money or other property not including stock or securities. However, section 1244(d)(2) authorizes exceptions to this rule. The exceptions may apply in three situations: (1) The receipt of a stock dividend; (2) the exchange of stock for stock pursuant to a reorganization described in section 368(a)(1)(E); and (3) the exchange of stock for stock pursuant to a reorganization described in section 368(a)(1)(F).

(b) *Stock dividends.* (1) If common stock is received by an individual or partnership in a nontaxable distribution under section 305(a) made solely with respect to stock owned by such individual or partnership which meets the requirements of section 1244 stock determinable at the time of the distribution, then the common stock so received will also be treated as meeting such requirements. For purposes of this paragraph and paragraphs (c) and (d) of this section, the requirements of section 1244 stock determinable at the time of the distribution or exchange are all of the requirements of section 1244(c)(1) other than the one described in subparagraph (C) thereof, relating to the gross receipts test.