

§ 1.1244(d)-2

26 CFR Ch. I (4-1-04 Edition)

(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.

(2) If, however, such stock dividend is received by such individual or partnership partly with respect to stock meeting the requirements of section 1244 stock determinable at the time of the distribution, and partly with respect to stock not meeting such requirements, then only part of the stock received as a stock dividend will be treated as meeting such requirements. Assuming all the shares with respect to which the dividend is received have equal rights to dividends, such part is the number of shares which bears the same ratio to the total number of shares received as the number of shares owned immediately before the stock dividend which meets such qualifications bears to the total number of shares with respect to

which the stock dividend is received. In determining the basis of shares received in the stock dividend and of the shares held before the stock dividend, section 307 shall apply as if two separate nontaxable stock dividends were made, one with respect to the shares that meet the requirements and the other with respect to shares that do not meet the requirements.

(3) The provisions of subparagraphs (1) and (2) of this paragraph may be illustrated by the following examples:

Example 1. Corporation X issues 100 shares of its common stock to B for \$1,000. Subsequently, in a nontaxable stock dividend B receives 5 more shares of common stock of Corporation X. If the 100 shares meet all the requirements of section 1244 stock determinable at the time of the distribution of the stock dividend, the 5 additional shares shall also be treated as meeting such requirements.

Example 2. In 1959, Corporation Y issues 100 shares of its common stock to C for \$1,000 and these shares meet the requirements of section 1244 stock determinable at the time of the issuance. In 1960, C purchases an additional 200 shares of such stock from another shareholder for \$3,000; however, these shares do not meet the requirements of section 1244 stock because they were not originally issued to C by the corporation. In 1961, C receives 15 shares of Corporation Y common stock as a stock dividend. Of the shares received, 5 shares, the number received with respect to the 100 shares of stock which met the requirements of section 1244 at the time of the distribution, i.e., $100/300 \times 15$, shall also be treated as meeting such requirements. The remaining 10 shares do not meet such requirements as they are not received with respect to section 1244 stock. The basis of such 5 shares is determined by applying section 307 as if the 5 shares were received as a separate stock dividend made solely with respect to shares that meet the requirements of section 1244 stock at the time of the distribution. Thus, the basis of the 5 shares is \$47.61 ($\frac{5}{105}$ of \$1,000).

(c) *Recapitalizations.* (1) If, pursuant to a recapitalization described in section 368(a)(1)(E), common stock of a corporation is received by an individual or partnership in exchange for stock of such corporation meeting the requirements of section 1244 stock determinable at the time of the exchange, such common stock shall be treated as meeting such requirements.

(2) If common stock is received pursuant to such a recapitalization partly