Internal Revenue Service, Treasury

§ 1.1243–1 Loss of small business investment company.

(a) In general—(1) Taxable years beginning after July 11, 1974. For taxable years beginning after July 11, 1969, a small business investment company to which section 582(c) applies, and which sustains a loss as a result of the worthlessness, or on the sale or exchange, of the stock of a small business concern (as defined in section 103(5) of the Small Business Investment Act of 1958, as amended (15 U.S.C. 662(5)) and 13 CFR 107.3), shall treat such loss as a loss from the sale or exchange of property which is not a capital asset if:

(i) The stock was issued pursuant to the conversion privilege of the convertible debentures acquired in accordance with the provisions of section 304 of the Small Business Investment Act of 1958 (15 U.S.C. 662(5)) and in 13 CFR 107.3, shall treat such loss as a loss from the sale or exchange of property which is not a capital asset if:

(ii) Such loss would, but for the provisions of section 1242, be a loss from the sale or exchange of a capital asset, and

(iii) At the time of the loss, the company is licensed to operate as a small business investment company pursuant to regulations promulgated by the Small Business Administration (13 CFR part 107).

(2) Taxable years beginning before July 11, 1974. For taxable years beginning

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(b) Treatment of losses for purposes of section 172. For the purposes of section 172 (relating to the net operating loss deduction), any amount of loss treated by reason of section 1242 as a loss from the sale or exchange of property which is not a capital asset shall be treated as attributable to the trade or business of the taxpayer. Accordingly, the limitation of section 172(d)(4) on the allowance of nonbusiness deductions in computing a net operating loss shall not apply to any loss with respect to the stock of a small business investment company as described in paragraph (a) of this section. See section 172(d) and §1.172–3.

(c) Statement to be filed with return. A taxpayer claiming a deduction for a loss on the stock of a small business investment company shall file with his income tax return a statement containing: The name and address of the small business investment company which issued the stock, the number of shares, basis, and selling price of the stock with respect to which the loss is claimed, the respective dates of purchase and sale of such stock, or the reason for its worthlessness and approximate date thereof. For the rules applicable in determining the worthlessness of securities, see section 165 and the regulations thereunder.

§ 1.1244(a)–1 Loss on small business stock treated as ordinary loss.

(a) In general. Subject to certain conditions and limitations, section 1244 provides that a loss on the sale or exchange (including a transaction treated as a sale or exchange, such as worthlessness) of section 1244 stock which would otherwise be treated as a loss from the sale or exchange of a capital asset shall be treated as a loss from the sale or exchange of an asset which is not a capital asset (referred to in this section and §§1.1244(b)–1 to 1.1244(e)–1, inclusive, as an ordinary loss). Such a loss shall be allowed as a deduction from gross income in arriving at adjusted gross income. The requirements that must be satisfied in order that stock may be considered section 1244 stock are described in §§1.1244(c)–1 and 1.1244(c)–2. These requirements relate to the stock itself and the corporation issuing such stock. In addition, the taxpayer who claims an ordinary loss deduction pursuant to section 1244 must satisfy the requirements of paragraph (b) of this section.

(b) Taxpayers entitled to ordinary loss. The allowance of an ordinary loss deduction for a loss of section 1244 stock is permitted only to the following two classes of taxpayers:

(1) An individual sustaining the loss to whom the stock was issued by a small business corporation, or

(2) An individual who is a partner in a partnership at the time the partnership acquired the stock in an issuance from a small business corporation and whose distributive share of partnership items reflects the loss sustained by the partnership. The ordinary loss deduction is limited to the lesser of the partner's distributive share at the time of the issuance of the stock or the partner's distributive share at the time the loss is sustained. In order to claim a deduction under section 1244 the individual, or the partnership, sustaining the loss must have continuously held the stock from the date of issuance. A corporation, trust, or estate is not entitled to ordinary loss treatment under section 1244 regardless of how the stock