

§ 1.1244(a)-1

26 CFR Ch. I (4-1-12 Edition)

after September 2, 1958, but before July 11, 1974, a small business investment company to which section 582(c) does not apply, and which sustains a loss as a result of the worthlessness, or on the sale or exchange, of the securities 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 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:

(i) The securities are either the convertible debentures, or the stock issued pursuant to the conversion privilege thereof, acquired in accordance with the provisions of section 304 of the Small Business Investment Act of 1958 (15 U.S.C. 684) and the regulations thereunder.

(ii) Such loss would, but for the provisions of this subparagraph, 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).

If section 582(c) applies for the taxable year, see subparagraph (1) of this paragraph.

(b) *Material to be filed with return.* A small business investment company which claims a deduction for a loss on the convertible debentures (pursuant to paragraph (a)(2) of this section) or stock (pursuant to paragraph (a) (1) or (2) of this section) of a small business concern shall submit with its income tax return a statement that it is a Federal licensee under the Small Business Investment Act of 1958 (15 U.S.C. chapter 14B). The statement shall also set forth: the name and address of the small business concern with respect to whose securities the loss was sustained, the number of shares of stock or the number and denomination of debentures with respect to which the loss is claimed, the basis and selling price thereof, and the respective dates of purchase and sale of the securities, or the reason for their worthlessness and the approximate date thereof. For the rules applicable in determining the

worthlessness of securities, see section 165 and the regulations thereunder.

[T.D. 7171, 37 FR 5621, Mar. 17, 1972]

§ 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

was acquired. An individual who acquires stock from a shareholder by purchase, gift, devise, or in any other manner is not entitled to an ordinary loss under section 1244 with respect to this stock.

Thus, ordinary loss treatment is not available to a partner to whom the stock is distributed by the partnership. Stock acquired through an investment banking firm, or other person, participating in the sale of an issue may qualify for ordinary loss treatment only if the stock is not first issued to the firm or person. Thus, for example, if the firm acts as a selling agent for the issuing corporation the stock may qualify. On the other hand, stock purchased by an investment firm and subsequently resold does not qualify as section 1244 stock in the hands of the person acquiring the stock from the firm.

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

Example 1. A and B, both individuals, and C, a trust, are equal partners in a partnership to which a small business corporation issues section 1244 stock. The partnership sells the stock at a loss. A's and B's distributive share of the loss may be treated as an ordinary loss pursuant to section 1244, but C's distributive share of the loss may not be so treated.

Example 2. The facts are the same as in example (1) except that the section 1244 stock is distributed by the partnership to partner A and he subsequently sells the stock at a loss. Section 1244 is not applicable to the loss since A did not acquire the stock by issuance from the small business corporation.

[T.D. 6495, 25 FR 9675, Oct. 8, 1960, as amended by T.D. 7779, 46 FR 29467, June 2, 1981]

§ 1.1244(b)-1 Annual limitation.

(a) *In general.* Subsection (b) of section 1244 imposes a limitation on the aggregate amount of loss that for any taxable year may be treated as an ordinary loss by a taxpayer by reason of that section. In the case of a partnership, the limitation is determined separately as to each partner. Any amount of loss in excess of the applicable limitation is treated as loss from the sale or exchange of a capital asset.

(b) *Amount of loss—(1) Taxable years beginning after December 31, 1978.* For any taxable year beginning after De-

ember 31, 1978, the maximum amount that may be treated as an ordinary loss under section 1244 is:

(i) \$50,000, or

(ii) \$100,000, if a husband and wife file a joint return under section 6013.

These limitations on the maximum amount of ordinary loss apply whether the loss or losses are sustained on pre-November 1978 stock (as defined in § 1.1244 (c)-1 (a)(1)), post-November 1978 stock (as defined in § 1.1244 (c)-1 (a)(2)), or on any combination of pre-November 1978 stock and post-November 1978 stock. The limitation referred to in (ii) applies to a joint return whether the loss or losses are sustained by one or both spouses.

(2) *Taxable years ending before November 6, 1978.* For any taxable year ending before November 6, 1978, the maximum amount that may be treated as an ordinary loss under section 1244 is:

(i) \$25,000 or

(ii) \$50,000, if a husband and wife file a joint return under section 6013.

The limitation referred to in (ii) applies to a joint return whether the loss or losses are sustained by one or both spouses.

(3) *Taxable years including November 6, 1978.* For a taxable year including November 6, 1978, the maximum amount that may be treated as ordinary loss under section 1244 is the sum of:

(i) The amount calculated by applying the limitations described in subparagraph (1) of this paragraph (b) to the amount of loss, if any, sustained during the taxable year on post-November 1978 stock, plus

(ii) The amount calculated by applying the limitations described in subparagraph (2) of this paragraph (b) to the amount of loss, if any, sustained during the taxable year on pre-November 1978 stock,

To the extent this sum does not exceed \$50,000, or, if a husband and wife file a joint return under section 6013 for the taxable year, \$100,000.

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

Example 1. A, a married taxpayer who files a joint return for the taxable year ending December 31, 1977, sustains a \$50,000 loss