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qualifying under section 1244 on pre-November 1978 stock in Corporation X and an equal amount of loss qualifying under section 1244 on pre-November 1978 stock in Corporation Y. A is limited to \$50,000 of ordinary loss under paragraph (b)(2)(ii). The remaining \$50,000 of loss is treated as loss from the sale or exchange of a capital asset.

Example 2. For the taxable year ending December 31, 1979, B, a married taxpayer who files a joint return, sustains a \$90,000 loss on post-November 1978 stock in Corporation X. In the same taxable year, C, B's spouse, sustains a \$25,000 loss on post-November 1978 stock in Corporation Y. Both losses qualify under section 1244. B and C's ordinary loss is limited to \$100,000 under paragraph (b)(1)(ii). The remaining \$15,000 of loss is treated as loss from the sale or exchange of a capital asset.

Example 3. D, a married taxpayer who files a joint return and reports income on a fiscal year basis for the taxable year ending November 30, 1978, sustains a \$60,000 loss qualifying under section 1244 on pre-November 1978 stock and a \$40,000 loss qualifying under section 1244 on post-November 1978 stock. D's ordinary loss on pre-November 1978 stock is limited to \$50,000 under subparagraph (3)(ii) of this paragraph (b). D's \$40,000 loss on post-November 1978 stock is within the limit of subparagraph (3)(i) of this paragraph (b). The total of these losses, \$90,000, is the aggregate amount deductible by D as ordinary loss under section 1244. The remaining \$10,000 of loss is treated as loss from the sale or exchange of a capital asset.

Example 4. E, a married taxpayer who files a joint return for the taxable year ending December 31, 1980, sustains a \$75,000 loss qualifying under section 1244 on pre-November 1978 stock and a \$10,000 loss qualifying under section 1244 on post-November 1978 stock. E may deduct the total of these losses, \$85,000, as ordinary loss under paragraph (b)(1)(ii).

Example 5. Assume the same facts as in the preceding example, except that the losses are sustained in the taxable year beginning January 1, 1978, and ending December 31, 1978. E is limited to \$60,000 of ordinary loss (\$50,000 on pre-November 1978 stock plus \$10,000 on post-November 1978 stock) under paragraph (b)(3). The remaining \$25,000 of loss is treated as loss from the sale or exchange of a capital asset.

Example 6. F, a married taxpayer who files a joint return for the taxable year beginning January 1, 1978, and ending December 31, 1978, sustains a \$75,000 loss qualifying under section 1244 on pre-November 1978 stock and a \$125,000 loss qualifying under section 1244 on post-November 1978 stock. F's loss on pre-November 1978 stock is limited to \$50,000 of ordinary loss under subparagraph (3)(ii) of this paragraph (b). F's loss on post-November 1978 stock is limited to \$100,000 of ordinary

loss under subparagraph (3)(i) of this paragraph (b). The total of these losses, \$150,000, is limited to \$100,000 of ordinary loss under paragraph (b)(3). F's aggregate amount of ordinary loss under section 1244 is \$100,000. The remaining \$100,000 of loss is treated as loss from the sale or exchange of a capital asset.

[T.D. 7779, 46 FR 29467, June 2, 1981]

§ 1.1244(c)-1 Section 1244 stock defined.

(a) *In general.* For purposes of §§ 1.1244(a)-1 to 1.1244(e)-1, inclusive:

(1) The term *pre-November 1978 stock* means stock issued after June 30, 1958, and on or before November 6, 1978.

(2) The term *post-November 1978 stock* means stock issued after November 6, 1978.

In order that stock may qualify as section 1244 stock, the requirements described in paragraphs (b) through (e) of this section must be satisfied. In addition, the requirements of paragraph (f) of this section must be satisfied in the case of pre-November 1978 stock. Whether these requirements have been met is determined at the time the stock is issued, except for the requirement in paragraph (e) of this section. Whether the requirement in paragraph (e) of this section, relating to gross receipts of the corporation, has been satisfied is determined at the time a loss is sustained. Therefore, at the time of issuance it cannot be said with certainty that stock will qualify for the benefits of section 1244.

(b) *Common stock.* Only common stock, either voting or nonvoting, in a domestic corporation may qualify as section 1244 stock. For purposes of section 1244, neither securities of the corporation convertible into common stock nor common stock convertible into other securities of the corporation are treated as common stock. An increase in the basis of outstanding stock as a result of a contribution to capital is not treated as an issuance of stock under section 1244. For definition of domestic corporation, see section 7701(a)(4) and the regulations under that section.

(c) *Small business corporation.* At the time the stock is issued (or, in the case of pre-November 1978 stock, at the time of adoption of the plan described in paragraph (f)(1) of this section) the corporation must be a *small business corporation*. See § 1.1244(c)-2 for the definition of a small business corporation.

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(d) *Issued for money or other property.* (1) The stock must be issued to the taxpayer for money or other property transferred by the taxpayer to the corporation. However, stock issued in exchange for stock or securities, including stock or securities of the issuing corporation, cannot qualify as section 1244 stock, except as provided in § 1.1244(d)-3, relating to certain cases where stock is issued in exchange for section 1244 stock. Stock issued for services rendered or to be rendered to, or for the benefit of, the issuing corporation does not qualify as section 1244 stock. Stock issued in consideration for cancellation of indebtedness of the corporation shall be considered issued in exchange for money or other property unless such indebtedness is evidenced by a security, or arises out of the performance of personal services.

(2) The following examples illustrate situations where stock fails to qualify as section 1244 stock as a result of the rules in subparagraph (1) of this paragraph:

Example 1. A taxpayer owns stock of Corporation X issued to him prior to July 1, 1958. Under a plan adopted in 1977, he exchanges his stock for a new issuance of stock of Corporation X. The stock received by the taxpayer in the exchange may not qualify as section 1244 stock even if the corporation has adopted a valid plan and is a small business corporation.

Example 2. A taxpayer owns stock in Corporation X. Corporation X merges into Corporation Y. In exchange for his stock, Corporation Y issues shares of its stock to the taxpayer. The stock in Corporation Y does not qualify as section 1244 stock even if the stock exchanged by the taxpayer did qualify.

Example 3. Corporation X transfers part of its business assets to Corporation Y, a new corporation, and all of the stock of Corporation Y is issued directly to the shareholders of Corporation X. Since the Corporation Y stock was not issued to the shareholders for a transfer by them of money or other property, none of the Corporation Y stock in the hands of the shareholders can qualify.

(e) *Gross receipts.* (1)(i)(a) Except as provided in subparagraph (2) of this paragraph, stock will not qualify under section 1244, if 50 percent or more of the gross receipts of the corporation, for the period consisting of the five most recent taxable years of the corporation ending before the date the

loss on such stock is sustained by the shareholders, is derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities. If the corporation has not been in existence for five taxable years ending before such date, the percentage test referred to in the preceding sentence applies to the period of the taxable years ending before such date during which the corporation has been in existence; and if the loss is sustained during the first taxable year of the corporation such test applies to the period beginning with the first day of such taxable year and ending on the day before the loss is sustained. The test under this paragraph shall be made on the basis of total gross receipts, except that gross receipts from the sales or exchanges of stock or securities shall be taken into account only to the extent of gains therefrom. The term *gross receipts* as used in section 1244(c)(1)(C) is not synonymous with *gross income*. Gross receipts means the total amount received or accrued under the method of accounting used by the corporation in computing its taxable income. Thus, the total amount of receipts is not reduced by returns and allowances, cost, or deductions. For example, gross receipts will include the total amount received or accrued during the corporation's taxable year from the sale or exchange (including a sale or exchange to which section 337 applies) of any kind of property, from investments, and for services rendered by the corporation. However, gross receipts does not include amounts received in nontaxable sales or exchanges (other than those to which section 337 applies), except to the extent that gain is recognized by the corporation, nor does that term include amounts received as a loan, as a repayment of a loan, as a contribution to capital, or on the issuance by the corporation of its own stock.

(b) The meaning of the term *gross receipts* as used in section 1244(c)(1)(C) may be further illustrated by the following examples:

Example 1. A corporation on the accrual method sells property (other than stock or securities) and receives payment partly in money and partly in the form of a note payable at a future time. The amount of the money and the face amount of the note

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would be considered gross receipts in the taxable year of the sale and would not be reduced by the adjusted basis of the property, the costs of sale, or any other amount.

Example 2. A corporation has a long-term contract as defined in paragraph (a) of § 1.451-3 with respect to which it reports income according to the percentage-of-completion method as described in paragraph (b)(1) of § 1.451-3. The portion of the gross contract price which corresponds to the percentage of the entire contract which has been completed during the taxable year shall be included in gross receipts for such year.

Example 3. A corporation which regularly sells personal property on the installment plan elects to report its taxable income from the sale of property (other than stock or securities) on the installment method in accordance with section 453. The installment payments actually received in a given taxable year of the corporation shall be included in gross receipts for such year.

(ii) The term *royalties* as used in subdivision (i) of this subparagraph means all royalties, including mineral, oil, and gas royalties (whether or not the aggregate amount of such royalties constitutes 50 percent or more of the gross income of the corporation for the taxable year), and amounts received for the privilege of using patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other like property. The term *royalties* does not include amounts received upon the disposal of timber, coal, or domestic iron ore with a retained economic interest to which the special rules of section 631 (b) and (c) apply or amounts received from the transfer of patent rights to which section 1235 applies. For the definition of *mineral, oil, or gas royalties*, see paragraph (b)(11) (ii) and (iii) of § 1.543-1. For purposes of this subdivision, the gross amount of royalties shall not be reduced by any part of the cost of the rights under which they are received or by any amount allowable as a deduction in computing taxable income.

(iii) The term *rents* as used in subdivision (i) of this subparagraph means amounts received for the use of, or right to use, property (whether real or personal) of the corporation, whether or not such amounts constitute 50 percent or more of the gross income of the corporation for the taxable year. The term *rents* does not include payments for the use or occupancy of rooms or

other space where significant services are also rendered to the occupant, such as for the use or occupancy of rooms or other quarters in hotels, boarding houses, or apartment houses furnishing hotel services, or in tourist homes, motor courts, or motels. Generally, services are considered rendered to the occupant if they are primarily for his convenience and are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only. The supplying of maid service, for example, constitutes such services; whereas the furnishing of heat and light, the cleaning of public entrances, exits, stairways, and lobbies, the collection of trash, etc., are not considered as services rendered to the occupant. Payments for the use or occupancy of entire private residences or living quarters in duplex or multiple housing units, of offices in an office building, etc., are generally *rents* under section 1244(c)(1)(C). Payments for the parking of automobiles ordinarily do not constitute rents. Payments for the warehousing of goods or for the use of personal property do not constitute rents if significant services are rendered in connection with such payments.

(iv) The term *dividends* as used in subdivision (i) of this subparagraph includes dividends as defined in section 316, amounts required to be included in gross income under section 551 (relating to foreign personal holding company income taxed to United States shareholders), and consent dividends determined as provided in section 565.

(v) The term *interest* as used in subdivision (i) of this subparagraph means any amounts received for the use of money (including tax-exempt interest).

(vi) The term *annuities* as used in subdivision (i) of this subparagraph means the entire amount received as an annuity under an annuity, endowment, or life insurance contract, regardless of whether only part of such amount would be includable in gross income under section 72.

(vii) For purposes of subdivision (i) of this subparagraph, gross receipts from the sales or exchanges of stock or securities are taken into account only to the extent of gains therefrom. Thus,

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the gross receipts from the sale of a particular share of stock will be the excess of the amount realized over the adjusted basis of such share. If the adjusted basis should equal or exceed the amount realized on the sale or exchange of a certain share of stock, bond, etc., there would be no gross receipts resulting from the sale of such security. Losses on sales or exchanges of stock or securities do not offset gains on the sales or exchanges of other stock or securities for purposes of computing gross receipts from such sales or exchanges. Gross receipts from the sale or exchange of stocks and securities include gains received from such sales or exchanges by a corporation even though such corporation is a regular dealer in stocks and securities. For the meaning of the term *stocks or securities*, see paragraph (b)(5)(i) of § 1.543-1.

(2) The requirement of subparagraph (1) of this paragraph need not be satisfied if for the applicable period the aggregate amount of deductions allowed to the corporation exceeds the aggregate amount of its gross income. But for this purpose the deductions allowed by section 172, relating to the net operating loss deduction, and by sections 242, 243, 244, and 245, relating to certain special deductions for corporations, shall not be taken into account. Notwithstanding the provisions of this subparagraph and of subparagraph (1) of this paragraph, pursuant to the specific delegation of authority granted in section 1244(e) to prescribe such regulations as may be necessary to carry out the purposes of section 1244, ordinary loss treatment will not be available with respect to stock of a corporation which is not largely an operating company within the five most recent taxable years (or such lesser period as the corporation is in existence) ending before the date of the loss. Thus, for example, assume that a person who is not a dealer in real estate forms a corporation which issues stock to him which meets all the formal requirements of section 1244 stock. The corporation then acquires a piece of unimproved real estate which it holds as an investment. The property declines in value and the stockholder sells his stock at a loss. The loss does not qualify for ordi-

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nary loss treatment under section 1244 but must be treated as a capital loss.

(3) In applying subparagraphs (1) and (2) of this paragraph to a successor corporation in a reorganization described in section 368(a)(1)(F), such corporation shall be treated as the same corporation as its predecessor. See paragraph (d)(2) of § 1.1244(d)-3.

(f) *Special rules applicable to pre-November 1978 stock.* (1)(i) Pre-November 1978 common stock must have been issued under a written plan adopted by the corporation after June 30, 1958, and on or before November 6, 1978, to offer only this stock during a period specified in the plan ending not later than 2 years after the date the plan is adopted. The 2-year requirement referred to in the preceding sentence is met if the period specified in the plan is based upon the date when, under the rules or regulations of a Government agency relating to the issuance of the stock, the stock may lawfully be sold, and it is clear that this period will end, and in fact does end, within 2 years after the plan is adopted. The plan must specifically state, in terms of dollars, the maximum amount to be received by the corporation in consideration for the stock to be issued under the plan. See § 1.1244(c)-2 for the limitation on the amount that may be received by the corporation under the plan.

(ii) To qualify, the pre-November 1978 stock must be issued during the period of the offer, which period must end not later than two years after the date the plan is adopted. Pre-November 1978 stock which is subscribed for during the period of the plan but not issued during this period cannot qualify as section 1244 stock. Pre-November 1978 stock issued on the exercise of a stock right, stock warrant, or stock option (which right, warrant, or option was not outstanding at the time the plan was adopted) will be treated as issued under a plan only if the right, warrant, or option is applicable solely to unissued stock offered under the plan and is exercised during the period of the plan.

(iii) Pre-November 1978 stock subscribed for prior to the adoption of the plan, including stock subscribed for prior to the date the corporation comes into existence, may be considered

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issued under a plan adopted by the corporation if the stock is not in fact issued prior to the adoption of the plan.

(iv) Pre-November 1978 stock issued for a payment which, alone or together with prior payments, exceeds the maximum amount that may be received under the plan, is not considered issued under the plan, and none of the stock can qualify as section 1244 stock. See § 1.1244(c)-2(b) for a different rule with respect to post-November 1978 stock.

(2) Pre-November 1978 stock does not qualify as section 1244 stock if at the time of the adoption of the plan under which it is issued there remains unissued any portion of a prior offering of stock. Thus, if any portion of an outstanding offering of common or preferred stock is unissued at the time of the adoption of the plan, stock issued under the plan will not qualify as section 1244 stock. An offer is outstanding unless and until it is withdrawn by affirmative action before the plan is adopted. Stock rights, stock warrants, stock options, or securities convertible into stock, that are outstanding at the time the plan is adopted, are considered prior offerings. The authorization in the corporate charter to issue stock different from stock offered under the plan or in excess of stock offered under the plan is not of itself a prior offering.

(3)(i) Even though the plan satisfies the requirements of subparagraph (1) of this paragraph (f), if another offering of pre-November 1978 stock is made by the corporation subsequent to, or simultaneous with, the adoption of the plan, pre-November 1978 stock issued under the plan after the other offering does not qualify as section 1244 stock. The issuance of stock options, stock rights, or stock warrants at any time during the period of the plan, that are exercisable on stock other than stock offered under the plan, is considered a subsequent offering. Similarly, the issuance of pre-November 1978 stock other than that offered under the plan is considered a subsequent offering. Because stock issued upon exercise of a conversion privilege is stock issued for a security, and stock issued under a stock option granted in whole or in part for services is not issued for money or other property, the issuance

of securities with a conversion privilege and the issuance of such a stock option are subsequent offerings, because the conversion privilege and the stock option are exercisable with respect to stock other than that which may properly be offered under the plan. Pre-November 1978 stock issued under the plan before a subsequent offering is not disqualified because of the subsequent offering. The rule of the subparagraph, together with the rule of subparagraph (2) of this paragraph (f), relating to offers prior to the adoption of the plan, limits pre-November 1978 section 1244 stock to stock issued by the corporation during a period when any stock issued by it must have been issued under the plan.

(ii) Any modification of a plan that changes the offering to include preferred stock, or that increases the amount of pre-November 1978 stock that may be issued under the plan to such an extent that the requirements of paragraph (c) of this section would not have been satisfied if determined with reference to this amount as of the date the plan was initially adopted, or that extends the period of time during which stock may be issued under the plan to more than 2 years from the date the plan was initially adopted, is considered a subsequent offering, and no stock issued after this offering may qualify. However, a corporation may withdraw a plan and adopt a new plan to issue stock. To determine whether stock issued under this new plan may qualify, this paragraph (f) must be applied with respect to the new plan as of the date of its adoption. For example, amounts received for stock under the prior plan must be taken into account in determining whether the statutory requirements relating to definition of small business corporation are satisfied. In applying the requirements of paragraph (c) of this section, reference should be made to equity capital as of the date the new plan is adopted. The same principles apply if the period of the initial plan expires and the corporation adopts a new plan.

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