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1244 STOCKS

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Section 1244 is an important provision in the Internal Revenue Code because investments made to a small business corporation can be **deducted as ordinary loss** (instead of capital loss) in your personal income tax return. The distinction is important because ordinary loss can be **deducted at 100%** while the capital loss is limited to \$3,000 per year. With this in mind, let us learn a few things about section 1244 stocks.

It is not unusual for businesses to incur losses during the early years. Some business entities do not survive. When such an unfortunate event happens to your corporation, you may elect to characterize your loss as ordinary loss.

Taxpayers doing business as sole proprietorships and partnerships are able to deduct their operating losses in their personal income tax returns. On the other hand, taxpayers who choose the corporate form of business could not use these losses as deductions because corporate losses stay with the corporation. To make it even worse, losses become capital losses that can only be used to offset capital gains or be deducted at maximum rate of \$3,000 per year.

To remedy this inequity, **Congress encourages investment in small business corporations by allowing losses from such corporations to be deducted as ordinary losses**. In other words, if you form your corporation, invest \$30,000 and loan it \$20,000 and the company goes bankrupt, you may deduct the whole \$50,000 as ordinary loss, not just \$3,000. This is quite a difference.

TIP: Elect 1244 stock classification in your corporate minutes and by-laws.

Read on for more tips:

1. A small business corporation is a company whose capital contribution does not exceed \$1M.
2. Determination of the stock contribution is made at the time the cash or property is received by the corporation.
3. Both common and preferred qualify as 1244 stock.
4. The maximum amount of ordinary loss deduction for any taxable year is \$50,000 for single and \$100,000 for married filing joint.
5. Deduction is allowed only to the individual that the stock was originally issued to.
6. Only individuals and partnerships are qualified shareholders (trusts or estates do not qualify).