

Maximizing Tax Efficiency in the Case of Business Failure – Section 1244 Stock Issuance

There are obviously no guarantees of success when you start a new business venture. If the business goes sour, at least you can get a tax break. But some deductions are better than others.

Ordinarily, you can deduct capital losses, including stock losses, to the extent they offset capital gains, plus up to \$3,000 of ordinary income annually. Any excess must be carried forward.

Fortunately, there's a more lucrative tax break in store. Ask your tax adviser about issuing "Section 1244 stock" if you are setting up a new C or S corporation or contributing capital to one. With this tax break, your loss may be *fully* deductible against ordinary income.

For example, if you incur a \$50,000 loss, you don't have to spend many years writing it off in small amounts and carrying forward the rest. You can write off the entire \$50,000 against ordinary income such as salary, interest and self-employment income. Married couples can deduct up to \$100,000 in a year, regardless of whether only one spouse was the shareholder.

However, the business must be an actual functioning company - not merely a shell - to qualify for the Section 1244 tax break. In one case, the Tax Court determined that the corporation in question was not an operating company for the last five years. It earned all of its income from investments and had no operating assets or salaries. *Result:* The losses claimed under Section 1244 were denied. (*Crigler*, TC Memo 2003-93)

Section 1244 status makes investing in your corporation more attractive. Of course, no one goes into business with the idea the venture will fail. But this special tax break provides consolation if that happens. It's like getting a form of tax insurance - a fully deductible loss if the business fails and low-taxed capital gain if the business succeeds.

Source: Entrepreneur.com

To Qualify for Section 1244 Treatment...

You must meet certain requirements as a small business corporation including:

- The total capital invested in the business cannot exceed \$1 million.
- Your annual loss deduction for Section 1244 stock is limited to \$100,000 (\$50,000 for single filers).

Note: If the Section 1244 venture is a success, you're allowed the same favorable capital gain treatment as you receive with any stock. Depending on the holding period and when the stock was sold this year, you could qualify for a favorable long-term rate - 15 percent for shares sold on or after May 6, 2003 and 20 percent for shares sold before that date.