**8552. How is a loss realized on a sale between related persons treated for tax purposes?**

If an individual sells property at a loss to a related person (as defined below), that loss is disallowed and may *not* be used to offset capital gains for income tax purposes.[[1]](#footnote-1) It makes no difference that the sale was a bona fide, arm’s-length transaction.[[2]](#footnote-2) Neither does it matter that the sale was made indirectly through an unrelated middleman.[[3]](#footnote-3) The loss on the sale of stock will be disallowed even though the sale and purchase are made separately on a stock exchange and the stock certificates received are not the certificates sold.[[4]](#footnote-4) However, these rules will not apply to any loss of the distributing corporation (or the distributee) in the case of a distribution in complete liquidation.[[5]](#footnote-5)

A loss realized on the exchange of properties between related persons will also be disallowed under these rules.[[6]](#footnote-6)

“Related persons” for this purpose includes the following:

(1) members of the same family (i.e., brothers, sisters, spouses, ancestors, and lineal descendants (but not if they are in-laws));[[7]](#footnote-7)

(2) an individual and a corporation of which the individual actually or constructively owns more than 50 percent of the stock;

*Example*: Amy owns a parcel of land with a fair market value of $50,000. Amy’s basis in the land is $100,000. Amy sells the land to a corporation wholly owned by his brother. Although Asher owns no stock of the corporation, through the attribution rules, a taxpayer is deemed to constructively own all the stock owned by his brother.[[8]](#endnote-1) For that reason, the $50,000 loss would be disallowed.

(3) a grantor and a fiduciary of a trust;

The relationship between a grantor and fiduciary did not prevent recognition of loss on a sale of stock between them where the fiduciary purchased the stock in his individual capacity and where the sale was unrelated to the grantor-fiduciary relationship.[[9]](#footnote-8)

(4) fiduciaries of two trusts if the same person is the grantor of both;

(5) a fiduciary and a beneficiary of the same trust;

 (6) a fiduciary of a trust and a beneficiary of another trust set up by the same grantor;

(7) a fiduciary of a trust and a corporation of which the trust or the grantor of the trust actually or constructively owns more than 50 percent of the stock;

(8) a person and an IRC Section 501 tax-exempt organization controlled by the person or members of his family (as described in (1) above);

(9) a corporation and a partnership if the same person actually or constructively owns more than 50 percent of the stock of the corporation, and has more than a 50 percent interest in the partnership;

(10)two S corporations if the same persons actually or constructively own more than 50 percent of the stock of each;

(11)an S corporation and a C corporation, if the same persons actually or constructively own more than 50 percent of the stock of each;

(12)generally, an executor and a beneficiary of an estate; or

(13)possibly an individual and an individual retirement account (IRA).[[10]](#footnote-9)

Special rules apply for purposes of determining constructive ownership of stock.[[11]](#footnote-10)

Generally, loss will be disallowed on a sale between a partnership and a partner who owns more than a 50 percent interest, or between two partnerships if the same persons own more than a 50 percent interest in each.[[12]](#footnote-11) Furthermore, with respect to transactions between two partnerships having one or more common partners *or* in which one or more of the partners in each partnership are related, a portion of the loss will be disallowed according to the relative interests of the partners.[[13]](#footnote-12) If the transaction is between a partnership and an individual who is related to one of the partners, any deductions for losses will be denied with respect to the related partner’s distributive share, but not with respect to the relative shares of each unrelated partner.[[14]](#footnote-13) Loss on a sale or exchange (other than of inventory) between two corporations that are members of the same controlled group (using a 50 percent test instead of 80 percent) is generally not denied but is deferred until the property is transferred outside the controlled group.[[15]](#footnote-14)

If the related person to whom property was originally sold (or exchanged), sells or exchanges the same property (or property whose tax basis is determined by reference to such property) at a gain, the gain will be recognized only to the extent it exceeds the loss originally denied by reason of the related parties rules.[[16]](#footnote-15)

**Planning Point**: If one family member is considering selling a closely held business to another at a loss, there are probably better ways to achieve tax savings than for the seller to give up a tax loss. A related party buyer might pay a little more for a business than a non-related party. The goodwill may be justifiably higher because of the relationship, the customer base or the reputation, among other reasons. The seller can realize tax savings through the deal structure; the buyer can realize savings by depreciation and amortization.

1. . IRC Sec. 267(a); Treas. Reg. §1.267(a)-1 and Rev. Rul. 2008-5, 2008-3 IRB 271. [↑](#footnote-ref-1)
2. . Treas. Reg. §1.267(a)-1(c). [↑](#footnote-ref-2)
3. . See *Hassen v. Comm.*, 599 F.2d 305 (9th Cir. 1979). [↑](#footnote-ref-3)
4. . *McWilliams v. Comm.*, 331 U.S. 694 (1947). [↑](#footnote-ref-4)
5. . IRC Sec. 267(a)(1). [↑](#footnote-ref-5)
6. . IRC Sec. 267(a)(1). [↑](#footnote-ref-6)
7. . See Let. Rul. 9017008. [↑](#footnote-ref-7)
8. IRC Sec. 267(c)(4). [↑](#endnote-ref-1)
9. . Let. Rul. 9017008. [↑](#footnote-ref-8)
10. . IRC Sec. 267(b). [↑](#footnote-ref-9)
11. . See IRC Sec. 267(c). [↑](#footnote-ref-10)
12. . IRC Sec. 707(b). [↑](#footnote-ref-11)
13. . Temp. Treas. Reg. §1.267(a)-2T(c), A-2. [↑](#footnote-ref-12)
14. . Treas. Reg. §1.267(b)-1(b). [↑](#footnote-ref-13)
15. . IRC Sec. 267(f). [↑](#footnote-ref-14)
16. . IRC Sec. 267(d); Treas. Reg. §1.267(d)-1. [↑](#footnote-ref-15)