



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

OFFICE OF  
CHIEF COUNSEL

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The Honorable Martin Heinrich  
Member, U.S. House of Representatives  
20 First Plaza, N.W., Suite 603  
Albuquerque, New Mexico 87102

Attention:

Dear Congressman Heinrich:

I am responding to your inquiry dated April 14, 2010, on behalf of your constituent, \_\_\_\_\_, asked how he could establish that stock he purchased is worthless to obtain a deduction on his taxes.

Under the law, the taxpayer must establish that the security:

- Had a basis.
- Was not worthless before the year he or she claimed the worthlessness.
- Was worthless in the year claimed.

To show that the stock is worthless, \_\_\_\_\_ must show both balance sheet insolvency and a complete lack of future potential value (section 165(g) of the Internal Revenue Code).

To show balance sheet insolvency, the taxpayer must show that liabilities exceed assets in the year of worthlessness. The asset value must reflect any significant differences between the book value and the fair market value of the assets. If \_\_\_\_\_ is a minority shareholder, he may have trouble obtaining a reliable balance sheet. In that case, the decision as to whether the stock has any liquidation value in the year he claimed the stock as worthless would depend on the exercise of business judgment to the extent information is reasonably obtainable. See *Byrum v. Commissioner*, 58 T.C. 731, 734 (1972). \_\_\_\_\_ can establish that the stock had no liquidation value once a sale of assets and distribution in liquidation to creditors in the

bankruptcy proceeding has occurred.

Even though the balance sheet may show insolvency, the stock of the corporation could possibly have some value in the future. Therefore, the taxpayer must show not only current balance sheet insolvency but the destruction of potential value to establish current worthlessness. Generally, a series of events, which, in the context of what has happened previously, shows both current and future worthlessness would have to occur.

Based on the facts given, \_\_\_\_\_ can most likely use the following to establish that the stock is worthless:

- Adoption and commencement of a plan of liquidation.
- Sale of assets.
- Distribution in liquidation to creditors.

To show this, he will need to monitor the bankruptcy proceedings. Once the sale of assets has occurred and the distributions have taken place, \_\_\_\_\_ can use this documentation to establish that he did not receive anything for his stock or the amount that he received for his stock.

I hope this information is helpful. If you have additional questions, please contact me or \_\_\_\_\_ at \_\_\_\_\_.

Sincerely,

Thomas D. Moffitt  
Branch Chief, Branch 2  
(Income Tax & Accounting)