



Federal Tax ADVISORY ■

AUGUST 1, 2013

Section 336(e) Regulations Issued

Overview

Treasury has exercised its authority under Section 336(e) to write regulations allowing certain sellers of stock to elect to treat certain sales and distributions of 80 percent of the vote and value of the stock (“qualified stock disposition”) of a domestic target corporation as if the old target sold its assets to a new target and liquidated into the stock seller. Treasury finalized the regulations to be effective for qualified stock dispositions with a disposition date on or after May 15, 2013. The disposition date is the date on which the qualifying amount of stock is disposed of over a period of 12 months or less, so this regulation is effective for transactions right now.

The election works basically like the Section 338(h)(10) election, but the focus is on the seller, not the purchaser. Whereas the purchaser must be a domestic corporation for Section 338(h)(10) to apply, the purchaser can be any person other than a single domestic corporation for the Section 336(e) election to apply. The aim is to step up asset basis inside a sold or distributed subsidiary, with no additional tax.

Therefore, an election can be made if a domestic corporation sells or distributes the qualifying amount of the stock of another domestic corporation to any person other than a single domestic corporation. An election also can be made by S corporation shareholders who sell the qualifying amount of S corporation stock.

In one sense, the Section 336(e) election is not a huge deal, because in most cases, the same tax results could be reached “longhand,” meaning that the S corporation could liquidate into its shareholders and they could sell the assets. But longhand deals are sometimes hard to do, although check-the-box liquidations have made them easier.

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Scenarios for Election

Probably the principal usage of the Section 336(e) election will come in the cases of Section 355 spinoffs. The distributing corporation may be concerned that Section 355 might not apply, or if it does apply, that Section 355(d) or (e) might apply to make the spinoff partly taxable to the distributing corporation. In either case, a protective Section 336 election can be made.

Alternately, a distribution of a subsidiary to shareholders that is intended to be taxable and not subject to Section 355 can benefit from a Section 336(e) election to step up asset basis inside the distributed corporation.

Complicated Regulation

The regulation is quite lengthy and complicated, and was made so largely for two reasons. First, it had to accommodate the possibility that a qualifying sale or distribution would occur over a 12-month period. This will not often be the case, but the possibility is sort of built into Section 338, and so, had to be built into this regulation.

Second, Section 311 disallows losses on taxable distributions. The regulation had to take account of that in cases involving distributions and did so by allowing loss netting up to the amount of the gain, but not more.

The regulation does not address what may turn out to be a common scenario: the leveraged buyout involving a redemption of most of the old stockholders. It is not clear whether redeemed shares are ignored in determining whether 80 percent has been sold or whether redemption can count as a qualifying purchase by the target corporation itself. The latter seems the better answer.

Contracts

Contractual documentation for elections, or to prevent elections, between the seller and the target and possibly even the buyers, will be important new and different legal tasks. A buyer of 25 percent of the target's stock from a 100-percent corporate shareholder may be interested in knowing whether the seller plans to sell another 55 percent and make the election within the next 12 months. Also, tax sharing agreements will be crucial, because the cost of the election will be owed by the target in the buyer's hands, but economically the tax should be paid by seller.

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