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Federal Tax ADVISORY ▪

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Section 338 and the Tax Act

The 2017 tax act substantially changed the considerations and results for various uses of Section 338 elections, or not making Section 338 elections, or selling assets when the buyer, seller, or target is foreign. This has been the topic of many educational programs, and it is useful to review some of the basic rules and cases involving whole company (target) sales.

1. Domestic corporate seller and buyer and target
   - 338(g) election: Usually not done unless the target had net operating losses (NOLs) because it does not make sense to pay tax today for depreciation on the same amount to be deducted tomorrow; the gain falls on the buyer's side in a one day year of target, although the target generally can use its historic NOLs. However, now the buyer (new target, the next day) may expense part of the purchase price. Depending on the amount of expensing and the portion of the gain currently taxed, the election might make sense for the buyer.
   - 338(h)(10) election: Usually done unless the asset gain is much greater than the seller's stock gain. Expensing the benefit will fall on the buyer's side and make the election more favorable.

2. U.S. corporation sells U.S. sub to a foreign corporation
   - 338(g) election: Same as (1) above.
   - 338(h)(10) election: Same as (1) above.

3. U.S. corporation sells stock of a controlled foreign corporation (CFC) to a U.S. corporation
   - 338(g) election: Deemed asset sale can produce Subpart F income and global intangible low-taxed income (GILTI), which will be taxable to the seller as if the CFC's year closed on the day of the deemed sale. That inclusion will increase the seller's stock basis and create previously taxed income (PTI) for the seller, and the seller will recognize stock sale gain, Section 1248 will apply, and the dividend created will be eligible for a 245A dividends received deduction (DRD).

- 338(h)(10) election: N/A

- No 338 election: Section 1248 gain and dividend created will be eligible for a 245A DRD; seller will not have Subpart F or GILTI inclusion for the year because the CFC year will not close on sale.

4. U.S. corporation sells stock of CFC to a foreign buyer
   - 338(g) election: Deemed asset sale can produce Subpart F income and GILTI, which will be taxable to the seller as if the CFC's year closed on the day of the deemed sale. That inclusion will increase the seller's stock basis and create PTI, the seller will recognize stock sale gain, and Section 1248 will apply and 245A will apply to the dividend.

   - 338(h)(10) election: N/A

   - No 338 election: Section 1248 gain, 245A will apply to dividend; seller will have Subpart F or GILTI inclusion for the year because the CFC year will close on sale unless the foreign buyer has U.S. subs and CFC status continues.

5. Foreign corporation sells U.S. sub to a U.S. corporation
   - 338(g) election: Same as (1) above.

   - 338(h)(10) election: N/A

6. Foreign corporation sells foreign sub to a U.S. corporation
   - 338(g) election: If the target was not a CFC, the deemed asset sale cannot produce Subpart F income and GILTI; if it was a CFC, those income items would not be taxable except to the target's U.S. shareholder.

   - 338(h)(10) election: N/A

7. CFC sells CFC
   - Section 338(g) election: U.S. shareholder of the seller CFC will include Subpart F income and GILTI generated by deemed asset sale.

   - 338(h)(10) election: N/A

For more information, please contact Jack Cummings at 919.862.2302.

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