LEGAL UPDATES

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New Tax Regulations Expand Opportunities for Elective Asset Sale Treatment

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On May 15, 2013, new regulations under Section 336(e) of the Internal Revenue Code went into effect, creating a new election to treat certain corporate stock dispositions as asset sales. The election complements a similar election available under section 338(h)(10) for “qualified stock purchases” by allowing for asset sale treatment in a wider variety of stock transfer transactions. The election allows noncorporate acquirers, in particular, to more easily obtain the tax benefits associated with asset sale treatment, such as “stepped-up” basis in depreciable assets.

To qualify for the new Section 336(e) election, a “qualified stock disposition” (QSD) must occur. This is achieved when a domestic corporation, or S corporation shareholder(s), disposes of 80 percent of the vote and value of another domestic corporation, or S corporation, to unrelated parties by any combination of sale, exchange or distribution within a 12 month period. Where multiple members of a consolidated group hold stock of a subsidiary, the QSD test aggregates dispositions by each member. In addition, a QSD can occur with respect to a lower-tier subsidiary by virtue of a QSD of an upper-tier subsidiary’s stock, in which case a separate 336(e) election may be made for the lower-tier subsidiary.

The section 336(e) election causes a deemed asset sale and disregard of the stock sale for federal income tax purposes. Generally, the target will be treated as selling its assets to a new corporation for fair market value and then immediately liquidating into the seller. In some cases involving spin-offs, the regulations employ a “sale to self” model wherein the original target does not undergo a deemed termination. In either case, the seller incurs the tax liability resulting from the deemed asset sale. Loss recognition on the deemed asset sale may not exceed recognized gain.

The seller and the target corporation make the election by entering into a binding, written agreement and attaching a statement to the relevant return – generally, the seller's – for the year of the QSD. The election can be made no later than the due date for the relevant return, including extensions. In the case of an S corporation target, all of the S corporation shareholders must consent, even those who did not dispose of any stock. Concerned purchasers should secure agreement from the seller as to whether an election will be made.

The primary benefit of a Section 336(e) election over a section 338(h)(10) election is the ability to use pass-through entities as acquisition vehicles and to pair various types of dispositions to achieve a QSD. For example, the election will simplify the process of achieving basis step-up when a pass-through investment fund acquires a portfolio company.

What This Means to You

The Section 336(e) election is a valuable new mechanism to obtain asset sale treatment in a variety of stock transfer transactions. Taxpayers contemplating a corporate acquisition or disposition should consider the availability of the election as a planning and negotiation tool.

Contact Information

If you have questions about this or any other tax matter, please contact your Husch Blackwell attorney.

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