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## Final Section 336(e) Regulations Allow New Deemed Asset Sale Election for US Corporations

**New election permits treating certain stock dispositions as sales of underlying assets, offering an opportunity for increased tax efficiency in many transactions.**

On May 10, 2013, the US Treasury and Internal Revenue Service (IRS) published final regulations (the Final Regulations) under Section 336(e) of the Internal Revenue Code of 1986, as amended (the Code). Under the Final Regulations, a US corporation may elect to treat certain dispositions of stock representing 80 percent of the vote and value of a US corporation (the target corporation) as a sale of the assets of the target corporation for US federal income tax purposes (the 336(e) Election). The 336(e) Election is also available with respect to qualifying dispositions of S corporation stock.

The 336(e) Election, which is available in a wider range of circumstances than elections under Section 338 of the Code, presents a new opportunity for a “basis step-up” in many transactions.

### Background

Section 336(e)<sup>1</sup> is intended to alleviate the burden of multiple levels of tax on the same economic appreciation, *e.g.*, the taxation of gain from the disposition of appreciated stock of a target corporation followed by taxation of the target corporation on the corresponding gain in its assets upon a later asset sale. Accordingly, the 336(e) Election provides an opportunity to step up the basis of the target corporation’s assets upon a qualifying disposition of target corporation stock.

Proposed regulations were issued under Section 336(e) in 2008, and the Final Regulations follow the framework of the proposed regulations in many respects, with certain notable modifications described in the preamble to the Final Regulations.

### Requirements

For a 336(e) Election to be available, 80 percent of the voting power and value of the target corporation must be disposed of within a twelve-month period. The disposition can take the form of a sale, exchange, distribution or any combination(s) thereof and must be to unrelated persons. In contrast to an election under Section 338, which also provides for deemed asset sale treatment in certain stock purchase transactions, the 336(e) Election is available even where there are multiple acquirers, the stock of the target corporation is not acquired by a corporation and the disposition does not take the form of a sale.

The 336(e) Election must be made pursuant to a written, binding agreement between the target corporation and the seller or sellers (or, in the case where target is an S corporation, all of the S corporation shareholders, even those who do not dispose of their target corporation stock).<sup>2</sup> The due date for making the 336(e) Election is generally the due date of the seller's return for the year that includes the disposition date (or, in the case where target is an S corporation, the S corporation's return for such year).<sup>3</sup>

## **Effect of Election**

Generally, if a 336(e) Election is made for a stock disposition, the stock disposition is disregarded for US federal income tax purposes and the transaction is treated as if an "old" target corporation had sold its assets to an unrelated person, with the tax consequences of the deemed asset sale being reflected on the return for the period during which the target corporation was owned by the seller(s) or S corporation stockholders. Following the deemed asset sale, unless the stock disposition in question is described in Section 355(d)(2) or 355(e)(2) (relating to certain "spin-off" transactions), the "old" target corporation is deemed to transfer the consideration received to the seller(s) and liquidate. The "new" target corporation is deemed to have acquired the assets of the "old" target corporation in exchange for the consideration paid.

The Final Regulations include loss disallowance rules, which limit the amount of losses realized on the deemed asset sale to those offsetting realized gains<sup>4</sup> and which take into account certain distributions of stock to related persons.

## **Additional Considerations**

The Final Regulations allow taxpayers to make a "protective" 336(e) Election, which has no effect if the applicable stock disposition does not qualify for a 336(e) Election but otherwise is binding and irrevocable. A protective election may be advisable in the case of a "Morris Trust" transaction where it is unclear whether the spin-off is tax-free or taxable to the distributing corporation. Such an election can ameliorate some of the adverse impact of a taxable Morris Trust transaction by leaving the distributed corporation with a stepped-up basis.

Treasury and the IRS are continuing to consider several issues relating to Section 336(e), including whether related-party transactions should qualify for the 336(e) Election, whether the scope of the Section 336(e) regulations should be broadened to include nonrecognition transactions such as Section 351 exchanges or certain tax-free reorganizations and the application of Section 336(e) to transactions in which either the seller or the target corporation is a non-US corporation.

The Final Regulations will become effective upon publication in the Federal Register, which is scheduled for May 15, 2013.

## Endnotes

- <sup>1</sup> All "Section" references are to the Code.
- <sup>2</sup> This requirement represents a change in the Final Regulations from the proposed regulations published in 2008, which provided that the election could be made unilaterally by the seller(s).
- <sup>3</sup> The due date for a 336(e) Election differs from the due date for an election under Section 338, which generally must be made by the fifteenth day of the ninth month following the month in which the applicable stock purchase occurs.
- <sup>4</sup> The loss disallowance rule in the 2008 proposed regulations would have entirely disallowed gross loss recognition to the extent the disposition of target corporation stock with respect to which the 336(e) Election was made resulted from a distribution of such stock.

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