

# Code Sec. 336(e) Regulations Proposed

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Every time I think about Code Sec. 338 elections, I get nostalgic for the pre-simplification Tax Code that included old Code Sec. 334(b)(2). That time-worn provision contemplated *actual* liquidations of targets after a stock acquisition. Code Sec. 338, it should be remembered, was meant to be a simplified procedure, obviating the need for a real-life liquidation in order to achieve a step up in basis. Anyone wading through Code Sec. 338 and its copious regulations these days should find it a little amusing that the provision was supposed to make life easier.

Of course, we've come a long way since then. In particular, with *General Utilities* repeal, the Code Sec. 338(h)(10) election emerged as the only part of Code Sec. 338 that made very much sense. Today, we have a new entrant in 336(e).

## New Kid

Code Sec. 336(e) authorizes regulations under which a corporation (a seller) that owns stock in another corporation ("Target") and that sells, exchanges or distributes its stock can elect to treat the sale, exchange or distribution of Target stock as a sale of all of Target's assets. The stock must meet an 80-percent rate and value test. Of course, that sounds a lot like Code Sec. 338.

Despite the new regulations, Code Sec. 336(e) isn't all that new. In fact, Code Sec. 336(e) was

enacted way back in 1986 as part of *General Utilities* repeal. Like the Code Sec. 338(h)(10) election, Code Sec. 336(e) is meant to provide relief from potential multiple tax bites at the corporate level. Proposed regulations have now been issued to implement at least part of this long-planned bookend to Code Sec. 338. [See REG-143544-04, Tax Analysts Document Number 2008-18199, 2008 TNT 165-5.]

Helpfully, the preamble to the proposed regulations indicates that Code Sec. 338(h)(10) definitions and treatment control. Wherever possible, the same concepts are going to work under Code Sec. 336(e).

Code Sec. 336(e) requires that a seller own stock in another corporation sufficient to satisfy Code Sec. 1504(a)(2). That means at least 80 percent of the voting power and total value of Target's stock. Plus, the seller must either sell, exchange or distribute the stock to make the election. The seller must be a domestic corporation, and all members of a seller's consolidated group are treated as a single seller. Proposed Reg. §1.336-2(g)(2). The proposed regulations make it clear that because Code Sec. 336(e) requires a "corporate" seller, the election can't be made with respect to the stock of an S corporation. [Proposed Reg. §1.336-1(b)(5).]

## Partial Sales

Interestingly, although the 80 percent of vote and value test must be met with respect to the

stock, not all that stock must be the subject of a disposition. That means the seller (or a member of the seller's consolidated group) may retain a portion of its target stock. [Proposed Reg. §1.336-2(b)(1)(v).] To be clear, the sale or disposition would have to be of sufficient stock to also meet the Code Sec. 1504(a)(2) standard. Yet, if the parent owned say 90 percent of the stock and sold or distributed 80 percent, that would qualify for the Code Sec. 336(e) election.

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There are also some interesting aggregation rules, permitting target stock that is sold, exchanged or distributed to be aggregated with other target stock. Thus, if a domestic corporation sells 50 percent of the target stock to an unrelated person, and makes a distribution to unrelated shareholders of the remaining 50 percent of the target stock within a 12-month period, the sale and the distribution could be aggregated. That means it would be a qualified stock disposition. [Proposed Reg. §1.336-1(b)(5).]

### Related Parties

Any stock that is sold, exchanged or distributed to a related party is not considered disposed of for purposes of the qualified stock disposition rules. One generally determines related-party status immediately after the sale, exchange or distribution of the target stock.

### Code Sec. 355 Distributions

If you have to recognize gain under Code Sec. 355(e), you may be comforted to know that

a Code Sec. 336(e) election may be available. The preamble to the proposed regulations notes that the 1986 legislative history to Code Sec. 355(e) expressly said that Code Sec. 336(e) authority could trump Code Sec. 355(e). The preamble to the proposed regulations now says that if you get stuck recognizing gain under Code Sec. 355(e), a Code Sec. 336(e) election can pare the horrible three layers of taxation down to a more manageable two layers. That would still mean one tax at the controlled corporation level and one tax at the shareholder level when the controlled corporation stock is disposed of.

### New Terms

As if Code Sec. 338 did not already have enough defined terms, the proposed Code Sec. 336(e) regulations create a few new ones. For example, there's aggregated deemed asset disposition price (ADADP). ADADP is calculated by adding the grossed-up amount realized on the sale, exchange or distribution of recently disposed target stock and the liabilities of the old target. [Proposed Reg. §1.336-3(b)(1).] There is also a new "non-recently disposed stock" term. The meaning for this phrase is similar to "non-recently purchased stock" under Code Sec. 338.

### How You Do It

It will be quite some time before too many of us understand much about these proposed regulations. There are many subtleties. Still, the all-important "how you do it" instruction says that you make the Code Sec. 336(e) election by attaching a statement to the seller's timely filed federal income tax return for the tax year including the disposition.

If the seller is a member of a consolidated group, the statement is filed with the group's consolidated return. Fortunately, the seller (or the common parent of the seller's consolidated group) can unilaterally make the election, even if there are minority distributees.

Of course, these are only proposed regulations, and will not be effective until the date they are published as final regulations in the federal register.