

PRACTISING LAW INSTITUTE
TAX STRATEGIES FOR CORPORATE ACQUISITIONS,
DISPOSITIONS, SPIN-OFFS, JOINT VENTURES,
FINANCINGS, REORGANIZATIONS AND
RESTRUCTURINGS 2011

APPENDIX TO SECTION 338

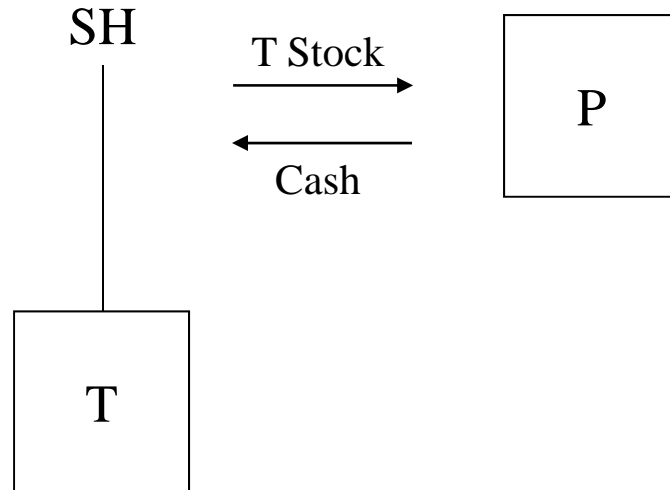
June 2011

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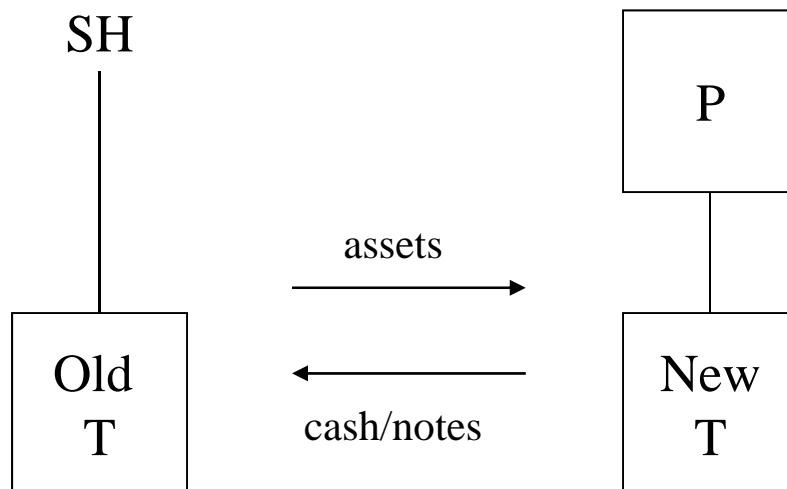
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Purchase of Stock Treated as Purchase of Assets

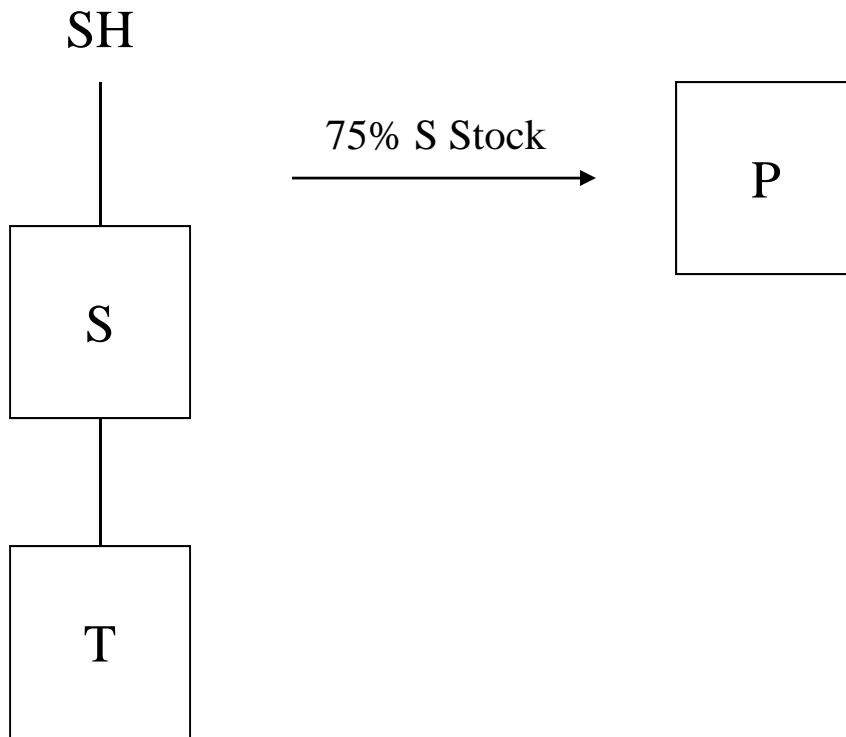


1. S Owns 100% of the stock of T.
2. P purchases at least 80% of the stock of T within a 12- month period and makes a section 338 election.



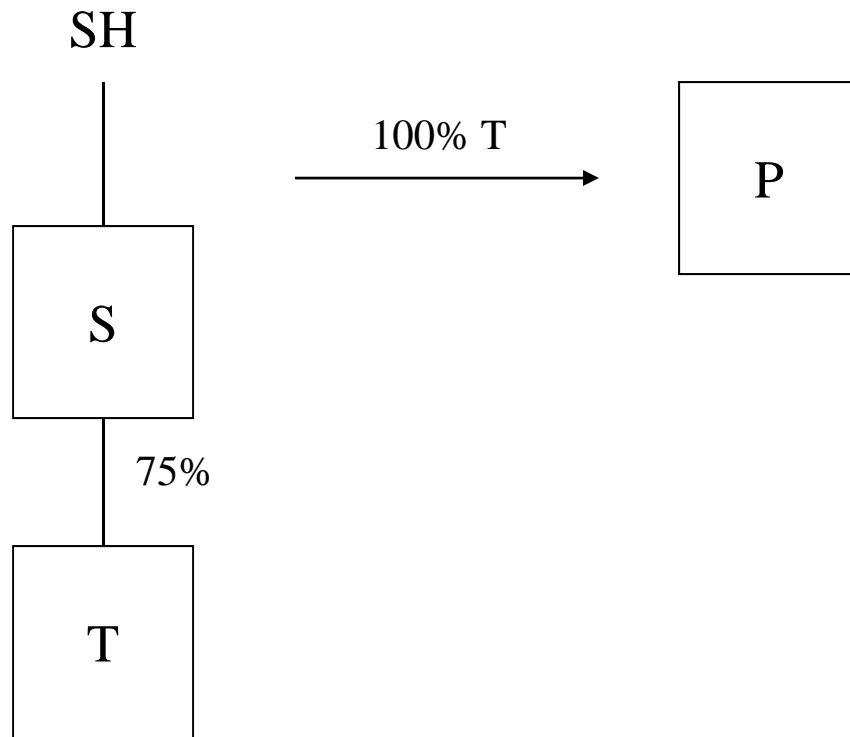
deemed sale transaction

Acquisitions From Related Corporations
(Related Party Exception -- Section 338(h)(3)(C)(i))



1. P Purchases 75% of the stock of S.
2. S liquidates in a section 331 transaction, and P receives 75% of the T stock.
3. Receipt of T stock in liquidation constitutes a purchase under section 338(h)(3).

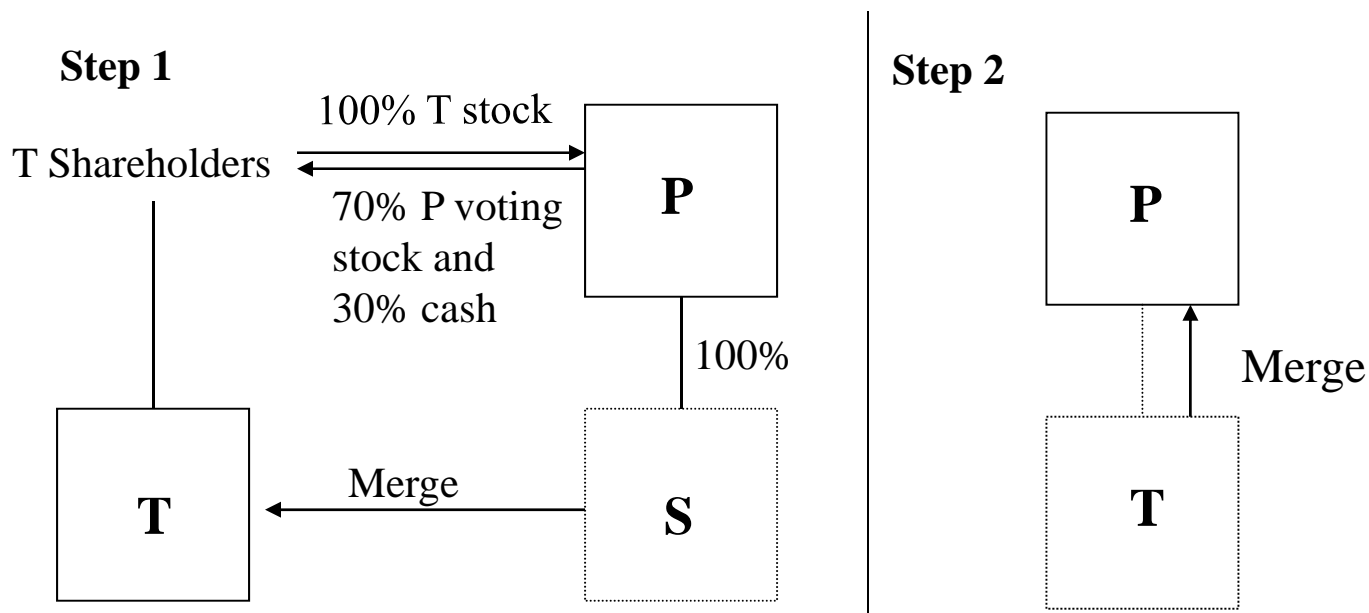
Acquisitions from Related Corporations
(Carryover Basis Exception -- Section 338(h)(3)(C)(ii))



1. P purchases 100% of S stock and makes a section 338 election.
2. S is liquidated under section 332.
3. P is treated as purchasing the T stock.

Step Transaction Doctrine- Rev. Rul. 2001-46

Situation 1



Facts: P owns all of the stock of S, a newly formed wholly owned subsidiary. Pursuant to an integrated plan, P acquires all of the stock of T, an unrelated corporation, in a statutory merger of S into T, with T surviving. In the merger, the T shareholders exchange their stock for consideration of 70% P voting stock and 30% cash. Immediately thereafter, T merges upstream into P.

Result: If the acquisition were viewed independently from the upstream merger of T into P, the result should be a QSP of T stock followed by a section 332 liquidation. See Rev. Rul. 90-95, 1990-2 C.B. 67. However, because step transaction principles apply, see King Enterprises, Inc. v. United States, 418 F.2d 511 (Ct. Cl. 1969), the transaction is treated as a single statutory merger of T into P under section 368(a)(1)(A). P acquires the T assets with a carry-over basis under section 362, and P may not make a section 338 election for T.

Note: On July 8, 2003, the Service issued new final and temporary regulations that permit taxpayers to turn off the step transaction doctrine and to make a section 338(h)(10) election in the transaction described above. See Treas. Reg. § 1.338-3(c)(1)(i), (2) and Temp. Treas. Reg. § 1.338(h)(10)-1T.

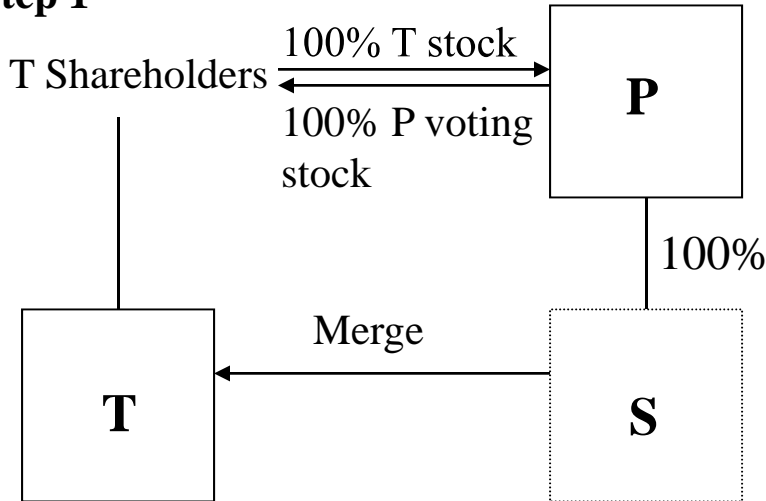
Temp. Treas. Reg. § 1.338(h)(10)-1T(c)(2), (e)

- The new temporary regulations provide that “a section 338(h)(10) election may be made for T where P’s acquisition of T stock, viewed independently, constitutes a qualified stock purchase and, after the stock acquisition, T merges or liquidates into P (or another member of the affiliated group that includes P) . . . ” Temp. Treas. Reg. § 1.338(h)(10)-1T(c)(2).
- This rule applies regardless of whether, under the step transaction doctrine, the acquisition of T stock and subsequent merger or liquidation of T into P (or P affiliate) qualifies as a reorganization under section 368(a). Id.
- If a section 338(h)(10) election is made under these facts, P’s acquisition of T stock will be treated as a QSP for all Federal tax purposes and will not be treated as a reorganization under section 368(a). See Temp. Treas. Reg. § 1.338(h)(10)-1T(e), Ex. 12 & 13.
- However, if taxpayers do not make a section 338(h)(10) election, Rev. Rul. 2001-46 will continue to apply so as to recharacterize the transaction as a reorganization under section 368(a). See id. at Ex. 11.
- The regulations are effective for stock acquisitions occurring on or after July 8, 2003.

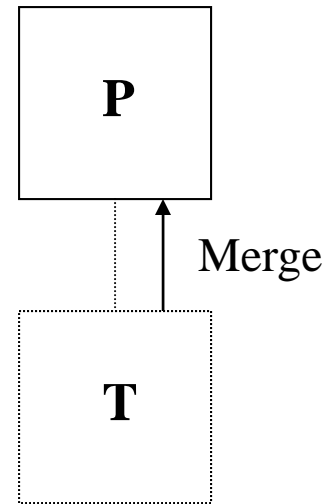
Step Transaction Doctrine- Rev. Rul. 2001-46

Situation 2

Step 1



Step 2

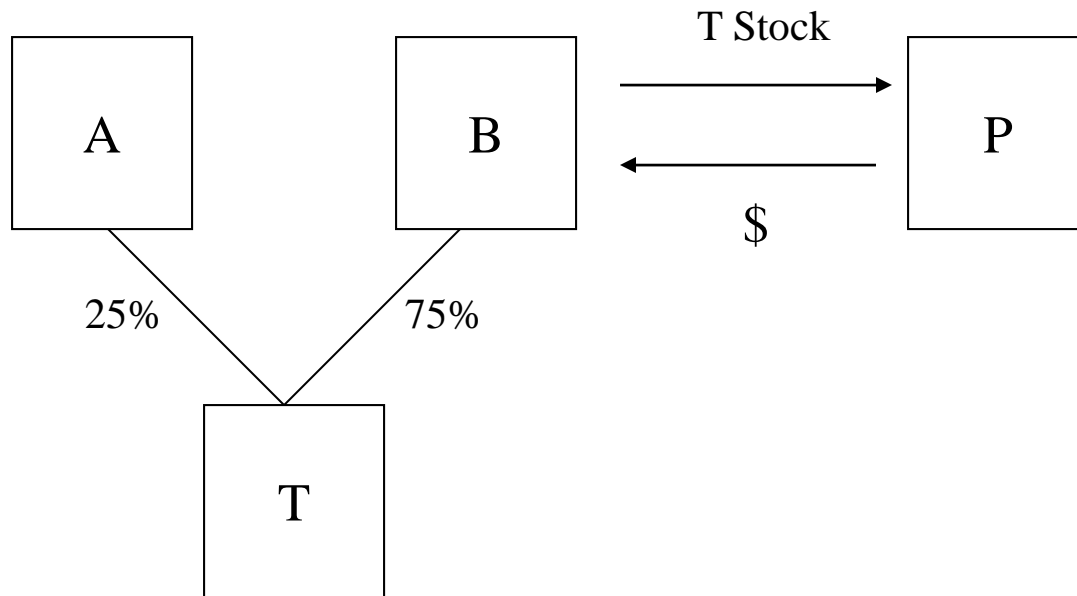


Facts: Same facts as in Situation 1, except that the T shareholders receive solely P stock in exchange for their T stock, so that the merger of S into T, if viewed independently of the upstream merger of T into P, would qualify as a reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(E).

Result: Step transaction principles apply to treat the transaction as a merger of T directly into P.

Note: The taxpayers cannot not change this result under the new section 338 regulations because, standing alone, P's acquisition of T does not constitute a qualified stock purchase.

Bootstrap Purchases **Redemptions from Unrelated Parties**



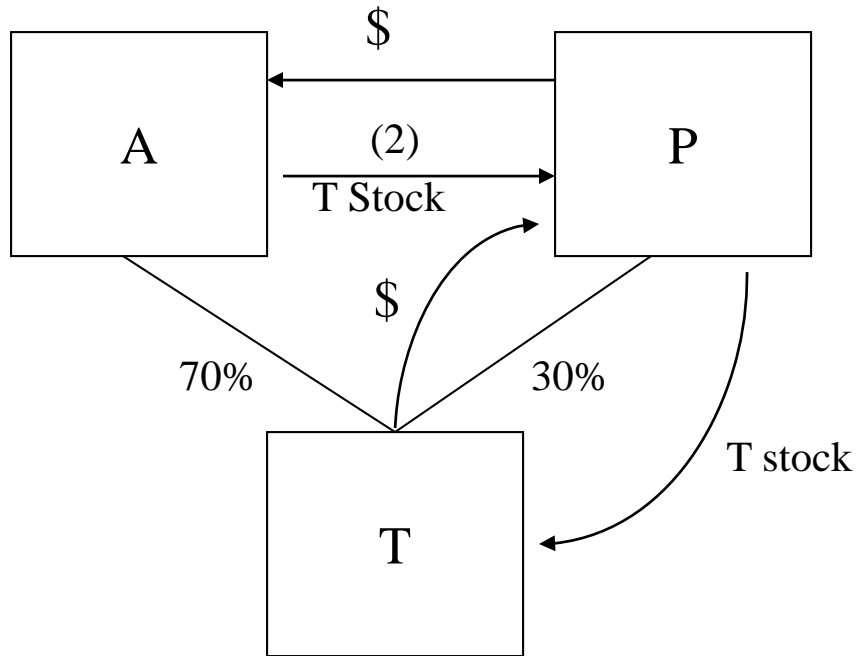
Scenario A

1. On January 1, 1997, P purchases 60% of the stock of T from B.
2. On June 1, 1997, T redeems all of the stock of T held by A.
3. June 1, 1997, is the acquisition date.

Scenario B

1. On January 1, 1997, P purchases 60% of the stock of T from B.
2. On February 1, 1998, T redeems all of the stock of T held by A.
3. P has not made a qualified stock purchase of T. The 80% ownership requirement was not satisfied within 12 months.

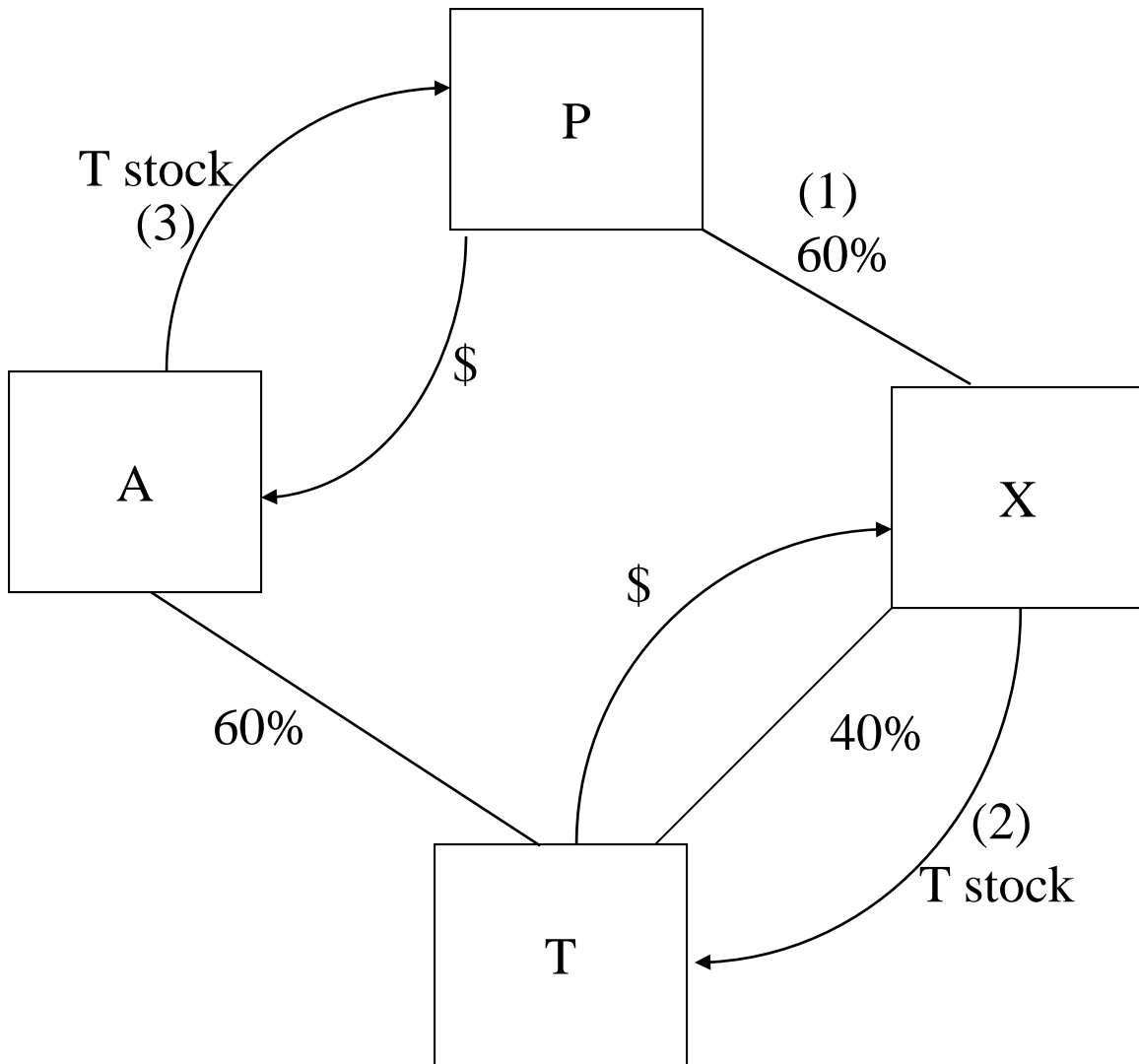
Bootstrap Purchases **Redemptions from Related Persons**



1. P owns 30% of the stock of T.
2. On December 15, 1996, T redeems the T stock held by P.
3. On December 1, 1997, P purchases the T stock held by A.
4. P has not made a qualified stock purchase of T. The redemption of P's T stock is not taken into account

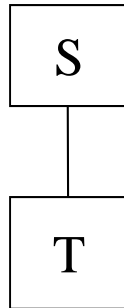
Bootstrap Purchases

Redemptions from Related Persons - Exception

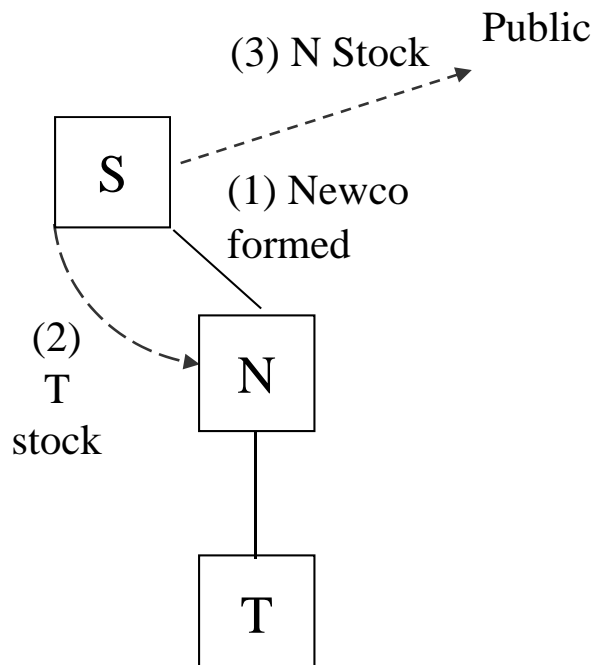


1. On January 1, 1997, P purchases 60% of X stock.
2. On April 1, 1997, T redeems X's T stock.
3. Also on April 1, 1997, P purchases the T stock held by A.
4. P has made a qualified stock purchases of T on April 1, 1997

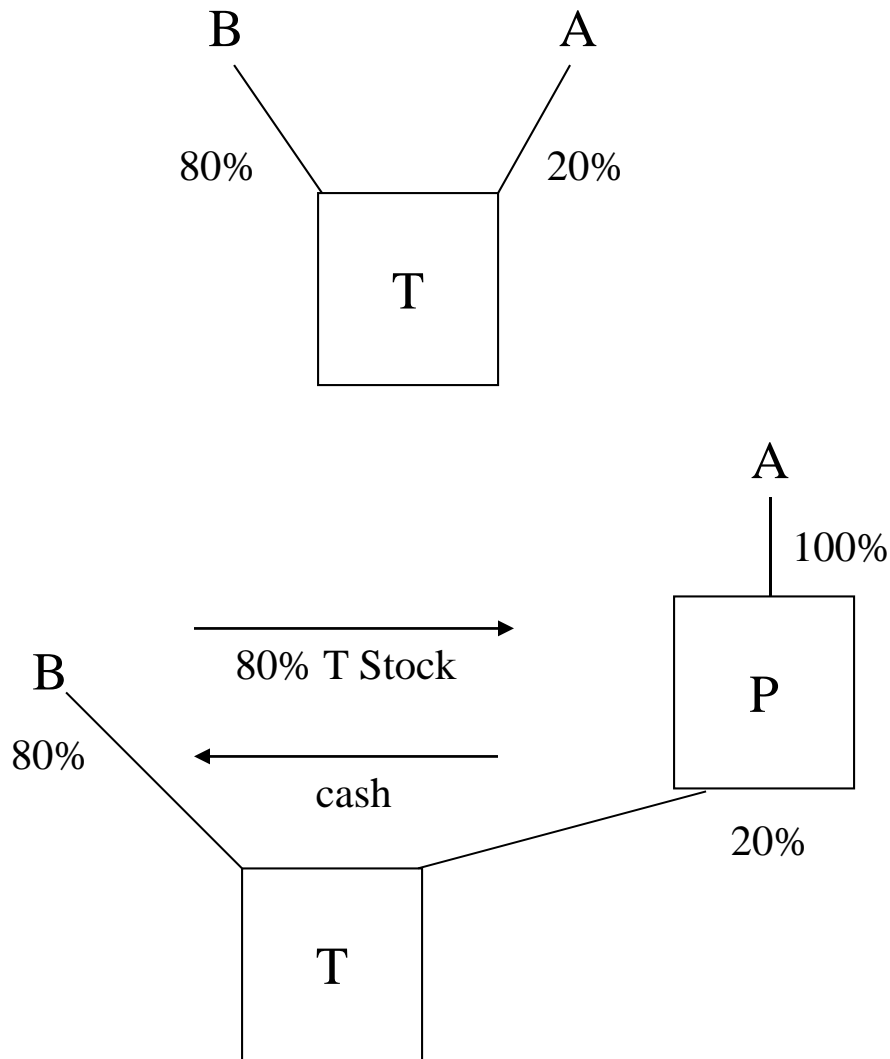
Busted 351s and Qualified Stock Purchases



1. S owns all of the stock of T and wants to sell T to the public.
2. S contributes the stock of T to Newco ("N") in exchange for N stock. At the time of the contribution, S has a binding commitment to sell the T stock to the public.
3. Has N made a qualified stock purchase of T?

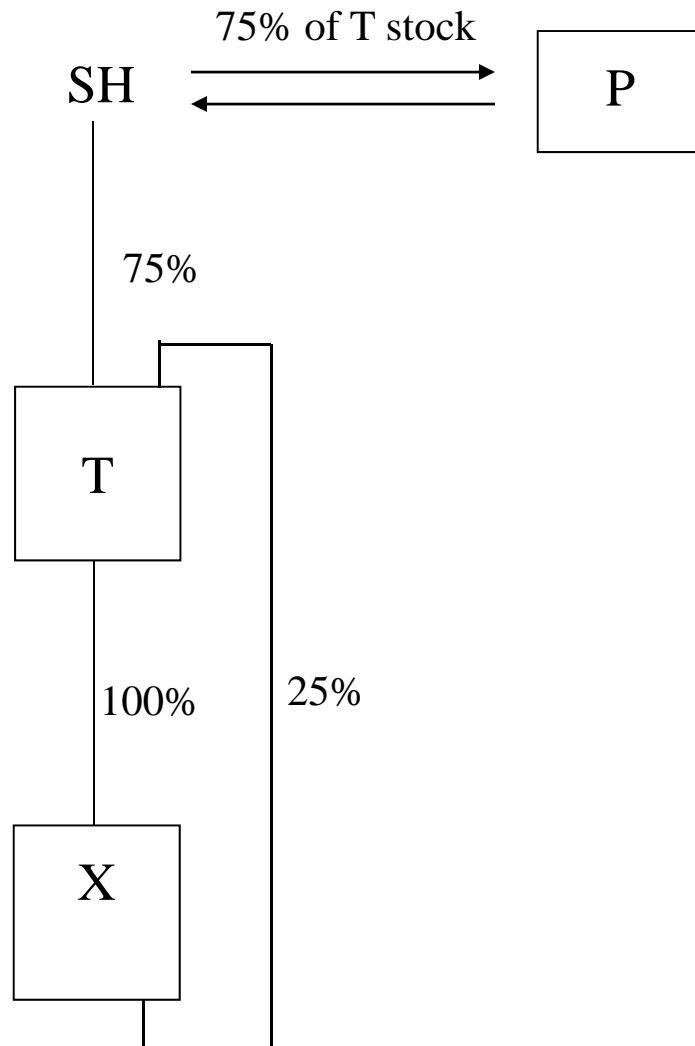


Section 304 and Qualified Stock Purchase



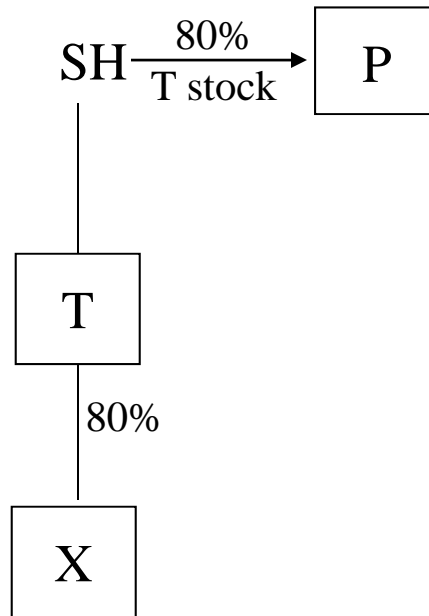
1. A owns 20% and B owns 80% of the stock of T.
2. A contributes the 20% interest in T to P in exchange for all of P's stock in a section 351 transaction.
3. As part of the same transaction, P purchases B's 80% interest in T for cash.
4. Section 304 does not apply, and P has made a qualified stock purchase of T.

T Stock Owned by Subsidiary



1. P purchases 75% of the T stock.
2. Has P made a qualified purchase of T?
3. If P makes a qualified stock purchase of T and files an election, how is the grossed-up basis calculation made?

Deemed Purchase Provision



Under Prior Law

1. P purchases 80% of the stock of T.
2. Under TEFRA, P was deemed to have purchased 64% of X.

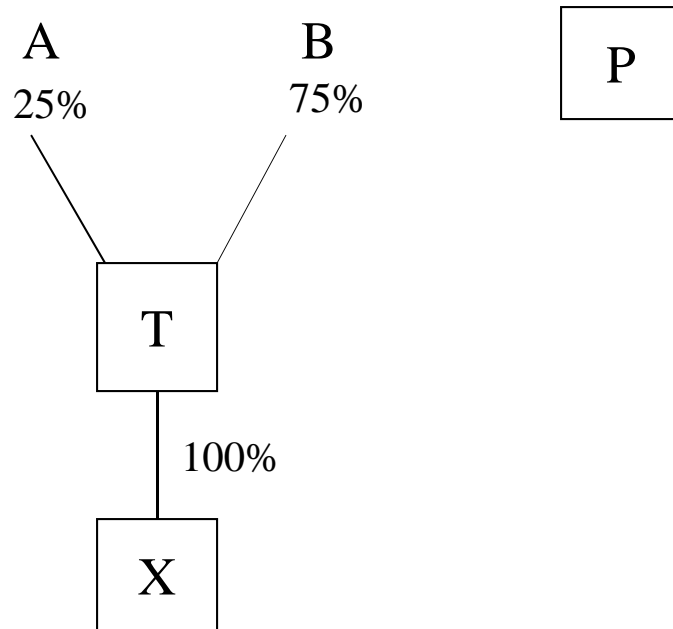
Under TRA 84

3. Under TRA 84, if P makes a section 338 election for T, New T is deemed to purchase 80% of the X stock. Under the consistency provisions, T is deemed to make a section 338 election as to X.

Current Law

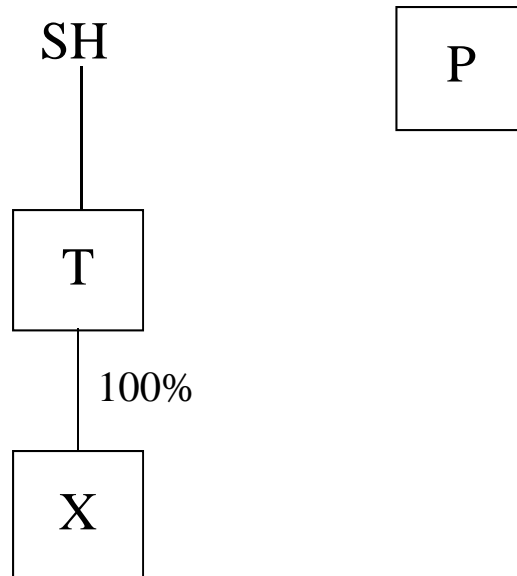
4. If P makes a section 338 election for T, T is deemed to make a QSP as to X. T is not deemed to make a section 338 election as to X.

Deemed Purchases and Stock Redemptions



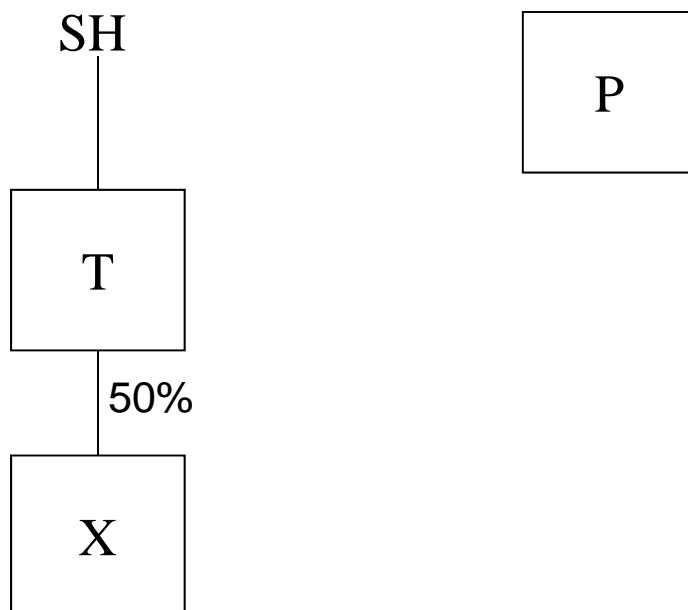
1. On January 1, 1999, P purchases 75% of the T stock from B.
2. On June 1, 1999, T redeems the T stock held by A in exchange for all of the X stock.
3. If P makes an election for T, there will be no election with respect to X.

Acquisition Period for Purchases from Related Corporations



1. On January 1, 1998, P purchases 30% of T's stock.
2. On March 1, 1998, P purchases an additional 30% of T's stock.
3. On February 1, 1999, T is liquidated, and P receives all of the X stock (nonprorata liquidating distribution).
4. Under section 318, March 1, 1998 is the date P is first considered to own X stock. March 1 begins the 12-month acquisition period.
5. Liquidation occurs within the 12-month acquisition period. P has made a qualified stock purchase of X.

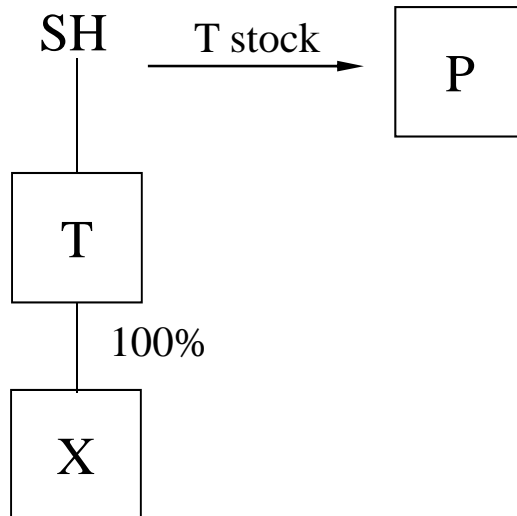
Deemed Purchases and the Acquisition Period



1. P purchases T stock on the following dates in the following amounts:

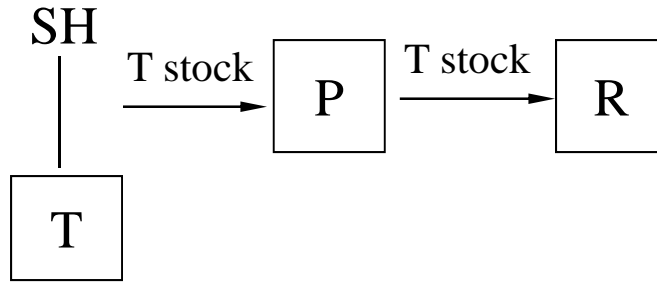
January 1, 1998	20%
March 1, 1998	20%
May 1, 1998	20% -- "attribution date"
July 1, 1998	20% -- acquisition date
September 1, 1998	20%
2. P makes a section 338 election as to T.
3. On July 1, 1998 (acquisition date), New T is deemed to purchase 50% of X stock.
4. On May 1, 1998, P is treated as owning 30% (60% x 50%) of X stock.
5. May 1, 1998 begins the acquisition period of X.

Acquisition Date and Deemed Purchases

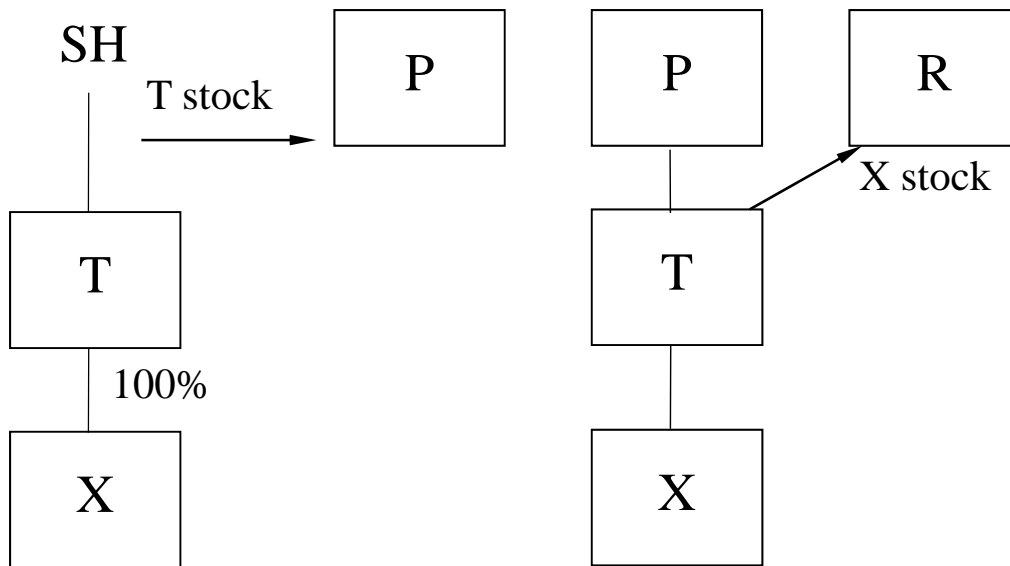


1. On January 1, 1985, P purchases 100% of the stock of T and makes an election under section 338. January 1 is the acquisition date.
2. New T is deemed to buy the assets from old T on January 2.
3. New T is deemed to purchase the X stock on January 2. January 2 should be the acquisition date.
4. The Service, however, will "redetermine" that new T bought the stock of X on January 1. The acquisition date for X is deemed to be January 1.

Post-Acquisition Events and the Elections

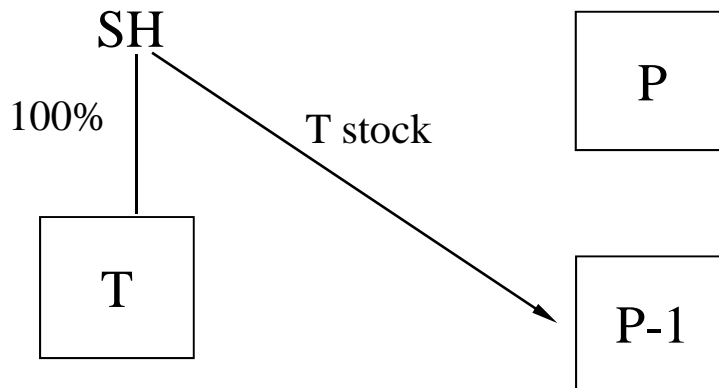


1. On January 1, 1999, P purchases T stock.
 2. On June 1, 1999, P sells T stock to R.
 3. P may file a section 338 election for T.
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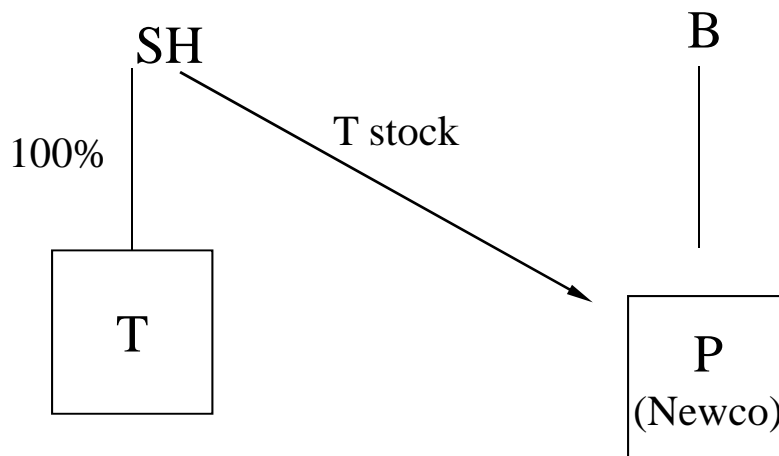


1. On January 1, 1999 P purchases T stock.
2. On June 1, 1999, T sells X stock to R.
3. P files a section 338 election as to T.
4. The election for T results in a QSP as to X.

Post-Acquisition Events (cont.)

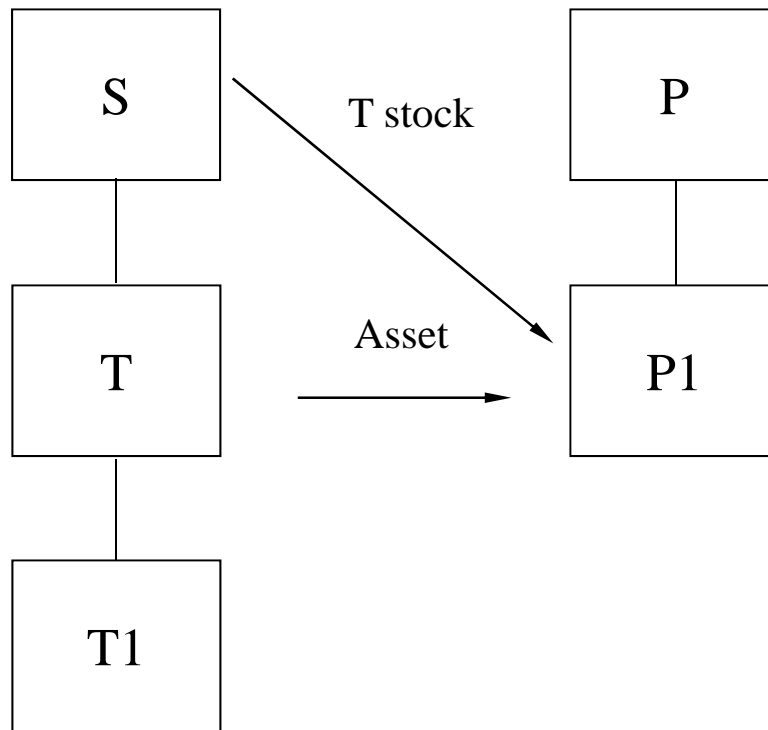


1. On January 1, 1999, P-1 purchases the T stock.
 2. On June 1, 1999, P1 is liquidated into P.
 3. P1 may make a section 338 election as to T so long as P1 is still considered the purchaser for Tax purposes.
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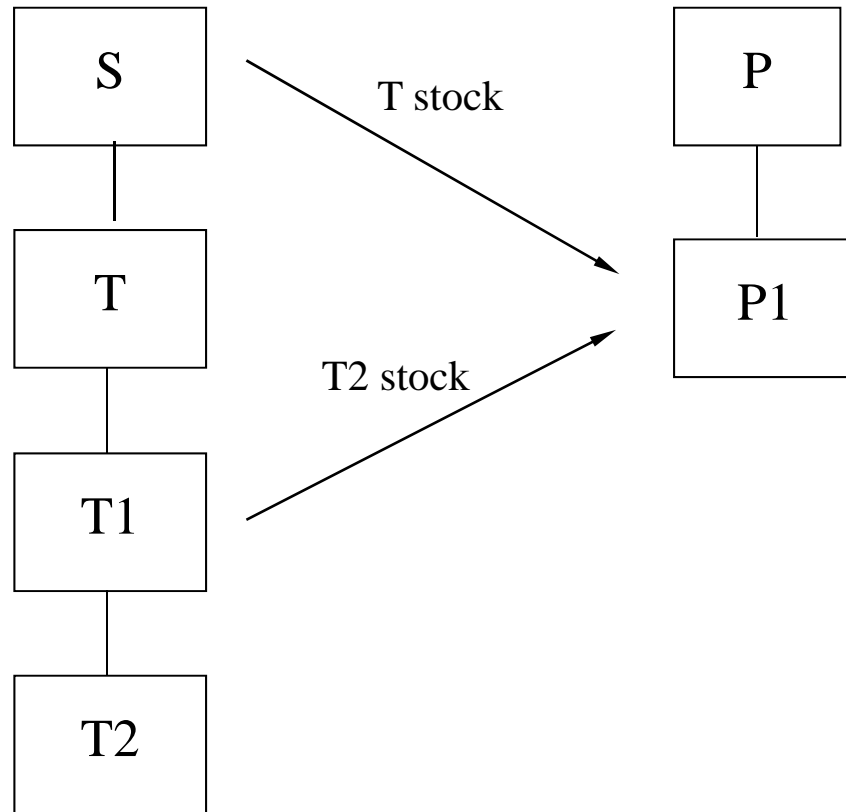
1. On January 1, 1999, B forms P, and P purchases the T stock.
2. On June 1, 1999, P is liquidated or merged into T.
3. P may file a section 338 election as to T prior to liquidation or merger.
4. What if liquidation or merger occurs immediately after purchase?

Consistency Rules: **Direct Asset Acquisitions -- Example 1**



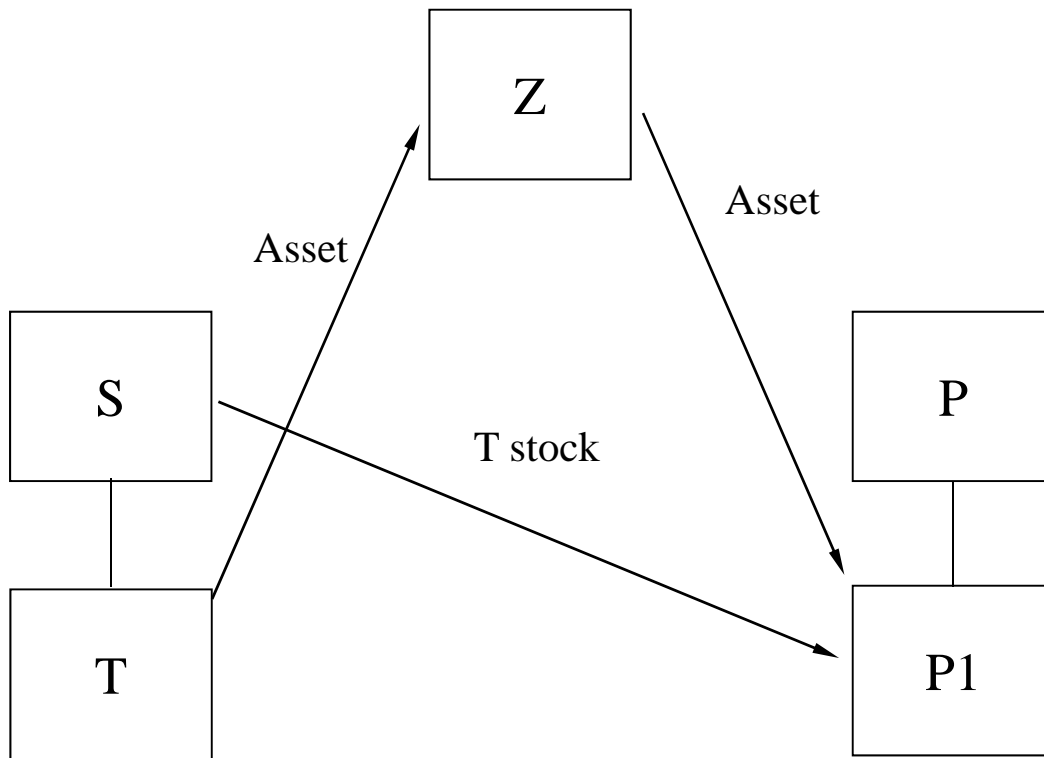
1. On February 1, 1996, T sells an asset on P1 and recognizes gain. The gain is taken into account under Treas. Reg. § 1.1502-32 in determining S's basis in the T stock.
2. On January 1, 1997, P1 makes a QSP of T. No section 338 election is made for T.
3. The carryover basis rule applies to the asset without the need for any action by P. Thus, P1's basis in the asset is T's adjusted basis in the asset immediately before the sale to P1.

Consistency Rules: **Direct Asset Acquisitions -- Example 2**



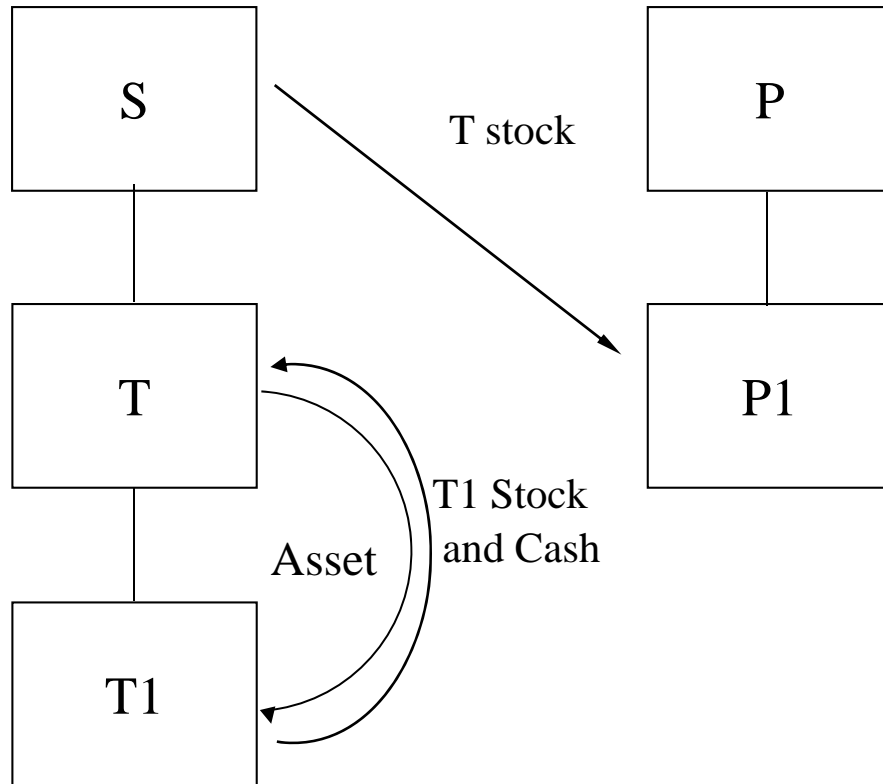
1. On February 1, 1996, P1 makes a QSP of T2. A section 338(h)(10) election is made for T2 and T2 recognizes gain on each of its assets. T2's gain is taken into account under Treas. Reg. § 1.1502-32 in determining S's basis in T stock.
2. On January 1, 1997, P1 makes a QSP of T. No section 338 election is made for T.
3. The acquisition of T2 stock is treated as an acquisition of T2's assets on February 1, 1996, because a section 338(h)(10) election is made for T2. Also, the carryover basis rule applies to the T2 assets.

Consistency Rules: Indirect Acquisitions -- Example 1



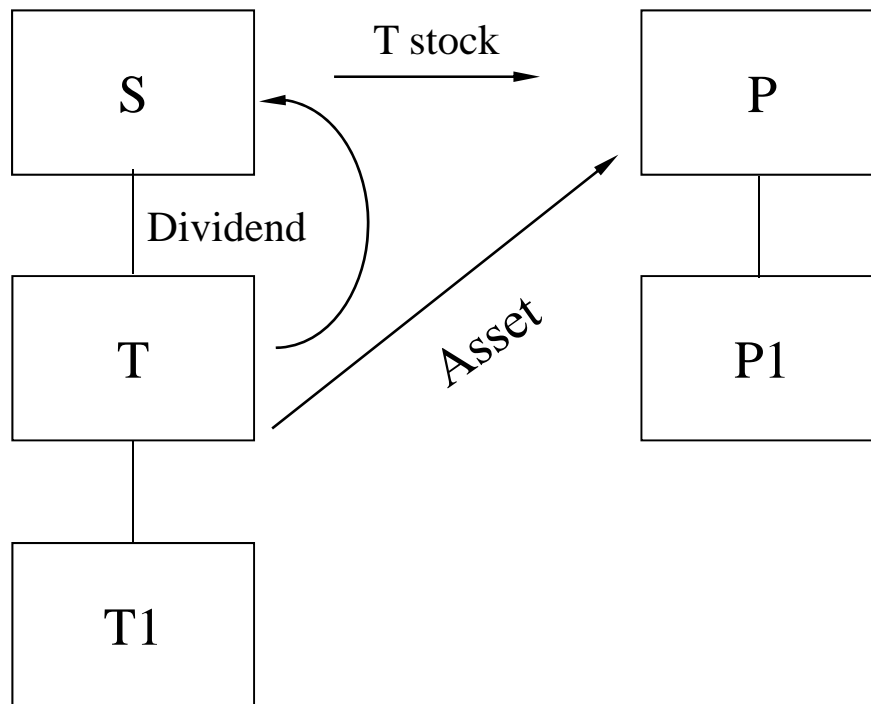
1. On February 1, 1996, pursuant to an arrangement, T sells an asset to Z and recognizes gain.
2. On February 15, 1996, P1 makes a QSP of T. No section 338 election is made for T.
3. On March 1, 1996, P1 buys the assets from Z.
4. Because the transaction was arranged so as to avoid the consistency rules, P1's basis in the asset is T's adjusted basis in the asset immediately before the sale to Z.

Consistency Rules: Indirect Acquisitions -- Example 2



1. On February 1, 1996, T transfers an asset to T1 in exchange for additional T1 stock and cash. The gain is deferred under Treas. Reg. § 1.1502-13.
2. On March 1, 1996, P1 makes a QSP of T and, pursuant to Treas. Reg. § 1.1502-13(d), the deferred gain is taken into account by T immediately before T ceases to be a member of the S group. No section 338 election is made for T.
3. During the portion of T's consistency period following T's acquisition date, T1 owns the asset while it is affiliated with T. Consequently, the indirect acquisition rules apply to the asset if there is an arrangement. The fact that at the time T1 acquires the asset from T, T1 is related to T indicates an arrangement exists.

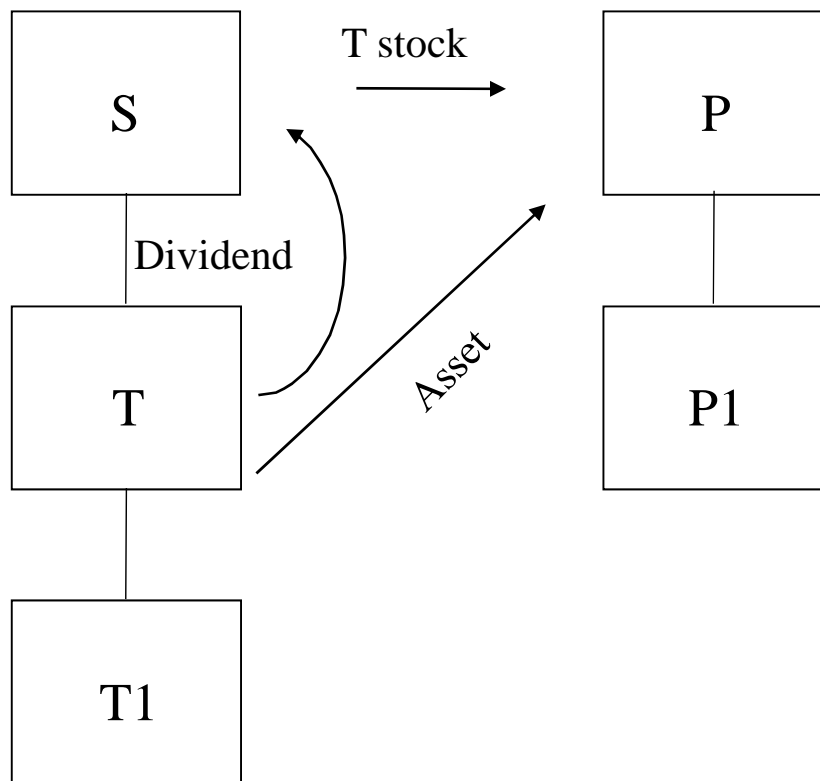
Consistency Rules: Nonconsolidated Groups --
Example 1



1. The S group does not file a consolidated return. On December 1, 1996, T sells an asset to P and recognizes \$1 million in gain.
2. On December 15, 1996, T pays a dividend to S of \$1 million subject to the 100% dividends-received deduction.
3. On January 2, 1997, P makes a QSP of T. No section 338 election is made for T.
4. Under Treas. Reg. § 1.338-8(g)(1), the carryover basis rule applies to the asset and P's basis in the asset is T's adjusted basis in the asset immediately before the sale to P.

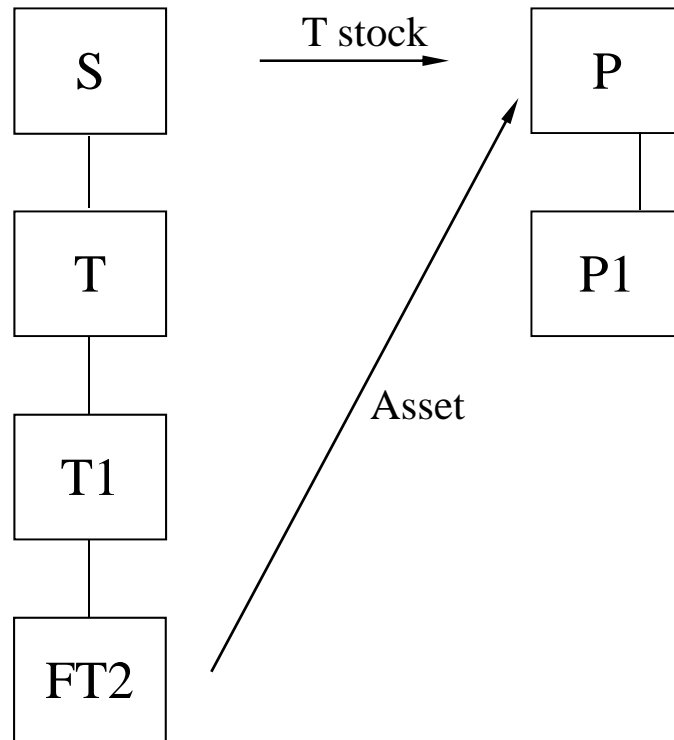
Consistency Rules: Nonconsolidated Groups --

Example 2



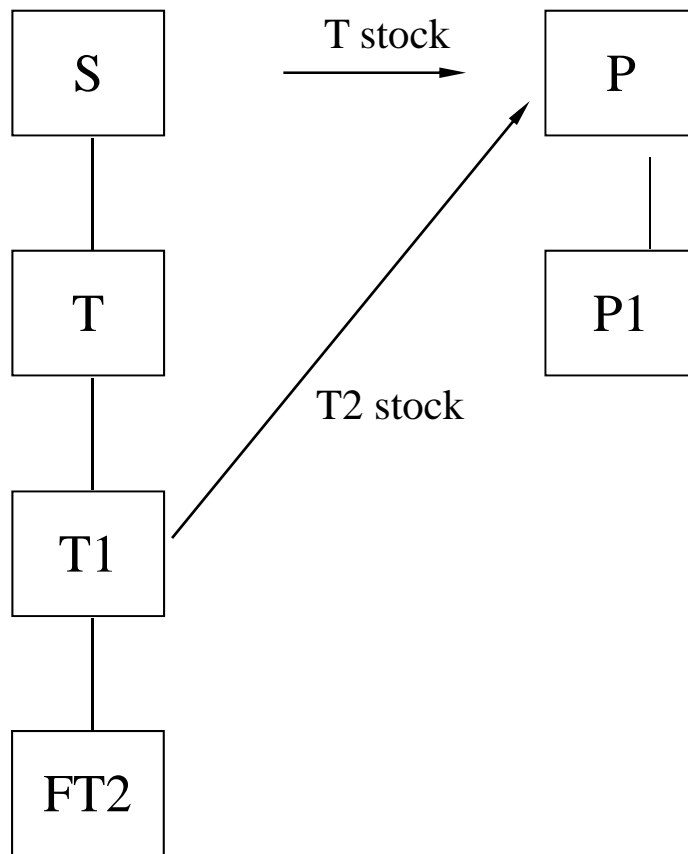
1. The S group does not file a consolidated return. On December 1, 1996, T sells an asset to P and recognizes a gain.
2. T pays a dividend to S which qualifies for the 100% dividends-received deduction and which exceeds \$250,000.
3. On January 2, 1997, P makes a QSP of T. No section 338 election is made for T.
4. Because of the asset disposition by T1 and the dividend paid by T achieve the effect of a transaction described in Treas. Reg. § 1.338-8(g), the carryover basis rule applies to the asset.

Consistency Rules: Asset Consistency for CFC's



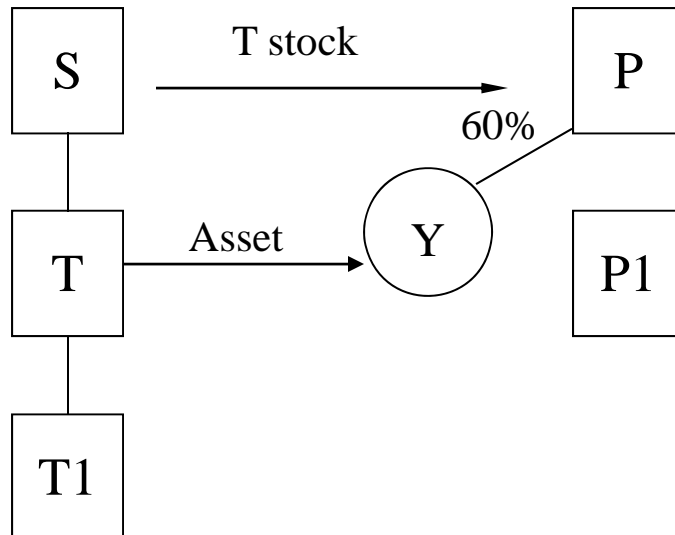
1. The S group files a consolidated return, however, T2 is a CFC. T2 sells an asset to P, generating subpart F income that results in inclusion in T1's gross income.
2. During the consistency period, P makes a QSP of T. No section 338 election is made for T.
3. The carryover basis rule applies to the asset sold by T2. Also, T1's basis in the T2 stock is not increased under section 961(a) by the amount of the inclusion attributable to the sale of the asset.

Consistency Rules: Asset Consistency for CFC's



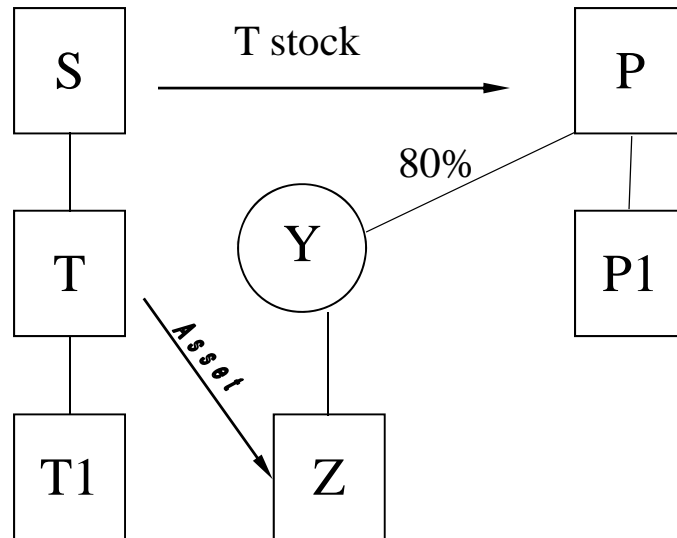
1. The S group files a consolidated return and T2 is a CFC. T1 sells T2 stock to P.
2. Within the consistency period, P makes a QSP of T. No section 338 election is made for T.
3. The carryover basis rule applies to the T2 stock. However, P's basis in the T2 stock is increased by the amount of T1's gain on the sale of the T2 stock that is treated as a dividend under section 1248.
4. Because P has a carryover basis in the T2 stock, the T2 stock is not considered purchased for purposes of section 338(h)(3) and no section 338 election may be made for T2.

Consistency Rules: Anti-Avoidance -- Example 1



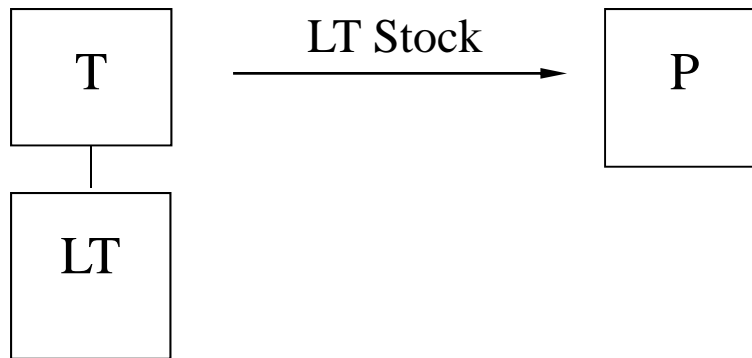
1. P owns a 60% interest in partnership Y. On March 1, 1996, T sells an asset to Y and recognizes gain.
2. On January 1, 1997, P makes a QSP of T. No section 338 election is made for T.
3. Since Y is a conduit with respect to P, P is treated as owning 60% of the asset on March 1, 1996 and January 1, 1997. Because P is treated as owning part of the asset both immediately after the asset disposition and on T's acquisition date, the carryover basis rule applies to the asset.

Consistency Rules: Anti-Avoidance -- Example 2



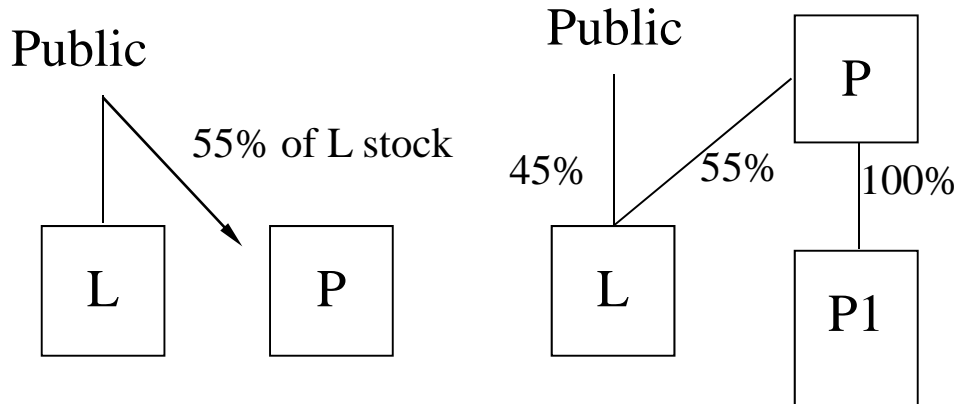
1. P owns an 80% interest in partnership Y. Y owns all the stock of Z. On March 1, 1996, T sells an asset to Z and recognizes gain.
2. On January 1, 1997, P makes a QSP of T. No section 338 election is made for T.
3. Since Y is a conduit with respect to P, P is treated as owning 80% of Z stock and thus, Z is treated as an affiliate of P. Because Z owns the asset both immediately after the asset disposition and on T's acquisition date, the carryover basis rule applies to the asset.
4. If P only owned 79% of Y, then Z would not be treated as an affiliate of P and the carryover basis rule would not apply.

Sections 382 and 338 -- One-Step Acquisitions



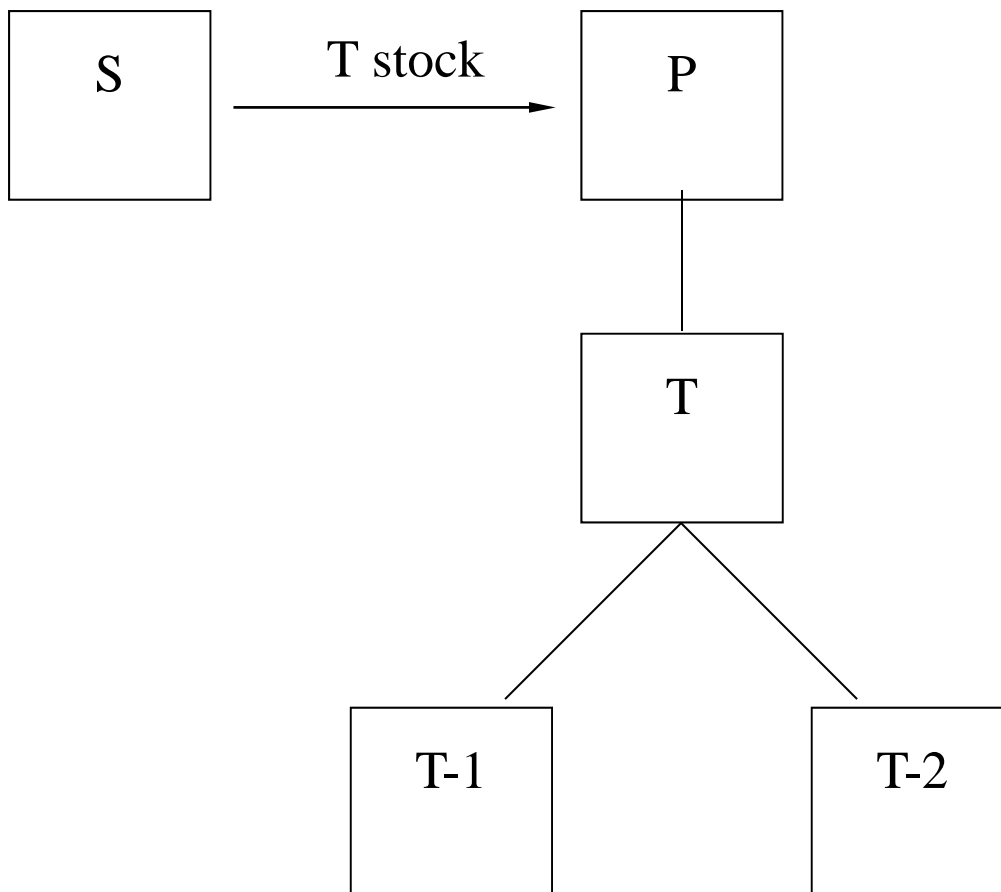
1. T owns all of the stock of LT, a loss corporation. T and LT file consolidated returns.
2. On December 31, 1996, P purchases all of the LT stock from T.
3. The transfer is both an ownership change and a qualified stock purchase. Thus, the change date and the acquisition date are the same date -- December 31, 1996.
4. If P makes a section 338 election (and no section 338(h)(10) election is made), all of the section 338 gain will be reported on LT's one-day deemed sales return for December 31, 1996.
5. The one-day period is a separate taxable year ending on the change date. Therefore, such period is not a post-change year. Section 382 does not apply.
6. Section 384 technically applies to old LT's section 338 gain, but such gain cannot be offset by P losses (if any) in any event. Section 384 should not apply.
7. Section 382 should not apply if T makes a section 338(h)(10) election. Under such an election, T is not considered to have sold LT's stock. LT is treated as selling its assets and then liquidating. T would inherit LT's NOL carryover in the deemed liquidation.
8. This analysis assumes that the option attribution rules of section 382 do not cause the change date to precede the acquisition date. If the change date precedes the acquisition date, the two-step analysis in the next diagram applies.

Sections 382 and 338 -- Two-Step Acquisitions



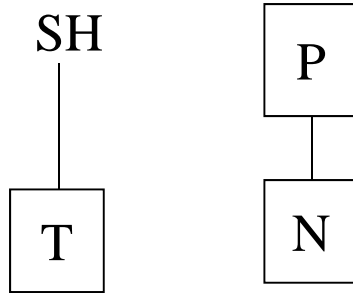
1. L is publicly-held.
2. On January 1, 1996, P buys 55% of the L stock in a cash tender offer.
3. On July 1, 1996, P acquires the remaining 45% of L stock in a merger transaction.
4. The change date for section 382 purposes is January 1, 1996; the acquisition date for section 338 purposes is July 1, 1996.
5. The section 338 gain is reported on L's final return ending July 1, 1996. Such year is a post-change year; therefore, section 382 applies.
6. Gain accrued as of January 1, 1996 is treated as recognized built-in gain, and , apparently, may be offset by L's NOL carryover to the extent permitted by section 382(h)(1)(A).
7. Gain accrued from January 2 through July 1, 1996 may not increase L's section 382 limitation under amended section 382(h)(1)(C).
8. Under amended section 382(h)(1), section 338 gain is treated as other recognized built-in gain. Section 382(h)(1)(C) provides relief if any of the threshold limitation is not exceeded.
9. Although section 384 technically may apply to old L's section 338 gain, such gain cannot be offset by P's losses (if any) in any event.

Sections 338 and 336(e) -- Two-Step



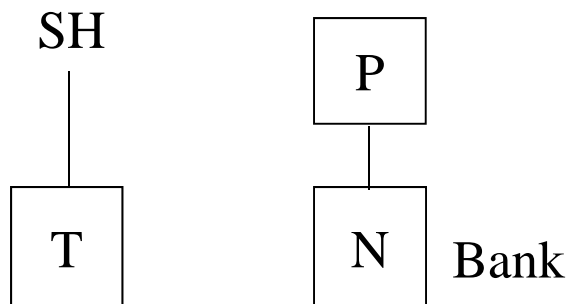
1. S owns all of the T stock. P buys T from S and makes a protective carryover election.
2. If P causes T to distribute the T-1 stock, can P and T make a section 336(e) election as to T-1? Does the protective carryover election prevent such an election?
3. If T distributes both T-1 and T-2 to P, can P and T elect section 336(e) treatment as to T-1 but not T-2?

Reverse Cash Mergers



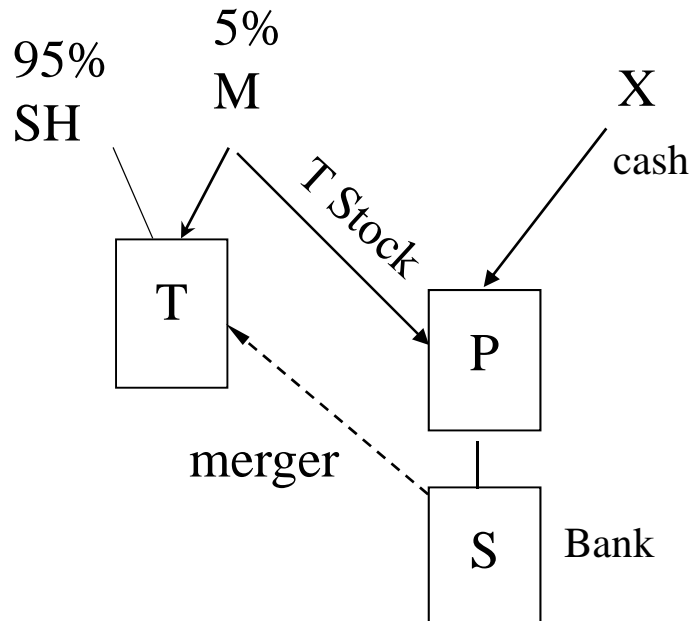
1. P forms N, and N is merged into T.
 2. The shareholders of T exchange their T stock for cash.
 3. P has made a qualified stock purchase of T.
-

Leveraged Buy-Out



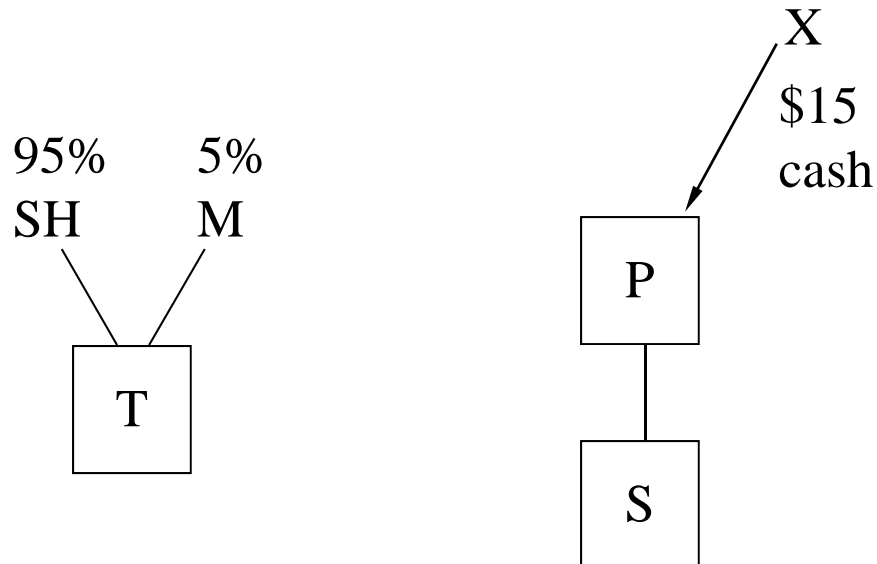
1. P forms N, and N is merged into T.
2. Money is borrowed, secured by the T assets, to acquire the T stock.
3. The acquisition of the T stock with borrowed funds is treated as a redemption -- not a purchase.
4. P must contribute some cash to purchase T stock in order to qualify under section 338, if so desired.

Participation by T Management -- Section 351



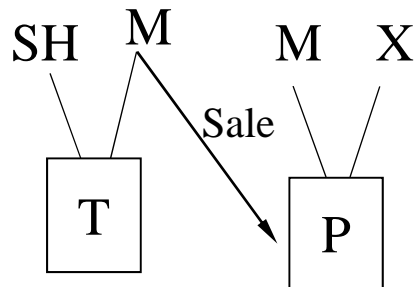
1. P is formed.
2. Management contributes 5% of T stock and X contributes \$15 in cash, in exchange for 25% and 75% interests in P, respectively.
3. P forms S.
4. \$80 is borrowed, secured by the T assets, to acquire the T stock.
5. S is merged into T with T surviving.
6. Acquisition of T stock with borrowed funds constitutes a redemption.
7. T stock from management -- section 351 -- is not purchased.
8. Section 338 will not apply unless X contributes cash equal to four times the value of management's stock and that cash is used to purchase T stock.

Sale by T Management to P -- Newly Formed P



1. P is formed.
2. Management (M) contributes \$5 in cash and X contributes \$15 in cash.
3. P forms S.
4. \$80 is borrowed, secured by the T assets, to acquire the T stock.
5. S is merged into T with T surviving. M receives \$5 in the transaction.
6. The service might ignore the \$5 contribution by M and treat the transaction as if M transferred its T stock to P in a section 351 exchange. Alternately, The Service could treat the transaction as if M contributed its T stock and \$5 in cash to P in exchange for P stock and \$5 in cash (boot).
7. The result is the same as the prior example -- section 338 is not available.

Sale by Management to P -- P Already in Existence



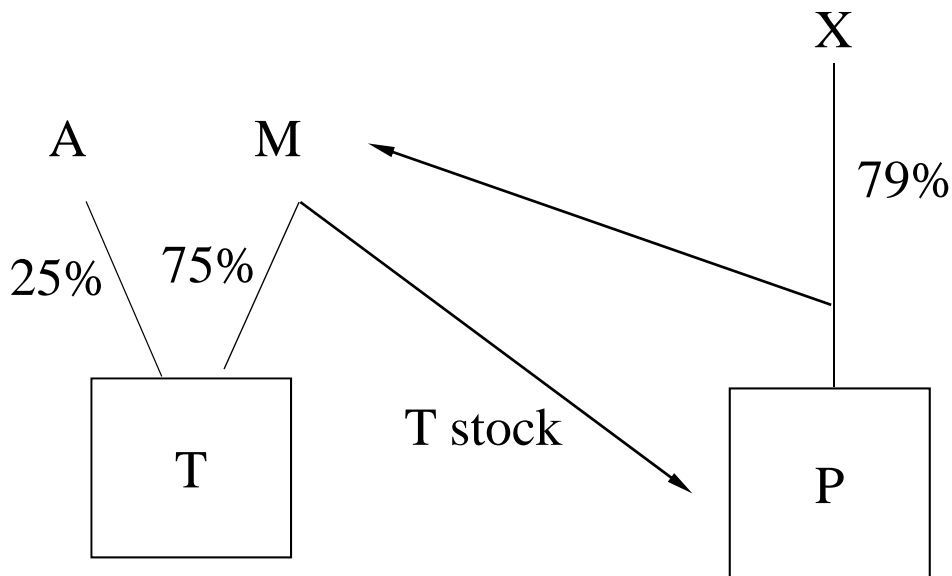
1. General Fact Pattern

- a. M sells its T stock to P for cash. P uses its own funds to acquire the T stock held by M.
- b. P acquires the T stock held by the remaining T shareholders either directly or through a reverse cash subsidiary merger.

2. M's Ownership in P and T

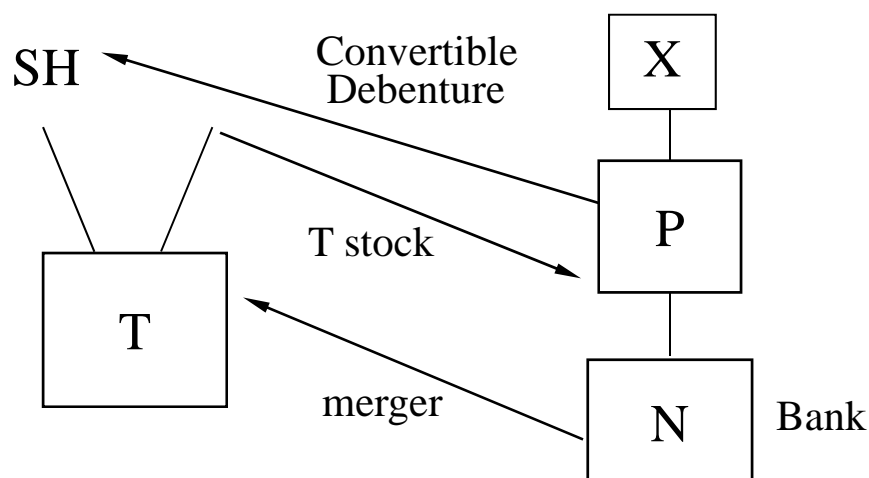
- a. M owns 50% or more of T and 50% more of P. section 338 is not available
 - (1) Section 304 applies. To the extent that the transaction is treated as a S distribution, P acquires T stock held by M in a capital contribution.
 - (2) M is related to P; no purchase occurs under section 338(h)(3)(A)(iii) unless M is a group of unrelated individuals none of whom owns 50% or more of P.
- b. M owns more than 20% but less than 50% of T. M must own less than 50% of P for section 338 to apply.
 - (1) Section 304 does not apply.
 - (2) If M is a sole shareholder, P could not purchase M's T stock under section 338(h)(3)(A)(iii). If M is a group of unrelated individuals, and no individual more than 50% of P, P can acquire M's T stock by purchase.
- c. M owns less than 20% of T and 100% of P section 338 applies.
 - (1) Section 304 does not apply.
 - (2) M is a related to P, so stock acquired from M is not purchased. However, P may still acquire the remaining 80% of T by purchase (but not by redemption).

Taxable Transfer of T Stock to P



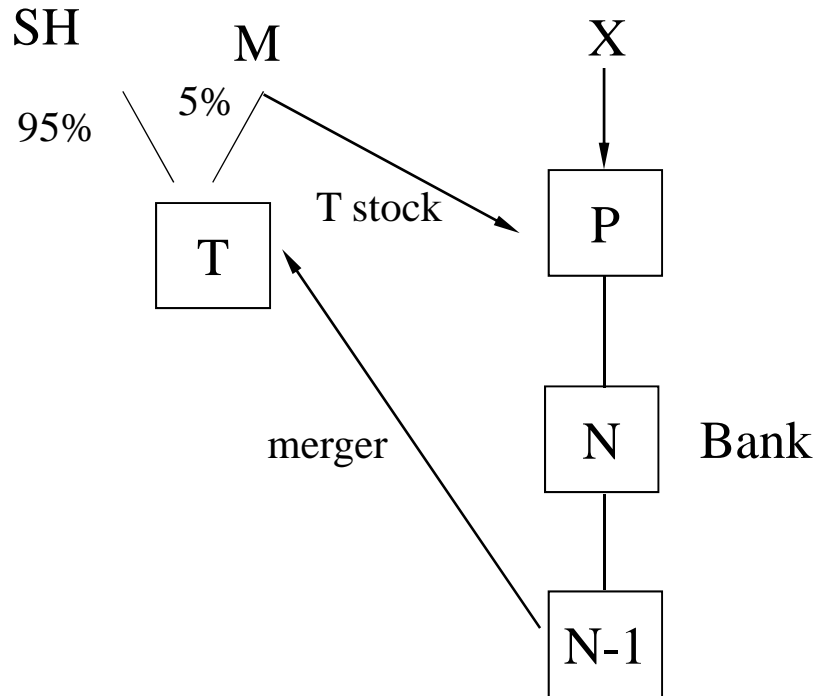
1. M owns 75% of T; A owns 25% of T and is unrelated to M.
2. T has significant NOL carryovers which are about to expire.
3. P is a pre-existing corporation owned solely by X.
4. M transfers its T stock to P in exchange for a 79% interest in P. X does not participate in the transfer.
5. P purchases A's interest in T using its own cash.
6. M's transfer to P is a taxable exchange. Section 351 does not apply since M did not obtain control of P.
7. Section 304 does not apply since M did not receive "property" from P.
8. P's acquisition does not constitute a "B" reorganization, so long as the funds used to acquire A's interest in T do not emanate from T.
9. Section 338 is available unless M is considered a related party of P, in which case P could not acquire M's stock in T by purchase.

Use of Convertible Debentures



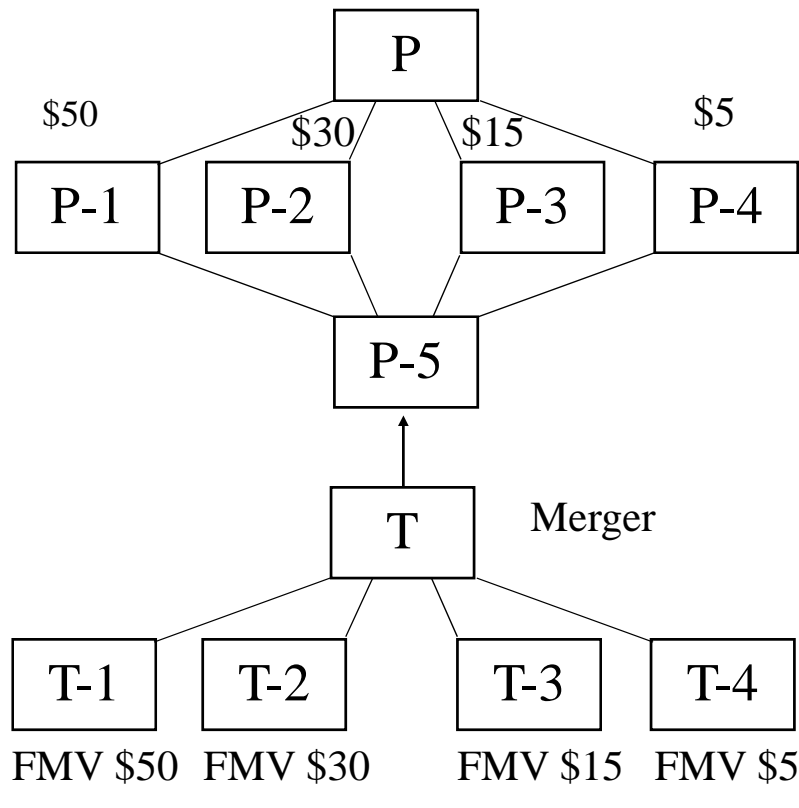
1. General
 - a. M transfers its T stock to P in exchange for convertible debentures of P. X transfers \$15 in cash in exchange for P stock.
 - b. P forms N and contributes the \$15 received from X. N borrows \$80, secured by the T assets.
 - c. N is merged into T with T surviving.
 - d. M's transfer of T stock for P convertible debentures is not a section 351 exchange.
2. M's participation in P.
 - a. M owns less than 50% of T, and a right to a greater-than-50% interest in P.
 - (1) Section 304 does not apply.
 - (2) M is not a related party for section 338(h)(3)(A)(iii) purposes. Stock acquired from M qualifies as a purchase.
 - (3) M probably will not qualify for capital gains under section 302.
 - b. M owns 50% or more of T, and a right to a maximum interest in P of 49%.
 - (1) Section 304 does not apply.
 - (2) P may acquire T stock held by M by purchase within the meaning of section 338(h)(3)(A).
 - (3) P should qualify for capital gains under section 302.
 - c. M owns 50% or more of T, and a right to a greater-than-50% interest in P.
 - (1) Section 304 will apply; to the extent that section 301 applies, P will not be treated as "purchasing" T stock.
 - (2) M is not related to P under section 338(h)(3)(A)(iii).

Use of Convertible Debentures



1. P is formed.
2. Management (M) contributes to T stock, and X contributes \$15 in cash.
3. P forms N and contributes T stock and \$15 cash. N borrows \$80 secured by T stock.
4. N forms N-1 and contributes \$95.
5. N-1 is merged into T.
6. N liquidates T or merges T upstream.
7. This transaction should be treated as a purchase of T stock and not a redemption by T.
8. M could contribute up to 20% of T stock and the transaction would still qualify for section 338. However, where M's interest in T exceeds 20% prior to the transaction, M's equity interest in P must be carefully structured so as not to run afoul of sections 304 and 338(h)(3)(A).
9. The transaction should not be viewed as a forward cash merger into N.

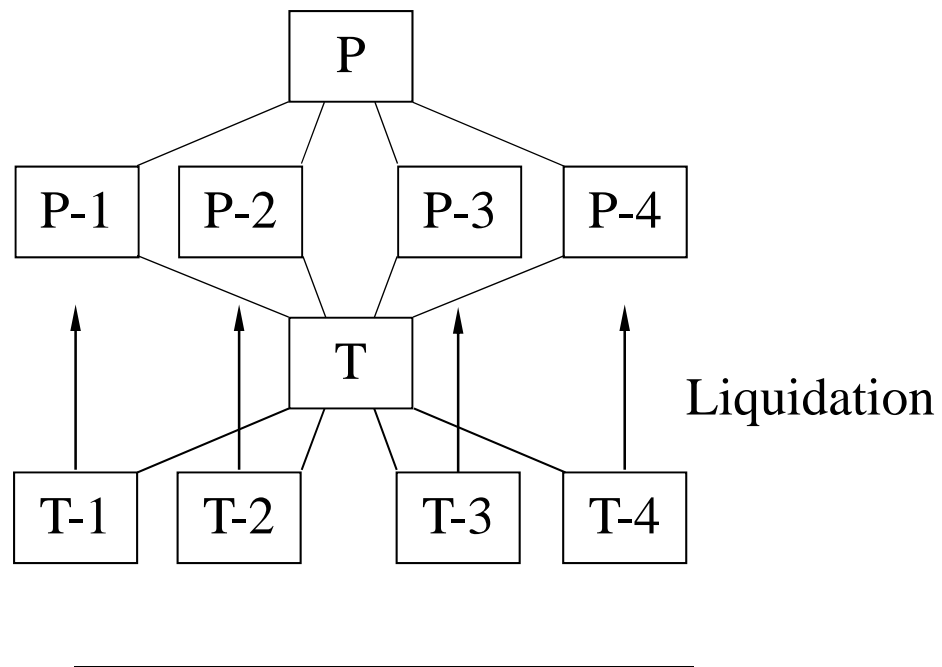
Alternative Acquisition Format



A.

1. P intends to acquire T. T is a holding company that owns all the stock of four subsidiaries
2. P will use \$20 of its own funds and \$80 will be borrowed.
3. P forms four tier subsidiaries -- P-1, P-2, P-3 and P-4. Each subsidiary capitalized to reflect the fair market value of the corresponding T subsidiary.
4. P-1, P-2, P-3 and P-4 form P-5 and collectively contribute \$100 to P-5.
5. P-5 merges into T with T surviving.
6. The merger would constitute a qualified stock purchase by P to the extent of P's funds, and a redemption by T to the extent of borrowings.
7. A protective carryover basis election should be made.

Mirror Plan Acquisition (cont.)

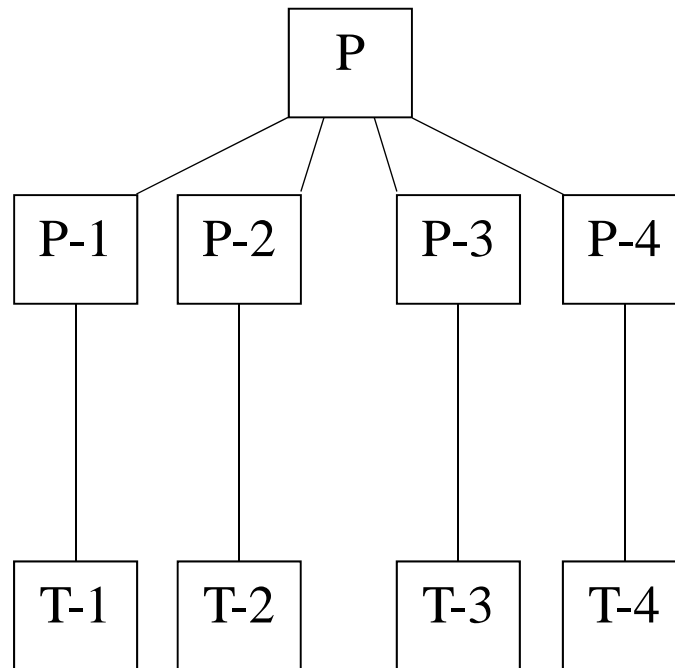


B.

1. T is liquidated.
2. In the liquidation, the following stock is distributed: T-1 to P-1, T-2 to P-2 to P-3, and T-4 to P-4.
3. The liquidation will be taxable if the grandfather provision does not apply.
4. If taxable, the gain will be deferred under Treas. Reg. § 1.1502-14T(a).

But see Treas. Reg. Sec. 1.1502-14T(b). P would inherit any deferred gain from T under Treas. Reg. § 1.1502-13T(c).

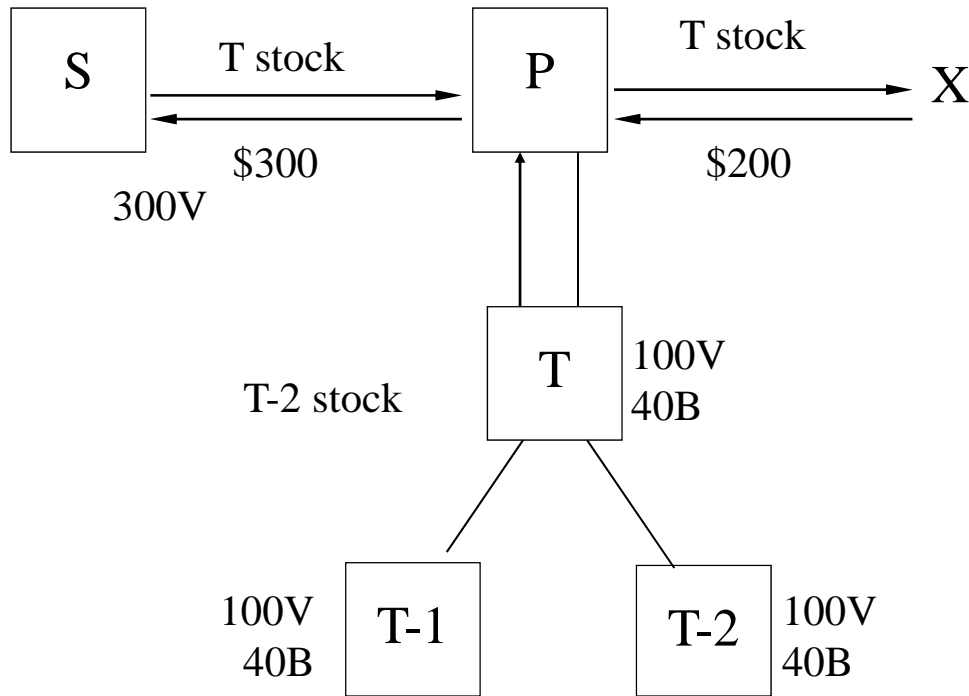
Mirror Plan Acquisition (cont.)



C.

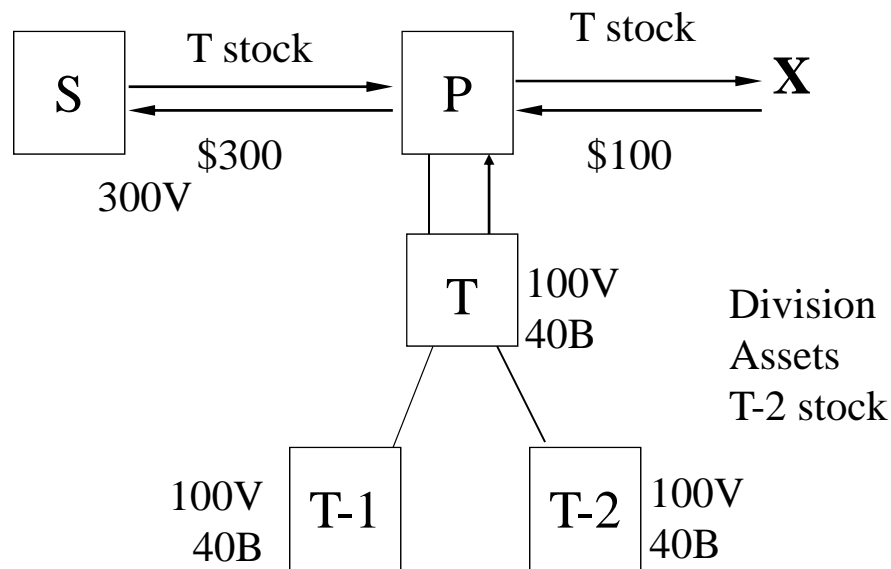
1. P sells P-2 to an unrelated buyer for \$30. Under section 358, P's basis in P-2 is \$30. Thus, P recognizes no gain on the disposition.
2. However, P-1 will restore to its income any deferred gain relating to T-2.
3. The buyer must pay tax on the full gain to obtain a step-up in the basis of T-2 assets.

Son of Mirrors -- Variation One



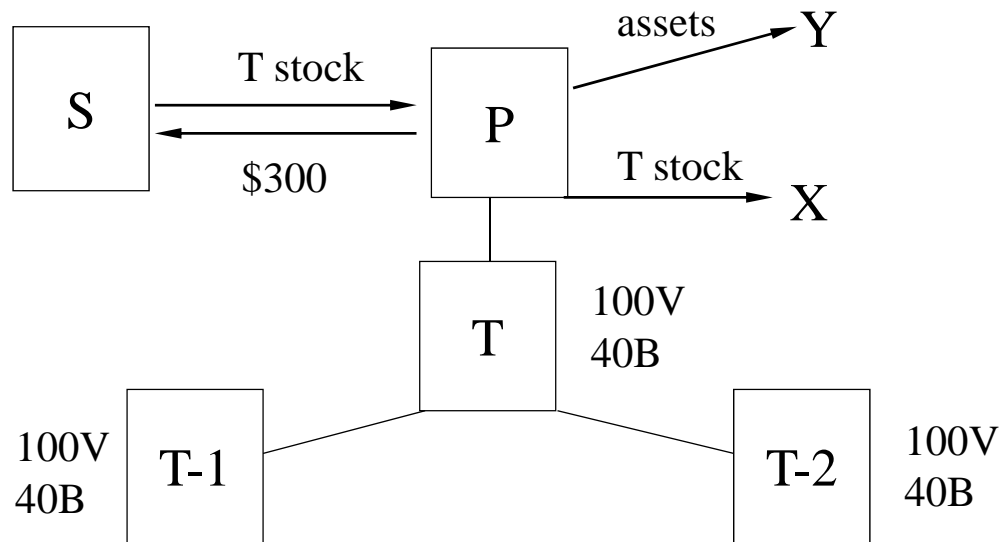
1. P buys all of T stock for \$300. P makes a protective carryover election. P and T file a consolidated return.
2. P causes T to distribute the T-2 stock to P.
3. T's gain of \$60 (\$100V -\$40B) is recognized, but deferred.
4. T's E&P is reduced by \$100; P's basis in T stock is decreased from \$300 to \$200. P's basis in T-2 stock is \$100.
5. P sells the T stock to X, an unrelated buyer, for \$200.
6. The sale triggers T's deferred gain. T's E&P increases by \$60; P's basis in T stock increases to \$260.
7. The sale produces a capital loss of \$60. Prior to the issuance of Treas. Reg. § 1.1502-20(a) this loss offset T's deferred gain of \$60. However, Treas. Reg. Sec. 1.1502-20(a) disallows this loss; see also New Temp. Treas. Reg. §§ 1.337(d)-2T, 1.1502-20T(i).

Son of Mirrors -- Variation Two



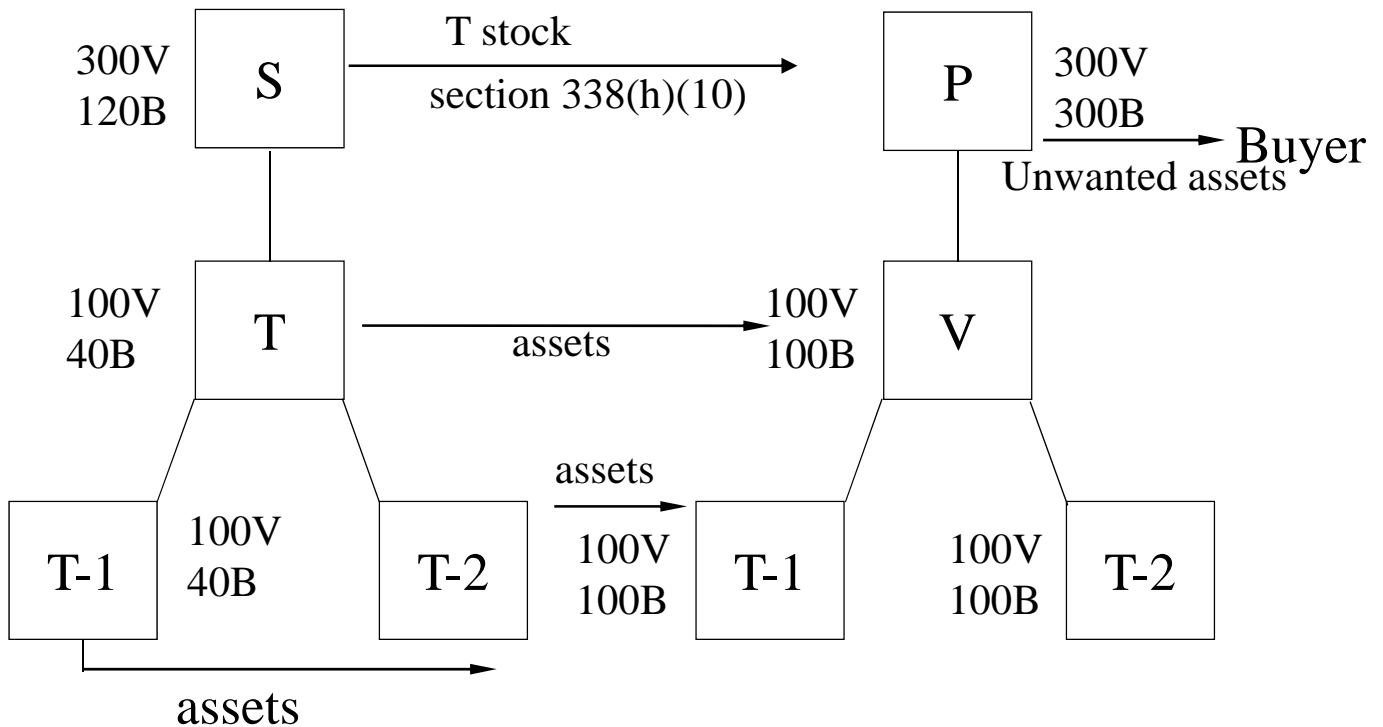
1. P buys the T stock from S for \$300.
2. P causes T to distribute the division assets and the T-2 stock to P.
3. T's gain of \$120 (\$60 + \$60) is recognized, but deferred.
4. T's E&P is reduced by \$200 (\$100 + \$100); accordingly, P's basis in T stock is decreased from \$300 to \$100.
5. P's basis in T-2 stock is \$100. The distribution of division assets is an ICA acquisition; however, P's initial basis in such assets is \$100.
6. After the distribution, P sells the T stock to X, an unrelated third party for \$100.
7. The sale by T triggers deferred gain of \$120. This increases P's basis in T's from \$100 to \$220.
8. The sale produces a \$120 capital loss to P (\$220 -\$100). Prior to issuance of Treas. Reg. Sec. § 1502-20(a) this loss offsets T's capital gain in full and T's ordinary income. However, Treas. Reg. § 1.1502-20(a) disallows this loss; see also New Temp. Treas. Reg. §§ 1.337(d)-2T, 1.1502-20T(i).
9. P must reduce its basis in the division assets to \$40.
10. Had P made an offset prohibition election, T's deferred gain could not be offset by P's capital loss, and P's basis would remain at \$100.

Son of Mirrors -- Variation Three



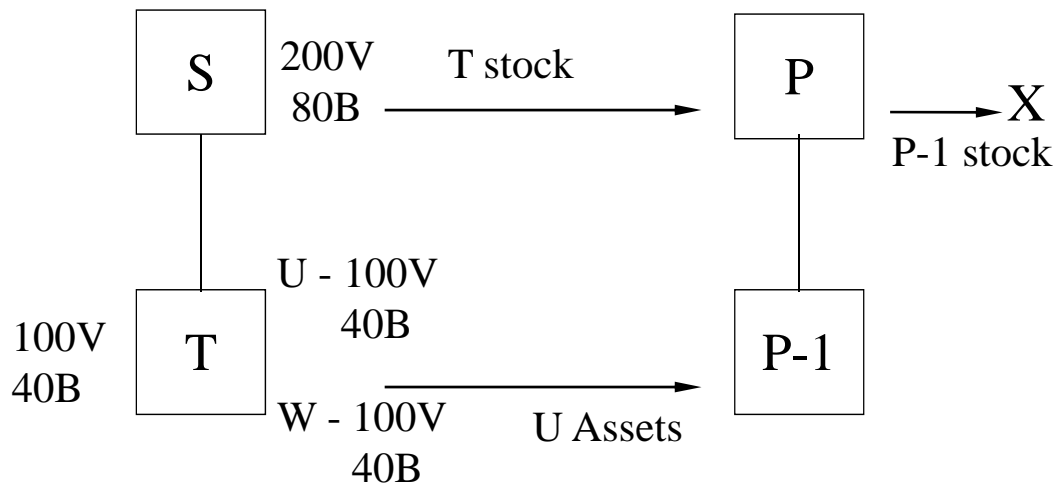
1. P buys the T stock from S for \$300.
2. P causes T to distribute the division assets and the T-2 stock. P then sells the division assets to Y for \$100, and the T-2 stock to X for \$100. Both X and Y are unrelated.
3. T's gain of \$120 is recognized, but deferred.
4. T's E&P is reduced by \$200. P's basis in the T stock is decreased from \$300 to \$100. P's basis in the T-2 stock and assets is \$100 each.
5. P sells the T stock to X for \$100, and the assets to Y for \$100.
6. The sale by P triggers T's deferred gain; T's E&P increases by \$120. P's basis in T stock increases to \$220.
7. The sale produces a \$120 capital loss. Prior to issuance of Treas. Reg. § 1.1502-20(a) this loss offsets T's capital gain in full and T's ordinary income. However, Treas. Reg. § 1.1502-20(a) disallows this loss; see also New Temp. Treas. Reg. §§ 1.337(d)-2T, 1.1502-20T(i).
8. P's basis in the division assets is not reduced. Thus, P recognizes no gain on the sale of assets to Y.
9. Y has a cost basis in such assets.

Comparison with section 338(h)(10)



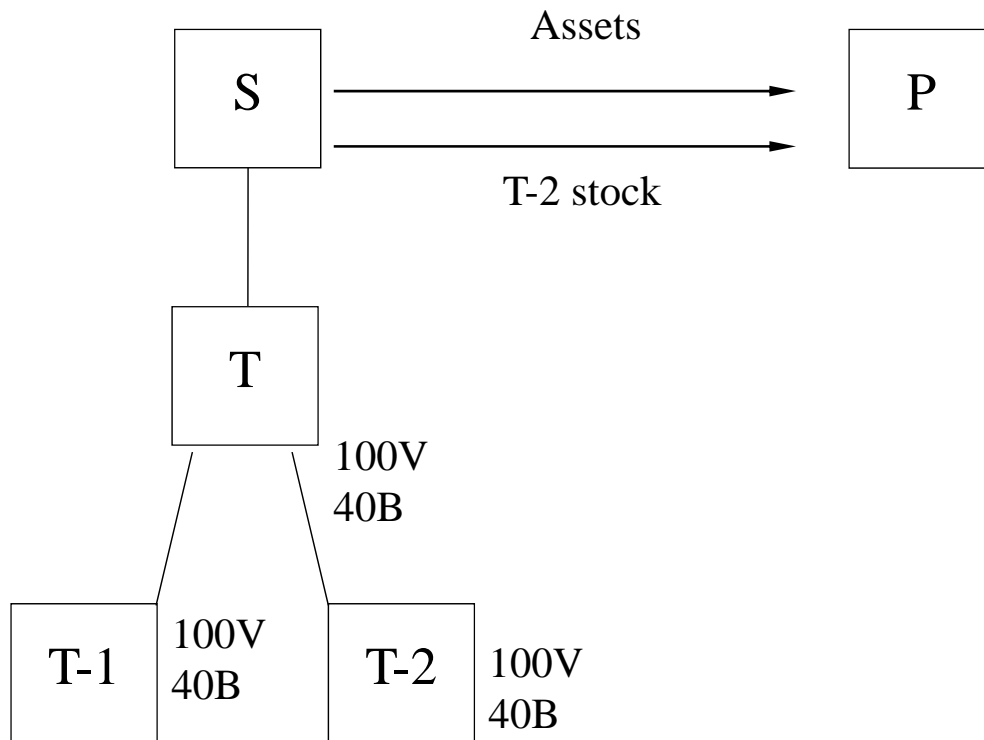
1. Son of mirrors complexity and the harsh effect of Treas. Reg. § 1.1502-20 (a) (and New Temp. Treas. Reg. §§ 1.337(d)-2T, 1.1502-20T(i)) can be avoided by using section 338(h)(10).
2. S sells the T stock to P, and S and P make a section 338(h)(10) election.
3. S's total gain on the deemed assets is \$180 -- the same gain S would recognize in the son of mirror transaction if its basis in the T stock were \$120.
4. P receives the stock and assets of T, T-1, and T-2 with a cost basis.
5. P can dispose of any of such property without further gain (assuming no future appreciation).

Cousin of Mirrors -- Variation One



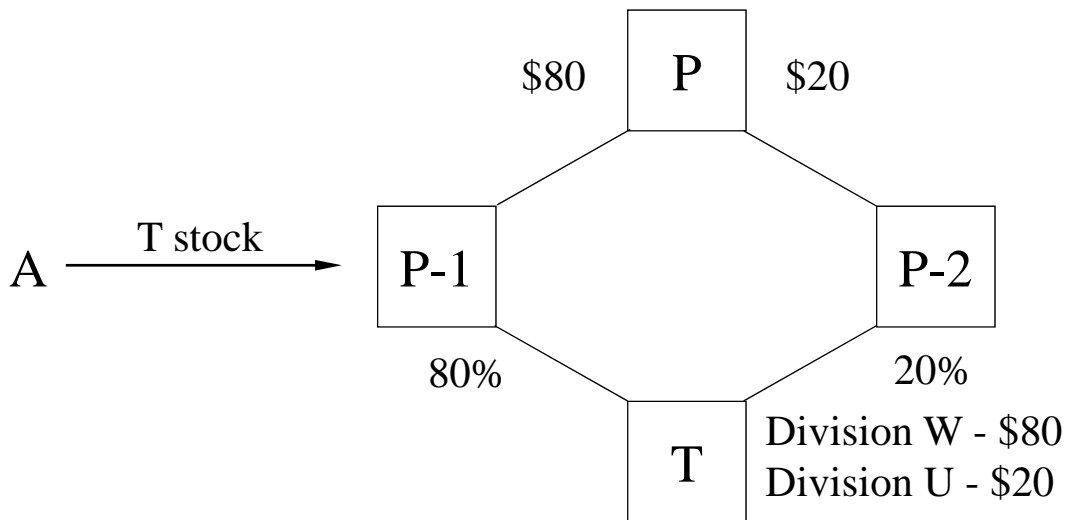
1. P wishes to acquire division W but not division U. S wishes to sell both.
2. P forms P-1. P contributes \$100 to P-1. P purchases the division U assets for \$100.
3. T recognizes \$60 of gain in the asset sale. S's basis in T stock is increased to \$140.
4. S sells the T stock to P for \$200. P makes a protective carryover election.
5. S recognizes \$60 of gain on the sale of T stock.
6. P can dispose of the P-1 stock for \$100 without further gain. If P timely disposes of P-1 stock, the assets inside P-1 will have a cost basis.
7. If section 338(h)(10) applies, this technique appears to be unnecessary.
8. If P sold the T stock at a loss, Treas. Reg. § 1.1502-20 would disallow the loss; see also New Temp. Treas. Reg. §§ 1.337(d)-2T, 1.1502-20T(i).

Cousin of Mirrors -- Variation Two



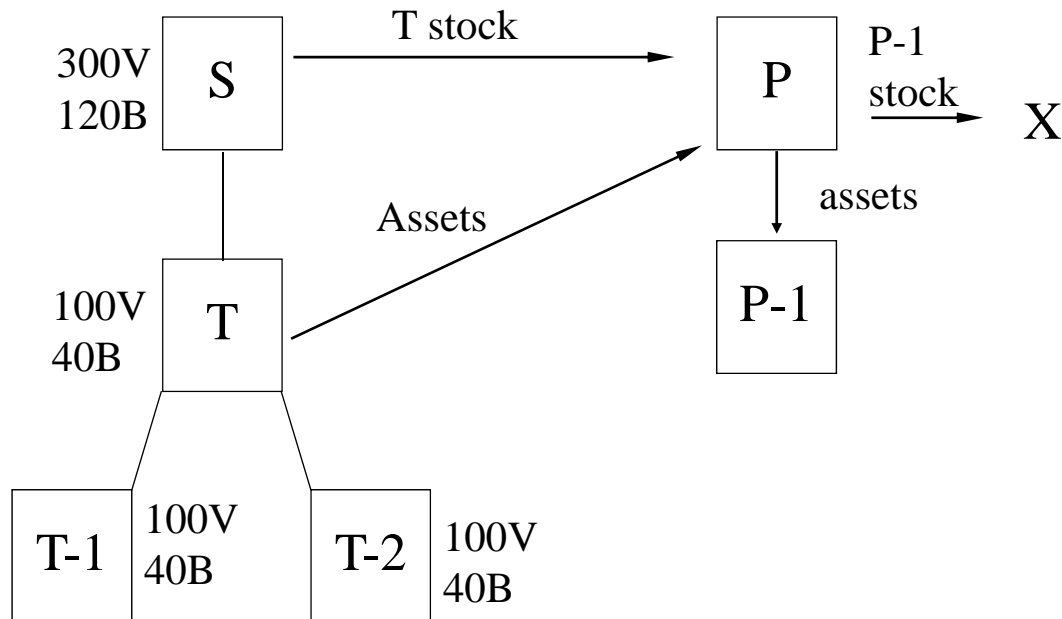
1. P wishes to acquire the T-2 stock and division assets owned by T. P will make a protective carryover election. T will sell T-2 stock and assets separately.
2. T distributes the division assets to S prior to the sale.
3. T recognizes \$60 of gain which is deferred.
4. S takes a fair market value in the T assets -- \$100.
5. P acquires the T-2 stock and T assets.
6. P takes a carryover basis in the division assets -- \$100. But see Court Holding and Former Temp. Treas. Reg. § 1.338-4T(g)(2).
7. Section 338(h)(10) makes the distribution of T assets unnecessary.

Baby Mirrors



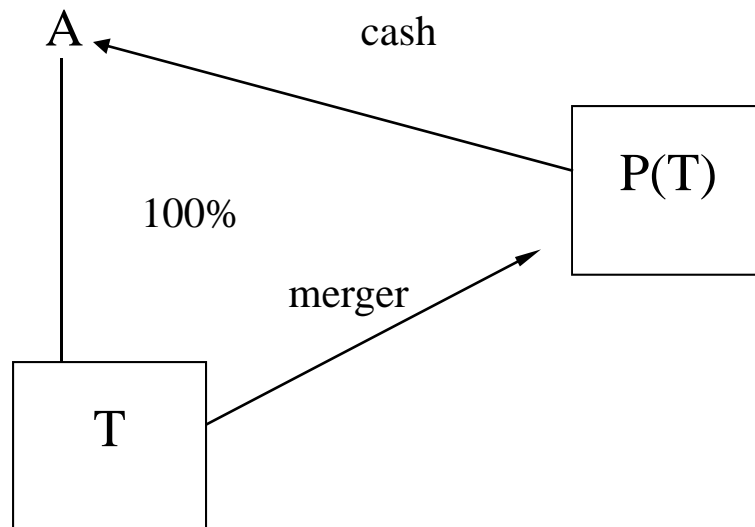
1. P wishes to acquire Division W which is operated by T. P does not want Division U. However, A will only sell T stock.
2. P forms P-1 and P-2. P contributes \$80 to P-1 and \$20 to P-2.
3. P-1 acquires 80% of T stock and P-2 acquires 20% of T stock from A.
4. T is then liquidated. Under section 337, T will only be taxed on the distribution to P-2. The gain is deferred and inherited by P-1.
5. P-1 and P-2 should be protected under section 332. P-1 receives fair market value basis in the Division U assets.
6. A sale of P-2 (or its assets) would not trigger such deferred gain. P-2's ICA assets apparently would not be stepped-down.

section 338(h)(10) Analog to Mirrors



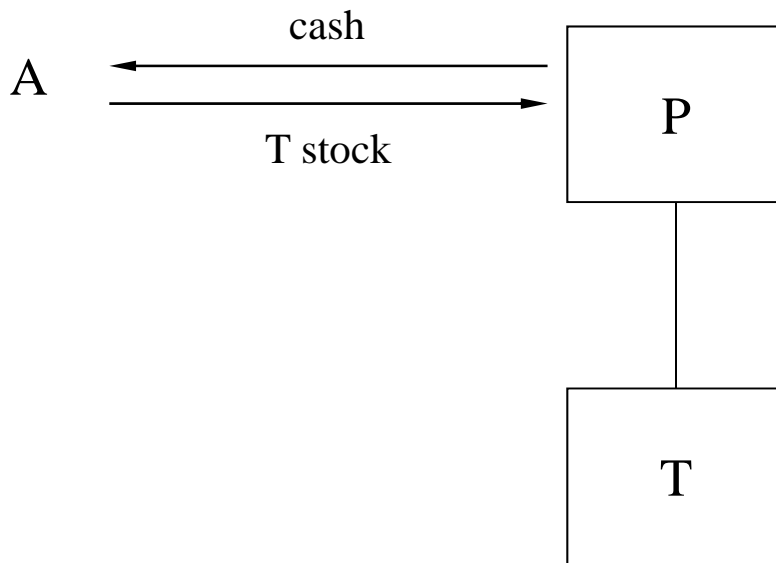
1. P wishes to acquire T-1 and T-2 stock, but not T's division assets. S will only sell T stock.
2. P purchases the division assets for \$100. T recognizes \$60 of gain which increases S's basis in the T stock to \$180.
3. P purchases the T stock for \$300, and P makes a protective carryover basis election. S recognizes an additional \$120 gain.
4. P transfers the T assets to P-1.
5. P's acquisition of assets is not covered by an exception to section 338(e) other than the protective carryover election. P must take the T assets with a \$40 basis.
6. Within the "permissible transfer period" P transferred the T assets to P-1 in exchange for P-1 stock. P's basis in P-1 stock is \$100 due to the special adjustment amount.
7. P may sell the P-1 stock to X without further gain for \$100.

Acquisition Techniques -- Cash Mergers



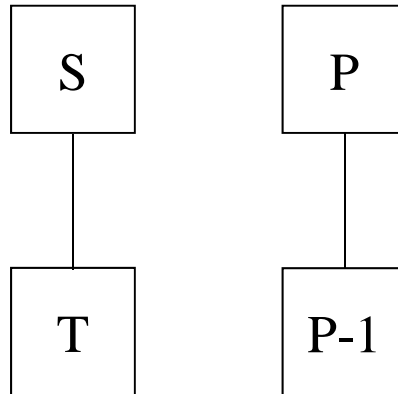
1. T's agreed value is \$1,000,000.
2. P wishes to purchase T and operate it in divisional rather than subsidiary form.
3. T merges into P with A transferring his T stock to P for \$1,000,000.
4. For tax purpose, this transaction constitutes a sale of assets by T to P, followed by a complete liquidation of T.
5. T's sale is fully taxable; A's gain on the liquidation is controlled by section 331.
6. As a result, although P obtains a step-up in basis, double-tax is imposed.

Acquisition Techniques -- Cash Mergers



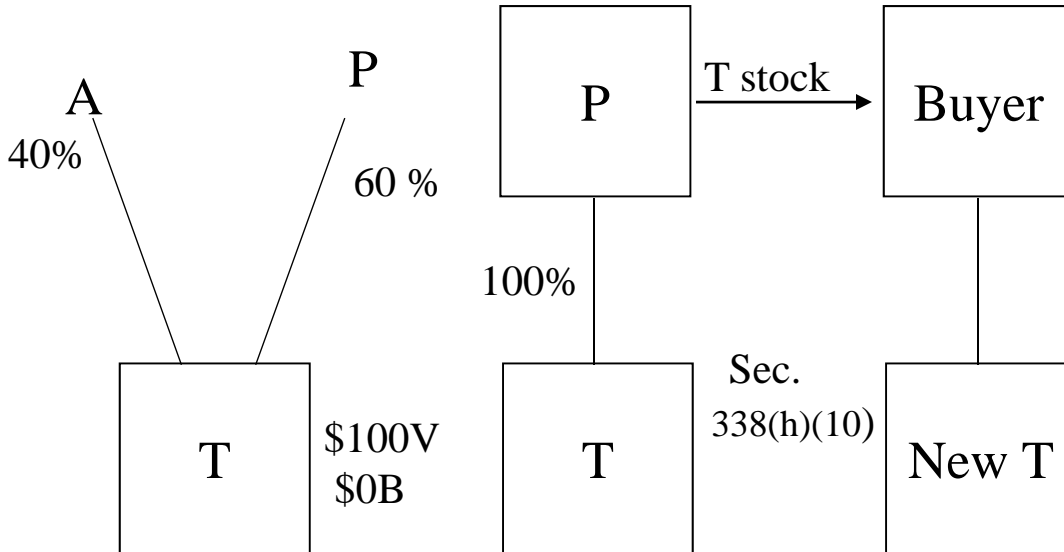
1. Same scenario as previous page, except P seeks a carryover basis. P may consider the following course of action:
2. As two separate steps, P first purchases T stock from A for \$1,000,000. P does not make a section 338 election.
3. T then merges into P.
4. The upstream merger is treated as a section 332 liquidation.
5. Pursuant to sections 334(b)(1) and 381(a)(1), P inherits T's asset bases and corporate attributes and no recapture is recognized. section 269(b) may apply.

Acquisition Techniques: section 338(h)(10) and Cash Mergers Compared



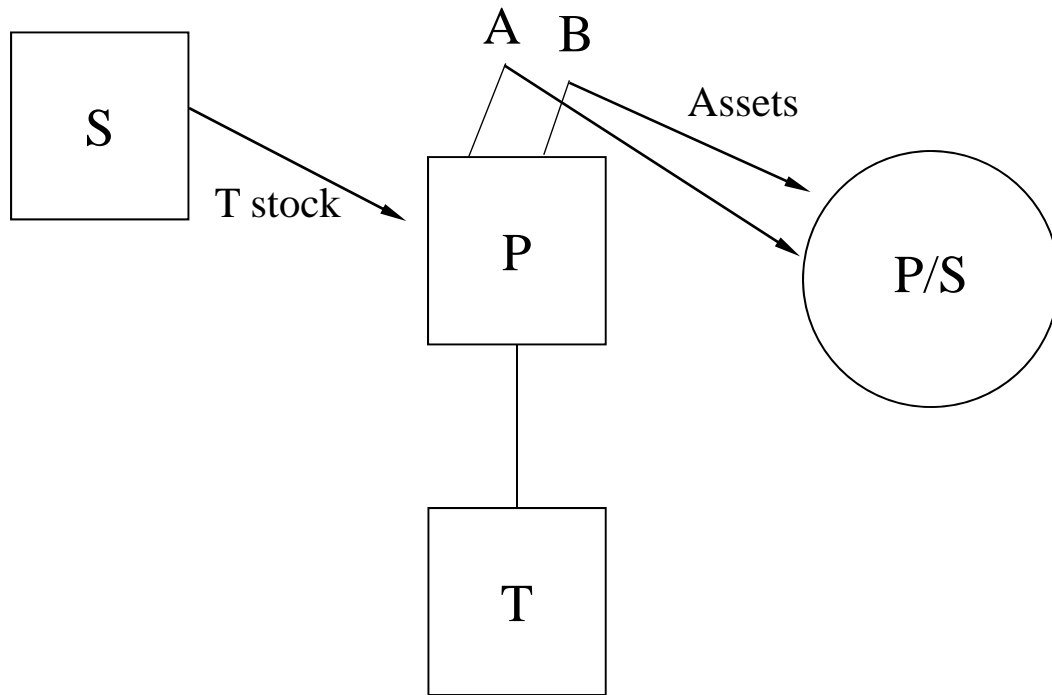
1. S owns T. S's basis in its T stock is \$900,000. T's basis in its assets is \$1,000,000. P wishes to acquire T. The agreed value for T is \$1,200,000.
2. P forms P-1 and acquires T in a forward cash merger.
 - a. T recognizes gain of \$200,000.
 - b. T is taxed on the full gain or loss in its assets.
 - c. T liquidates under section 332.
 - d. S inherits T's NOL carryovers (if any) under section 381.
3. The tax results are similar where P acquires T stock and a section 338(h)(10) election is made.
4. P's basis in the acquired assets will be governed generally by Former Temp. Treas. Reg. § 1.338-2T in each case.

Planning to Fit Within section 338(h)(10)



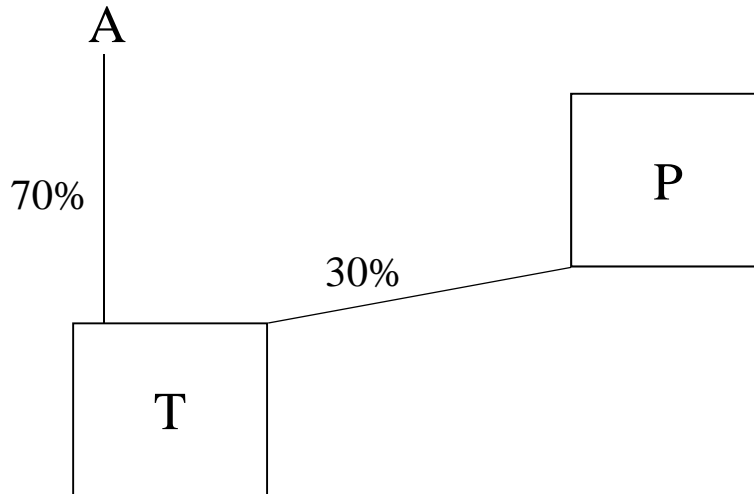
1. P owns 60% of T. Individual A owns 40% of T. T's assets have a value of \$100 and a zero basis. P and A have a zero basis in their T stock.
2. P and A wish to dispose of the stock or assets of T.
3. If T sells its assets and distributes the proceeds in complete liquidation, a double tax will apply.
4. If P and A sell their stock, a single level tax will apply, but T's assets will not be stepped-up.
5. If P buys A's stock in T, then subsequently sells all of the T stock to a corporate buyer, P and the buyer could make a joint section 338(h)(10) election. P's after-tax return should be enhanced.

Disincorporation of a Target



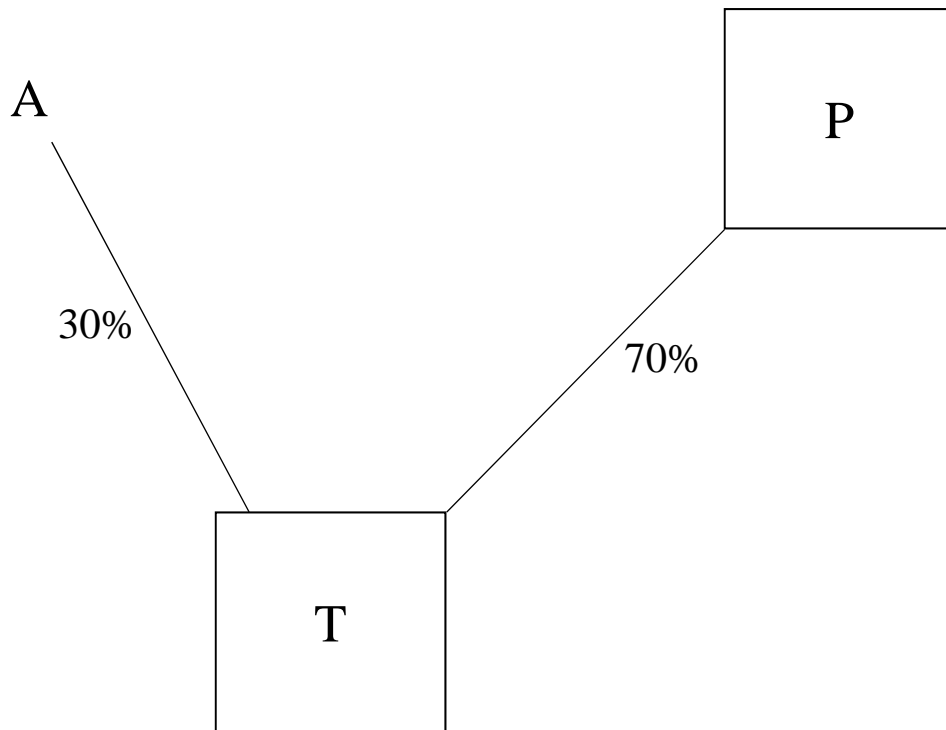
1. S sells T stock to P. P and S make a joint section 338(h)(10) election.
2. P liquidates T and distributes the T assets to A and B.
3. A and B contribute the assets to a newly-formed partnership (P/S).
4. P apparently will be treated as the true purchaser of T stock -- not A, B, or P/S -- if P is pre-existing and engaged in business before and after the acquisition. See PLR 8714019.

Qualified Stock Purchases: Overcoming Nonrecently Purchased Stock



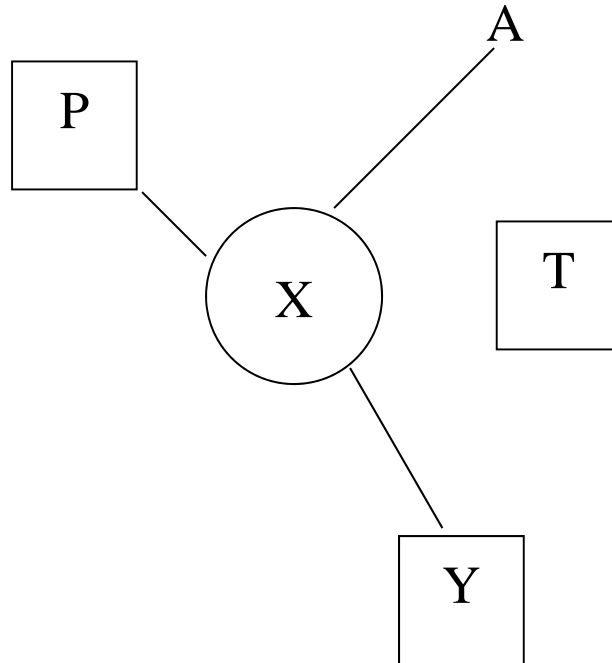
1. T has 100 shares of stock outstanding. P acquires 30% in 1975. A owns the other 70%. P wishes to buy out A and make a section 338 election.
2. A redemption of P's stock will increase A's interest to 100%. P cannot, however, acquire A's interest and make a section 338 election. For section 338 purposes, P's stock is still considered outstanding.
3. If T issues new shares to A so that A owns 80% of T, a subsequent purchase of A's interest by P probably will not allow P to make a section 338 election. Under the step-transaction doctrine, A's transitory ownership will probably be disregarded.
4. If P purges its 30% interest in an unconditional sale to an unrelated buyer, or through an unconditional gift to charity, a subsequent purchase by P of all the T stock should allow P to make a section 338 election.

Qualified Stock Purchases: Overcoming Nonrecently Purchased Stock



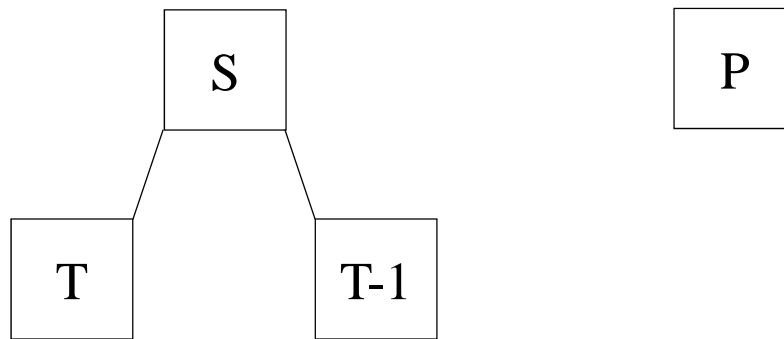
1. A owns all the T stock. A sells 70% of T to P. A's remaining 30% is recapitalized into nonvoting, nonparticipating preferred stock.
2. So long as the recapitalization occurs within the 12-month acquisition period, P's acquisition should constitute a qualified stock purchase.

Qualified Stock Purchases -- Acquisition by Partnership



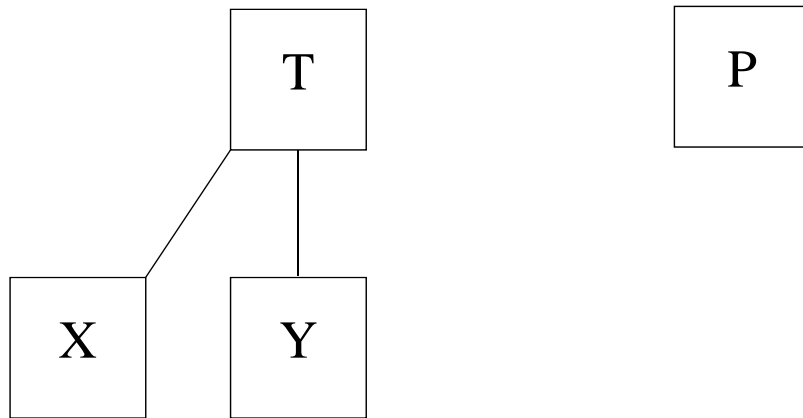
1. P and A form partnership X. X intends to acquire the stock of T and make a section 338 election.
2. X itself cannot make a section 338 election.
3. If P acquires T, makes a section 338 election, and contributes the stock to X, P's ownership of X may be disregarded. X would be treated as the true purchaser.
4. If X forms corporation Y, Y may acquire T and make a section 338 election.

The Former Stock Consistency Rules -- Statutory Scheme



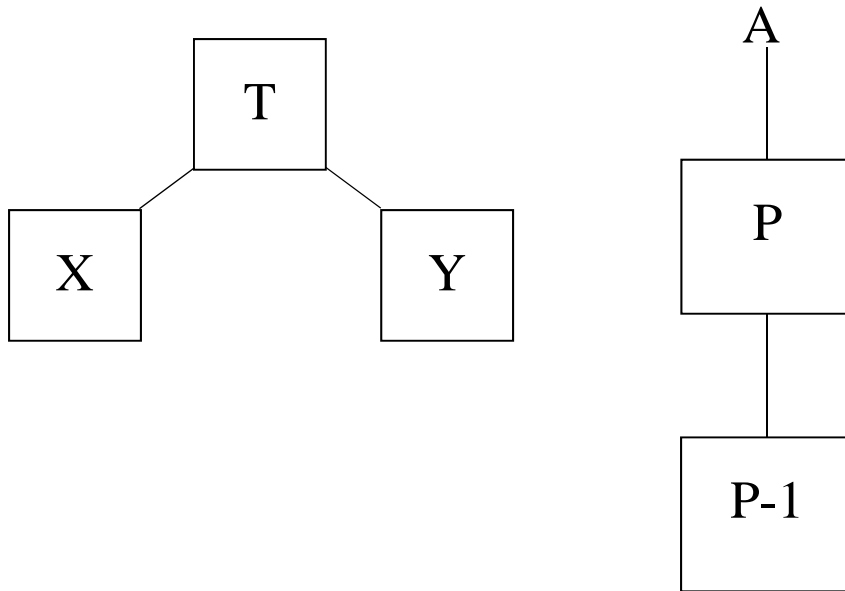
1. On January 1, 1985, P purchases the T stock from S.
2. On June 1, 1985, P purchases the T-1 stock from S.
3. An election by P with respect to T will also apply to T-1.
4. If P does not make an election with respect to T, no election can be made as to T-1.
5. If P purchases both T and T-1 on January 1, 1985, an express election as to either T or T-1 will bind the other. However, only one express election is required.

The Former Consistency Rules -- Deemed Purchases

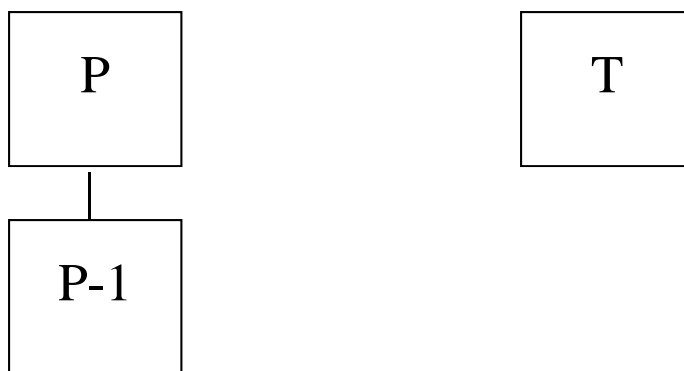


1. P makes qualified stock purchase of T and makes a section 338 election.
2. New T is deemed to have purchased both X and Y as a result of T's election.
3. The election as to T causes a deemed section 338 election with respect to X and Y.

The Former Consistency Rules -- Acquisitions by Affiliates

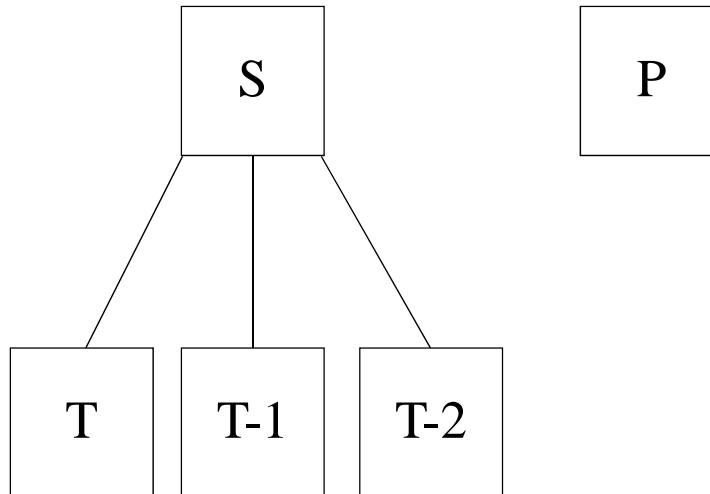


1. P purchases all of the X stock. P-1 purchases all of the Y stock.
2. The acquisition by P and P-1 are treated as if made by one corporation. Both acquisitions must be treated consistently.
3. If A purchases the Y stock instead of P-1, consistency between X and Y purchases is not required.
4. If P and P-1 each purchase 50% of X, a qualified stock purchase of X occurs, and section 338 applies.



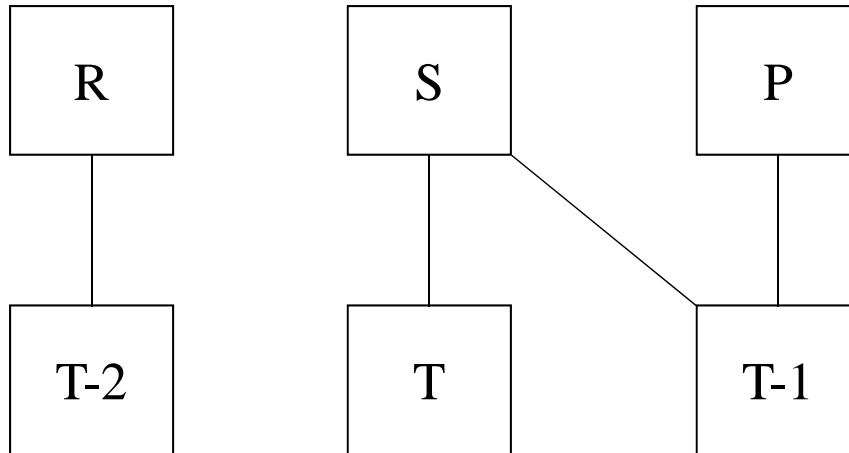
1. In 1982, P-1 acquires a 10% interest in T.
2. In 1985, P acquires 80% of T and makes a section 338 election.
3. The stock owned by P-1 is treated as nonrecently purchased stock. 63

Rule of Chain Reactions Under Former Consistency Rules



1. On January 1, 1985, P purchases the T stock.
2. On December 1, 1985, P purchases the T-1 stock.
3. On June 1, 1986, P purchases the T-2 stock.
4. P's election as to T will bind T-1, which in turn binds T-2. T-1 and T-2 are affected targets.

Affected Target Not a Target Affiliate

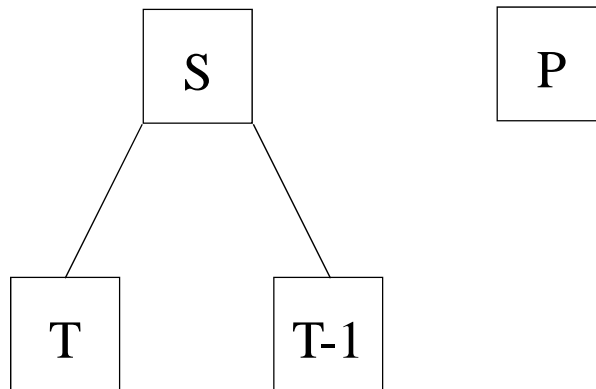


1. On January 1, 1985, P purchases T.
2. On June 1, 1985, P purchases T-2 from an unrelated party.
3. On July 1, 1985, P purchases T-1.
4. On September 1, 1985, P purchases T-2.
5. P's election as to T will bind both T-1 and T-2. T-2 is an affected target even though it is not an affiliate of T.

More Than One Original Target

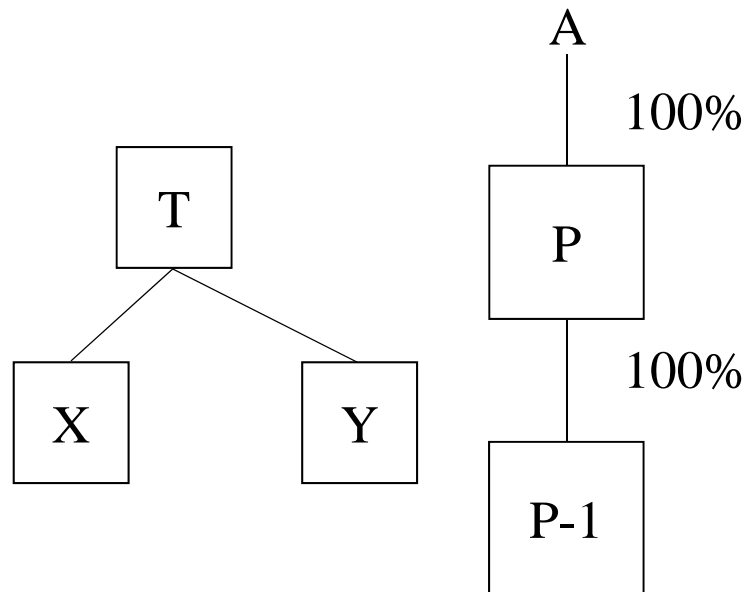
1. Same as above except P purchases T-2 from S on July 1, 1985.
2. On September 1, 1985, P purchases T-1.
3. P's election as to T is not binding on T-2. Also, P's election as to T-2 is not binding on T.
4. If P makes different elections as to T and T-2, which controls T-1? Should T-2 be considered an asset held by S, which could not be "purchased" within the meaning of section 338 if P makes a protective or affirmative action carryover election?
5. P's election as to T will bind both T-1 and T-2. T-2 is an affected target even though it is not an affiliate of T.

The Former Stock Consistency Rules -- Purchases and Reorganizations



1. On January 1, 1985, P purchases T makes a section 338 election.
2. On July 1, 1985, P acquires the T-1 stock in exchange for P stock in a "B" reorganization, giving S a 25% interest in P.
3. P's election as to T does not apply to T-1.
4. If S acquires a 51% interest in P, will the related party rules of section 338(h)(3)(C) prevent a section 338 election?

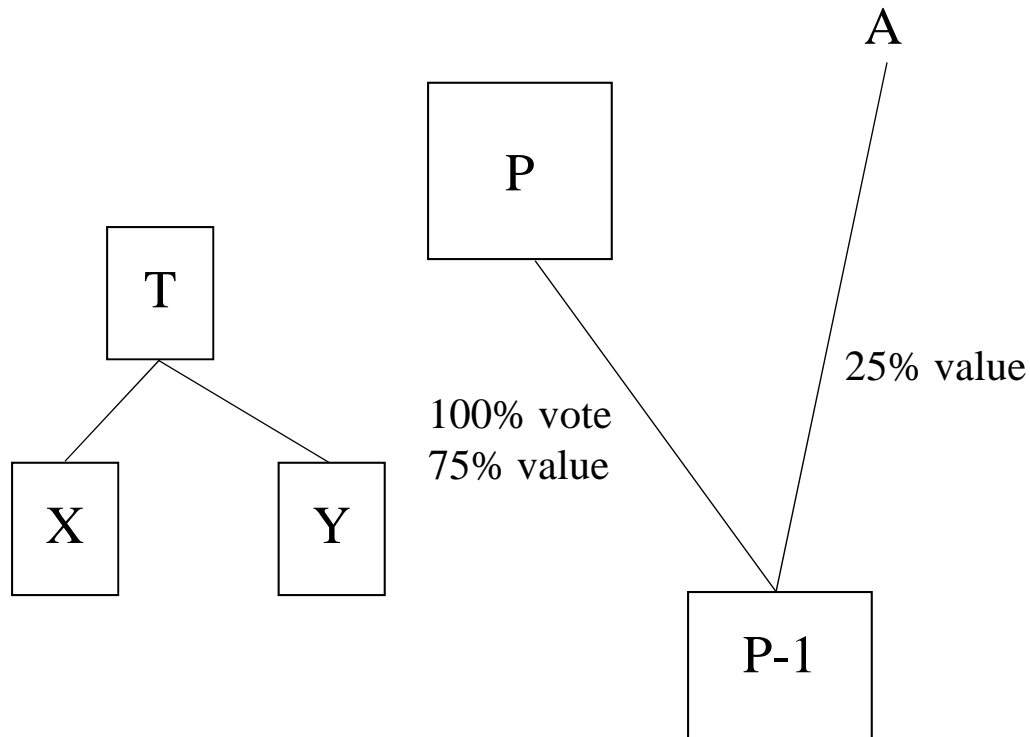
Planning for the Former Consistency Provisions



1. On January 1, 1985, P purchases the stock of X and makes a section 338 election.
 2. On February 1, 1985, A, an individual and sole shareholder of P, purchases their stock. A cannot make a section 338 election.
 3. On February 1, 1987, A transfers the Y stock to P.
 4. The P group ostensibly has avoided the consistency requirement since a step-up occurred for X but not Y.
 5. However, section 338(i) and Former Temp. Treas. Reg. Sec. 1.338-4T(g) may operate to restore consistency in this situation.
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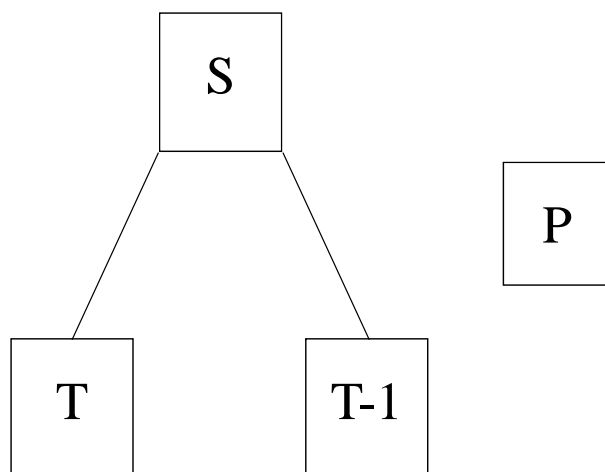
1. Same as above, except P-1 purchases the assets of X.
2. A purchases the Y stock.
3. If A retains the Y stock the consistency rules should not apply, unless the Commissioner shows that it is appropriate to treat A's acquisition as an "indirect acquisition" by the P group.

Planning for the Former Consistency Provisions (con't)



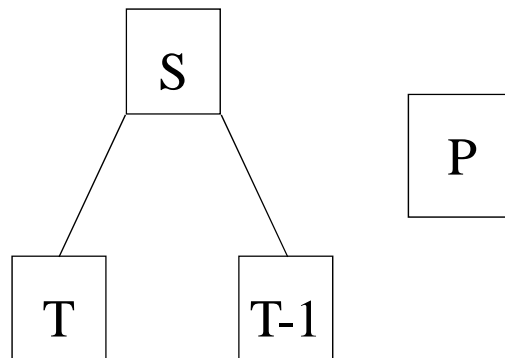
1. P1 issues a class of nonvoting, participating preferred stock to A, which has value equal to 25% of P-1's outstanding shares.
2. P-1 purchases X and makes a section 338 election.
3. P purchases the Y stock and makes no election.
4. The consistency rules should not apply because P-1 is not an affiliate of P.
5. However, the P-1 group (P-1 and X) cannot file a consolidated return with the P group (P and Y).

The Former Asset Consistency Rules -- Statutory Scheme



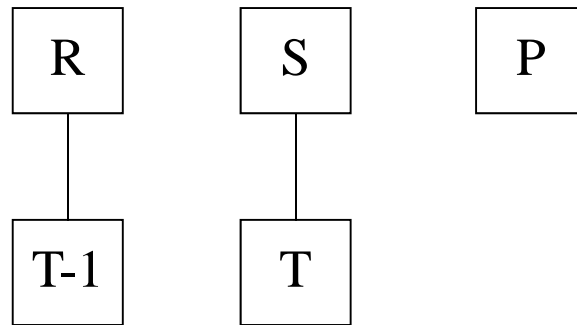
1. P makes a qualified stock purchase of T.
2. Within T's consistency period, P (or a P group member) purchases an asset from either T, an affiliate of T, an affected target, or an affiliate of an affected target.
3. Under section 338(e), P is deemed to make a section 338 election as to T, unless an exception applies to the asset acquisition.

Relationship Between Former Stock and Asset Consistency Rules



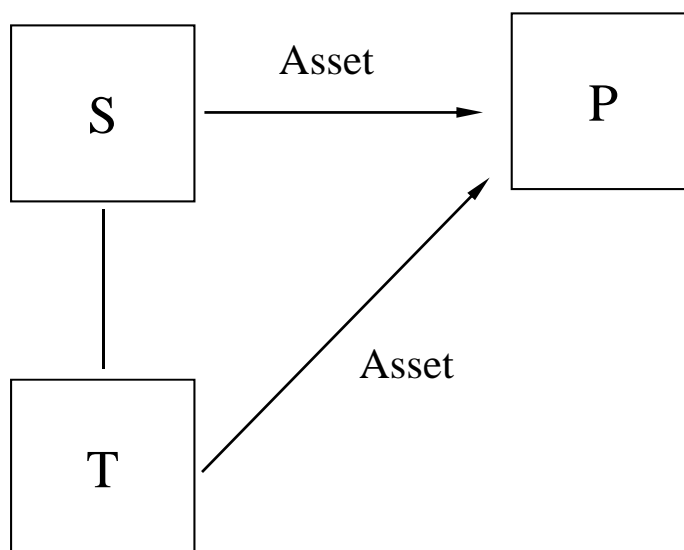
1. On January 1, 1985, P acquires T, but does not make a section 338 election.
2. On December 1, 1985, P acquires T-1.
3. On June 1, 1986, after the close of T's consistency period, P purchases an asset from S in a tainted asset acquisition.
4. The statute does not address this problem. However, Former Temp. Treas. Reg. § 1.338-4T(f)(1) confirms that asset consistency rules will override the stock consistency rules.
5. Thus, a deemed election is triggered with respect to both T and T-1. The election as to T is, in effect, deemed backward.

Miscellaneous Exceptions: section 338(e)(2)(D)
-- Stock as an Asset



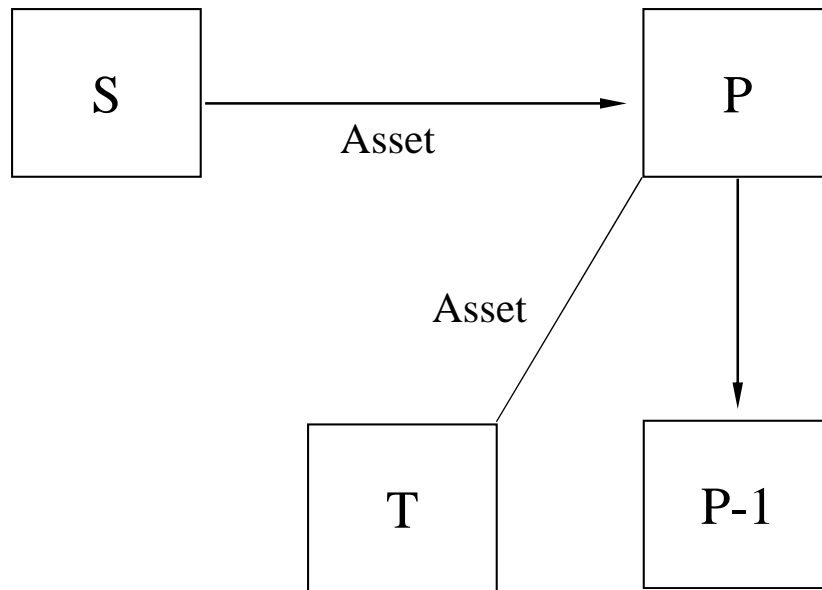
1. On January 1, 1985, P buys the stock of T, but makes no election.
2. On February 1, 1985, S buys the stock of T-1 from R.
3. On March 1, 1985, P buys T-1 from S.
4. P's T-1 stock acquisition is a tainted asset acquisition subject to the carryover basis rules. T-1 is not a target affiliate of T, but it is an asset held by target affiliate, S.
5. P may not make a section 338 election as to T since, under the affirmative action carryover election rules, a purchase has not occurred.
6. If the District Director triggers an election as to T as a result of the tainted acquisition of the T-1 stock, the deemed election will negate the carryover election, and P should be treated as having "purchased" T-1. P is free, then, to make or not make a section 338 election.
7. P could, however, purchase T-1's assets and obtain a basis step-up without triggering a deemed election as to T.

Unincluded Company Asset Acquisitions -- Definition



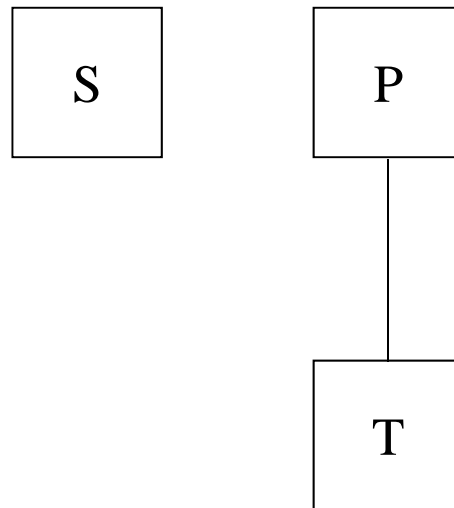
1. On January 1, 1985, P purchased an asset from T in a tainted asset acquisition.
2. On February 1, 1985, P purchases the stock of T from S.
3. On March 1, 1985, P purchases an asset from S in a tainted asset acquisition.
4. Both asset acquisitions are unincluded company asset (UCA) acquisitions.

Unincluded Company Asset Acquisitions -- Special Adjustment Amount



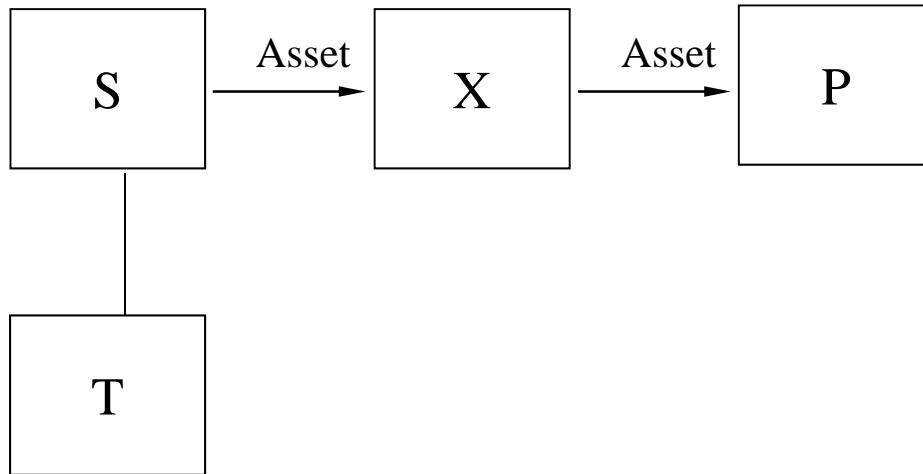
1. On January 1, 1985, P purchases the T stock and files a protective carryover election.
2. On December 1, 1985, P purchases a tainted asset from S for \$1,000 and assumes a \$600 liability. S's basis in the asset is \$250.
3. If P retains the asset, P's basis therein will be \$250.
4. If P transfers the asset to P-1 in a section 351 transaction, P-1's basis in the asset is \$600 [\$250 (carryover basis) + \$350 gain recognized to P (from section 357 (c)(3))]. Section 362(b).
5. P's basis in the P-1 stock is \$1,000 - zero under section 358 [\$250+ \$350 - \$600 (liability assumed) plus P's special adjustment amount of \$1,000 (\$1,600 - \$600)].

**Intercompany Consolidated Asset Acquisitions and Intercompany
Non-Consolidated Asset Acquisitions -- Definition**



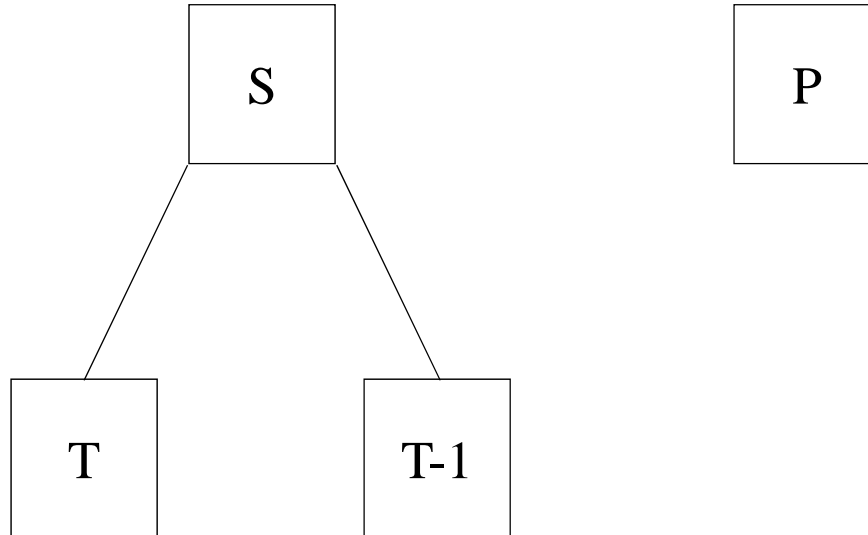
1. On January 1, 1985, P acquires T in a qualified stock purchase.
2. The P group does not file a consolidated tax return for the year 1985.
3. On March 1, 1985, P acquires an asset from T in a tainted asset acquisition, i.e., subject to an affirmative or protective carryover election.
4. The March 1, 1985 acquisition is an intercompany nonconsolidated asset (INA) acquisition.
5. If the P group files a consolidated tax return for the year 1985, March 1, 1985 acquisition would be an intercompany consolidated asset acquisition.

Asset Acquisitions by Nonmembers of the Acquiring Group



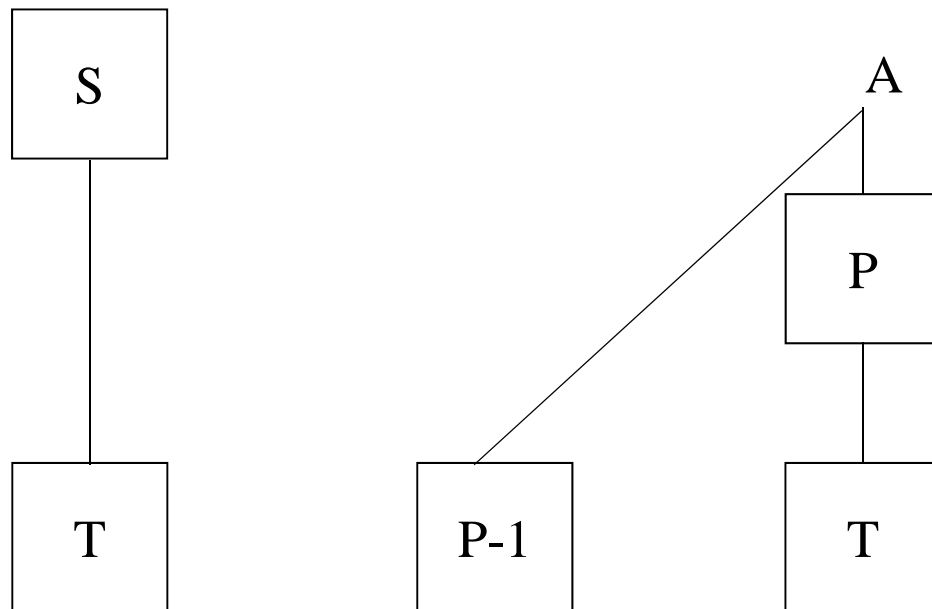
1. On January 1, 1985, P makes a qualified stock purchase of T.
2. During T's consistency period, X acquires an asset from S (or T).
3. Also during T's consistency period, X transfers an asset to P.
4. X is not related to P; however, the asset acquisition by X and subsequent transfer to P were made pursuant to a "single plan" of the P group.
5. The Commissioner may treat the acquisition by X as an acquisition by a P group member.
6. X need not be a corporation for this result to obtain.
7. If X transfers the asset to P, or becomes a P group member after the close of T's consistency period, the Service may nevertheless extend the consistency period to cover such an event, if it can show that an extension is "appropriate" under the circumstances.

Asset Acquisitions by Nonmembers of the Acquiring Group



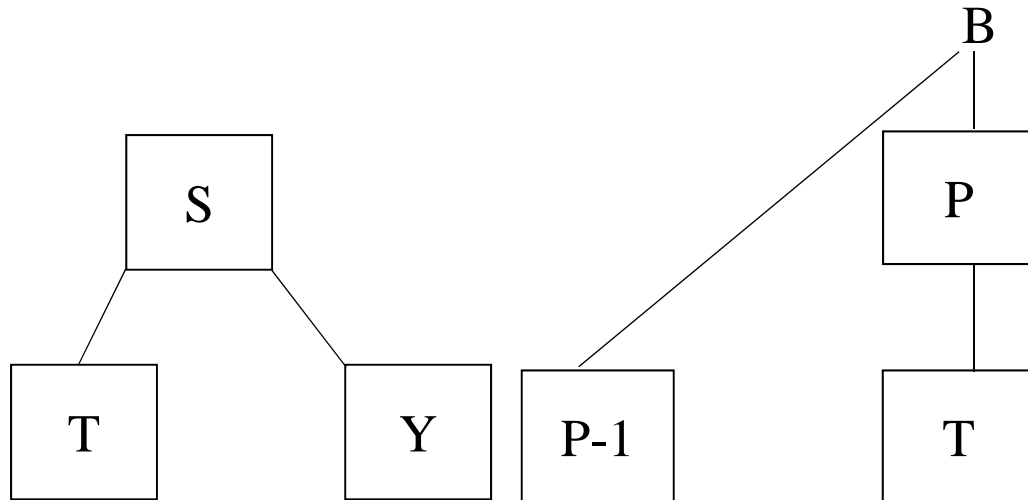
1. On January 1, 1985, T buys assets from T-1 at fair market value.
2. On February 1, 1985, P purchases the stock of T and does not make an election.
3. Can the Service treat T as a P group member for purposes of applying the consistency rules? Note that under Former Temp. Treas. Reg. § 1.338-4T(f)(2)(Ans.2), T is normally treated as a P group member only after it joins the P group.
4. Because T is not related to P, T's asset acquisition and P's acquisition of T must be made pursuant to a "single plan of the P group." What is a single plan of the P group"? How does it differ from the plan requirement of Former Temp. Treas. Reg. § 1.338-4T(g)(1)?

Asset Acquisitions by Nonmembers of the Acquiring Group - Indirect Acquisitions



1. A, an individual, is the sole shareholder of both P and P-1.
2. On January 1, 1985, P makes a qualified stock purchase of T and does not make an election.
3. During T's consistency period, P-1 acquires an asset from T.
4. P-1 retains the T asset and does not become a member of P's affiliated group.
5. May the Service nevertheless treat the acquisition by P-1 as an acquisition by P under the regulatory provisions for "indirect acquisitions"? The Service need only show that such treatment is appropriate.

Stock Acquisitions by Nonmembers of the Acquiring Group



1. On May 1, 1985, P makes a qualified stock purchase of T, and makes a section 338 election.
2. On June 1, 1985, B, an individual and sole shareholder of P, acquires Y for cash.
3. On December 1, 1985, B transfers the Y stock to P.
4. The Commissioner may treat P as having acquired the Y stock by purchase since:
 - a. If B were treated as a P group member, a qualified stock purchase of Y would be made.
 - b. Had an actual purchase of Y by the P group been made, a deemed election for Y would result by reason of P's actual election for T.
 - c. B transferred the Y stock to a P group member.
5. P's acquisition date of the Y stock is December 1, 1985.