

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

Appendix to Section 338(h)(10)

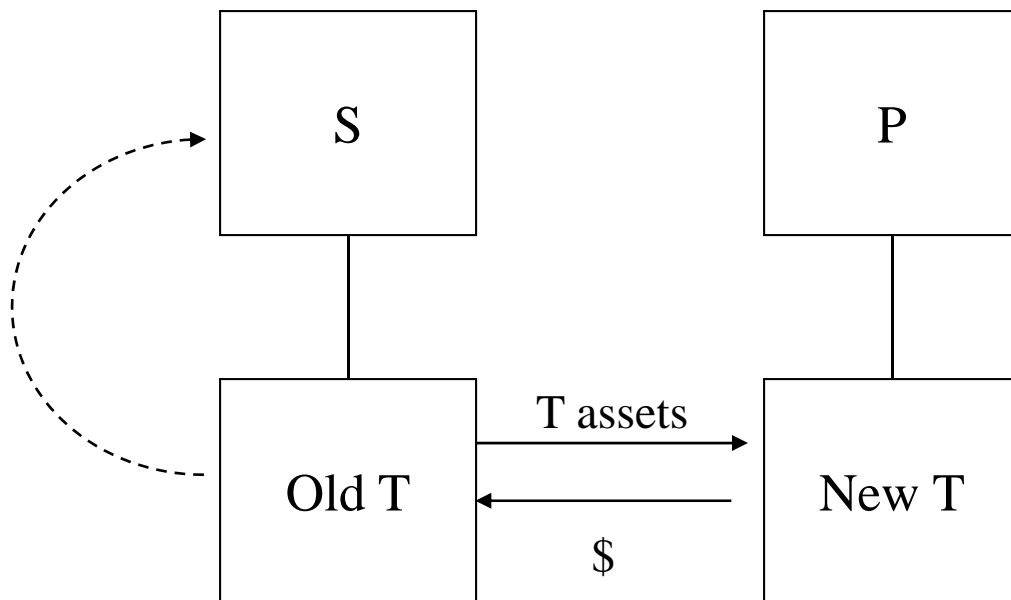
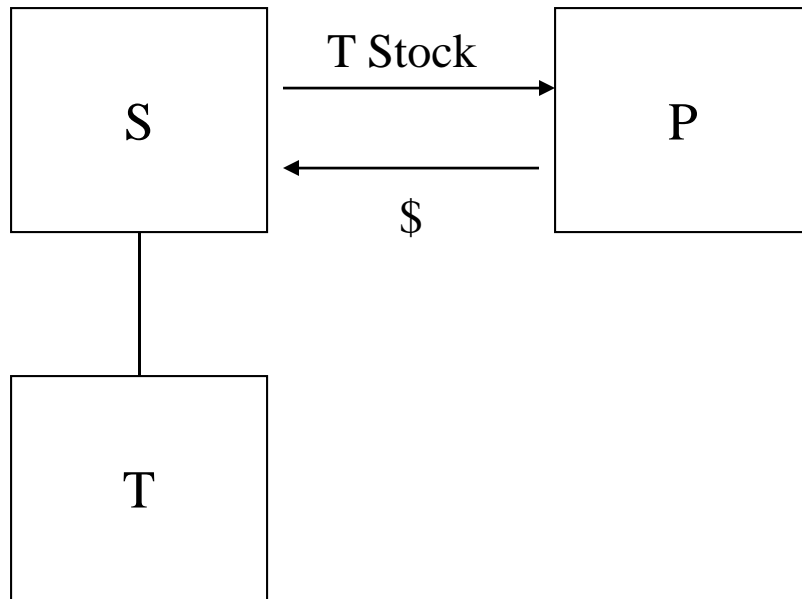
By

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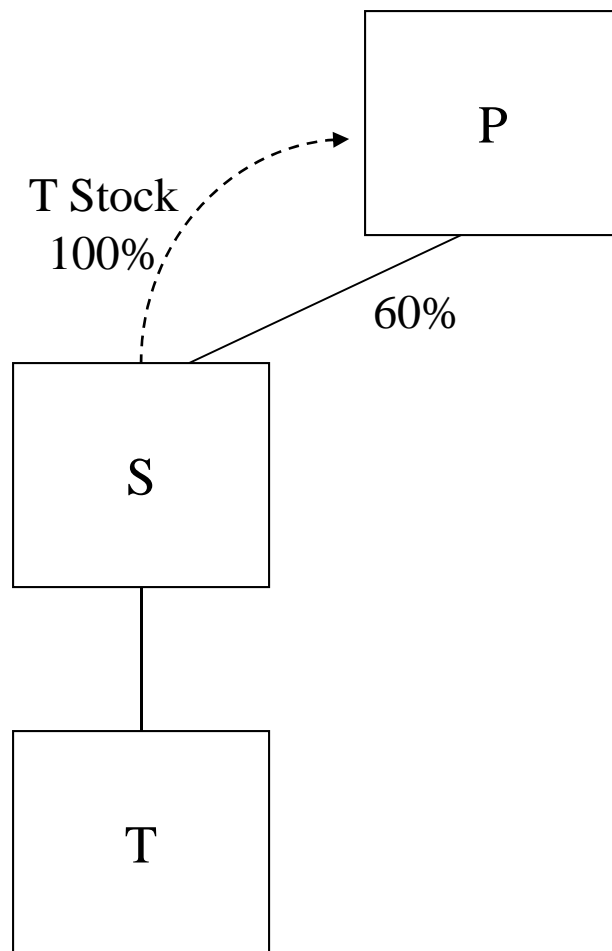
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Acquisition with Section 338(h)(10) Election



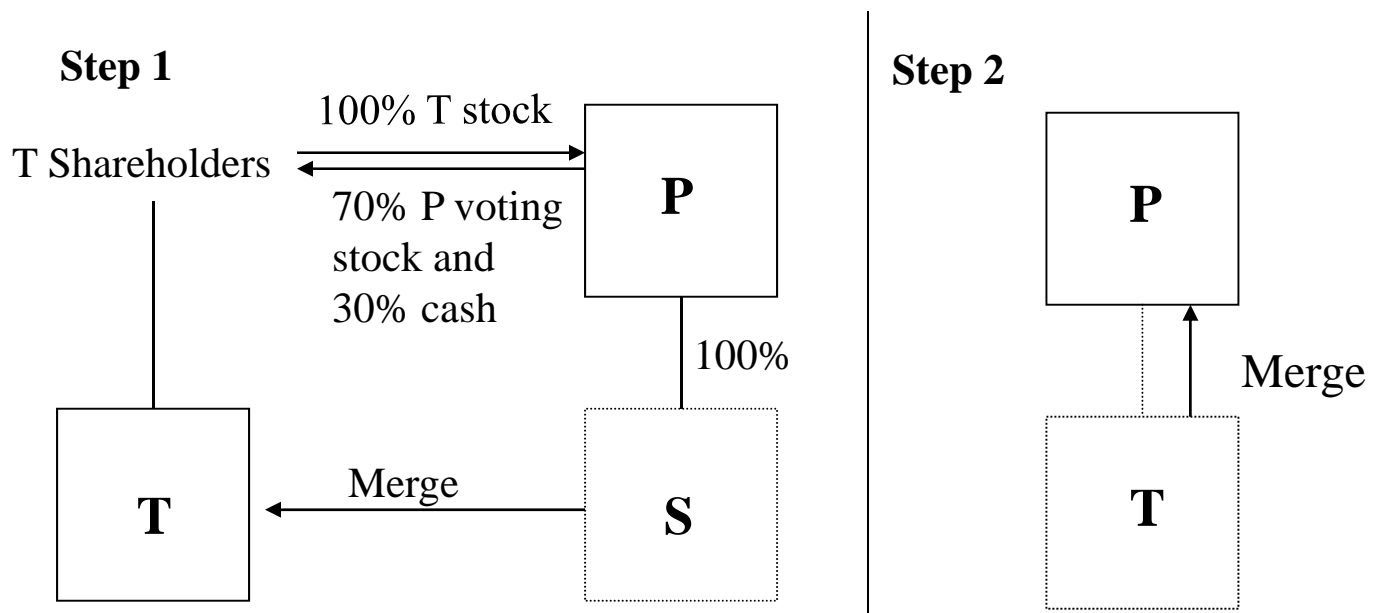
Acquisition Period for Purchases from Related Corps.

1. S owns 100% of the stock of T.
2. On January 1, Year 1, P purchases 30% of the stock of S.
3. On March 1, Year 1, P purchases an additional 30% of the stock of S.
4. On February 1, Year 2, S is liquidated, and P receives 100% of the T stock in the liquidating distribution.
5. May P make a section 338(h)(10) election with respect to its acquisition of T?



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.

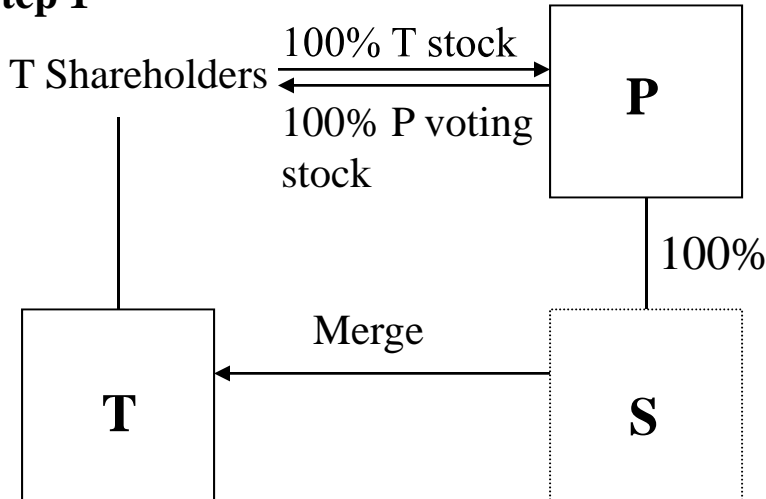
Temp. Treas. Reg. § 1.338(h)(10)-1T(c)(2), (e)

- 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.

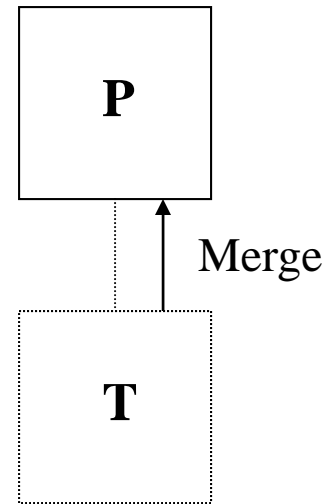
Step Transaction Doctrine- Rev. Rul. 2001-46

Situation 2

Step 1



Step 2

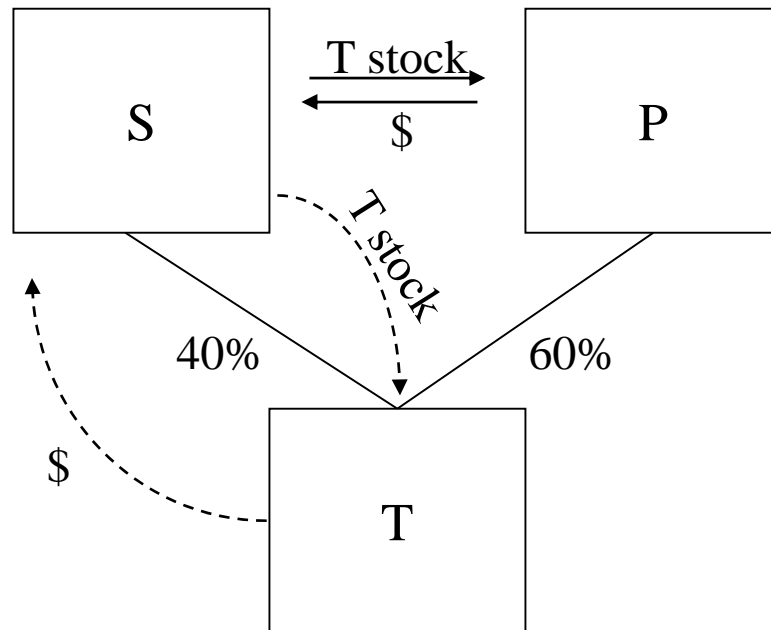


Facts: Same facts as in Situation 1, except that the T shareholders receive solely P stock in exchange for their T stock, so that the merger of S into T, if viewed independently of the upstream merger of T into P, would qualify as a reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(E).

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

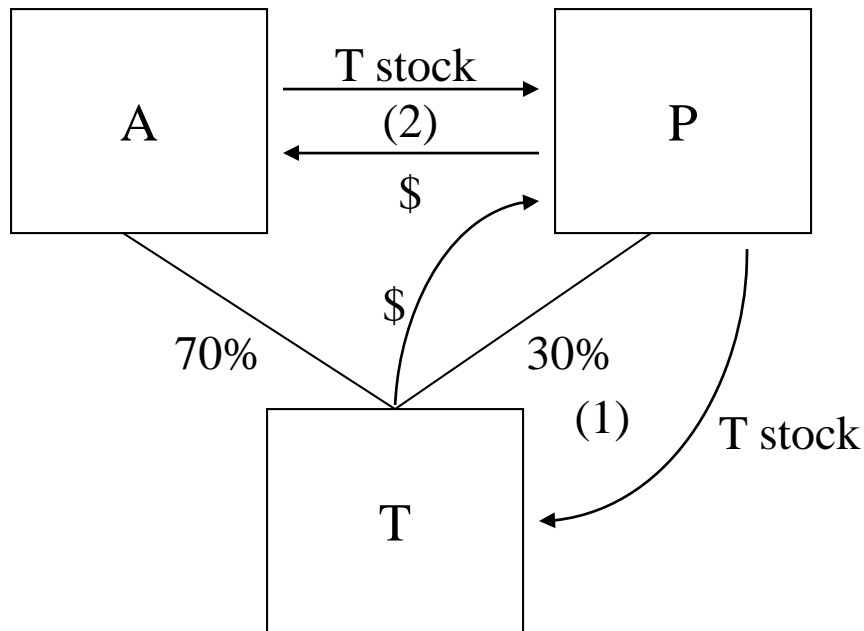
Note: The taxpayers cannot not change this result under the new section 338 regulations because, standing alone, P's acquisition of T does not constitute a qualified stock purchase.

Bootstrap Purposes
Redemptions from Unrelated Parties



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

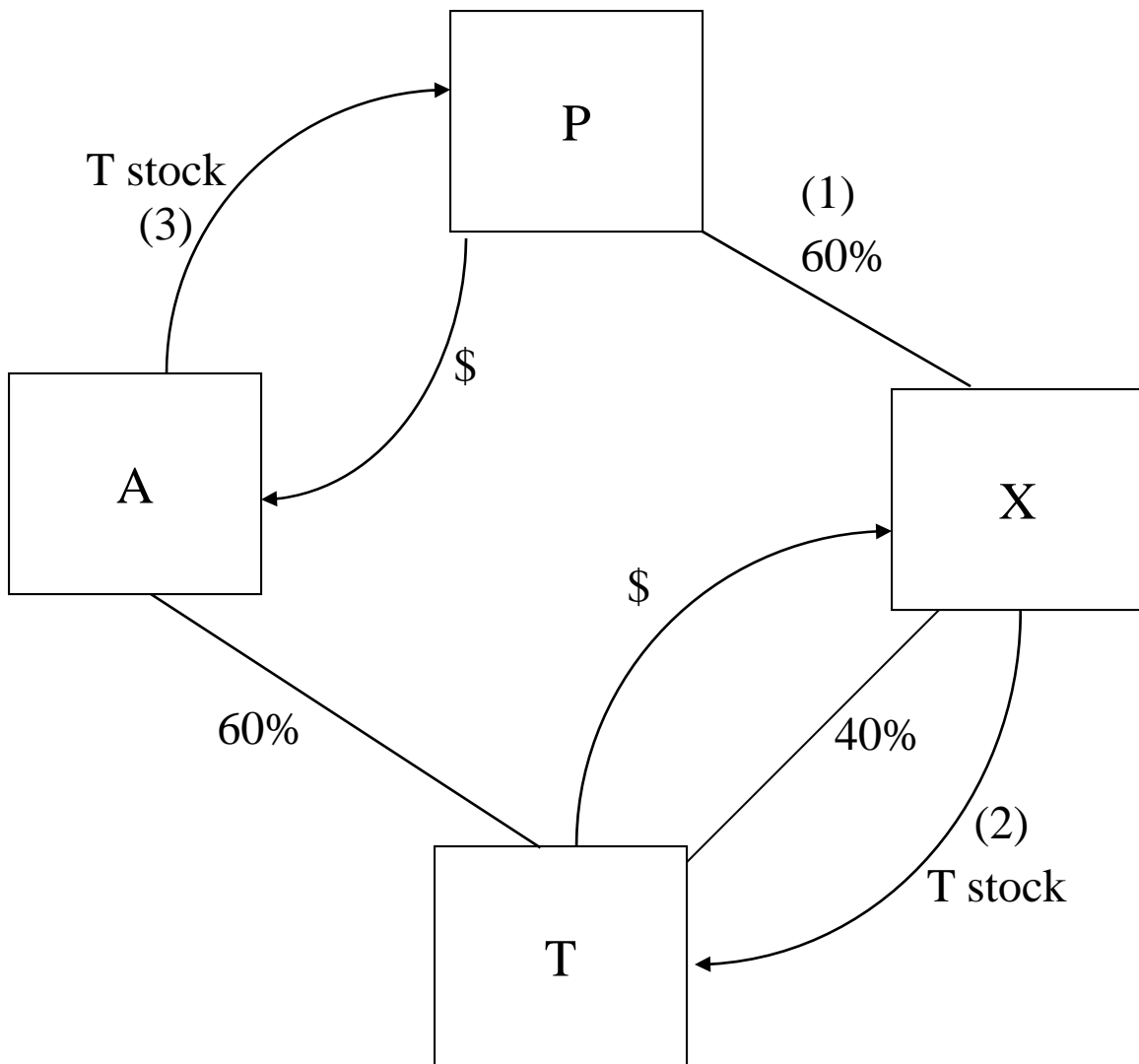
Bootstrap Purposes
Redemptions from Related Parties



1. P owns 30% of the stock of T.
2. On December 15, Year 1, T redeems the T stock held by P.
3. On December 1, Year 2, 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.

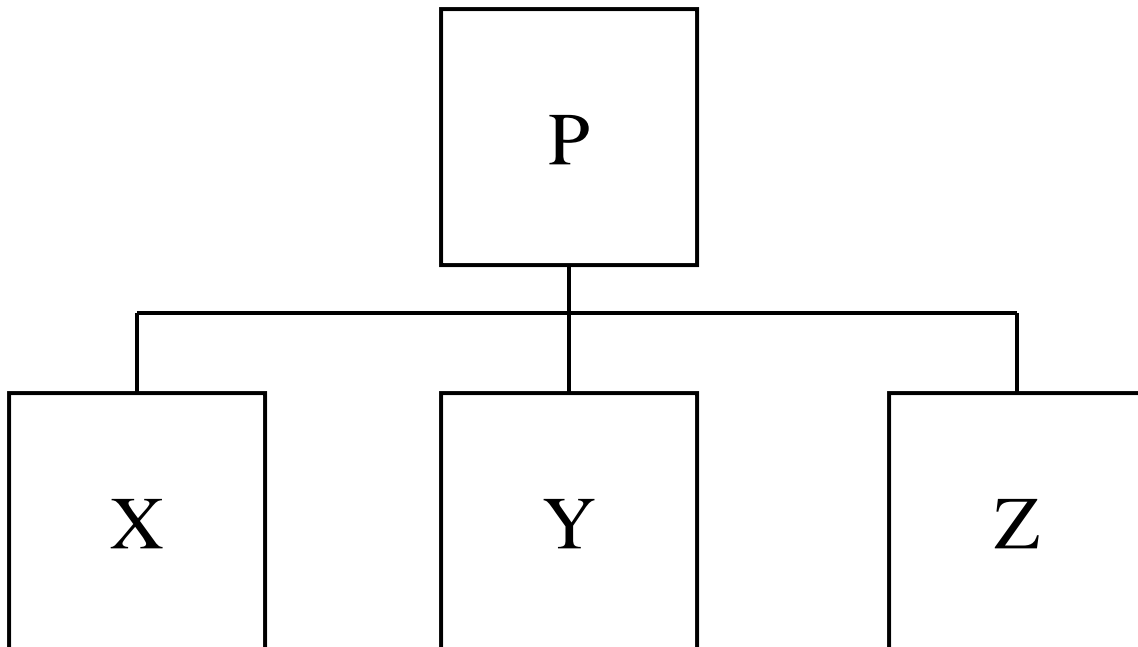
Bootstrap Purchases

Redemptions from Related Persons - Exception



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

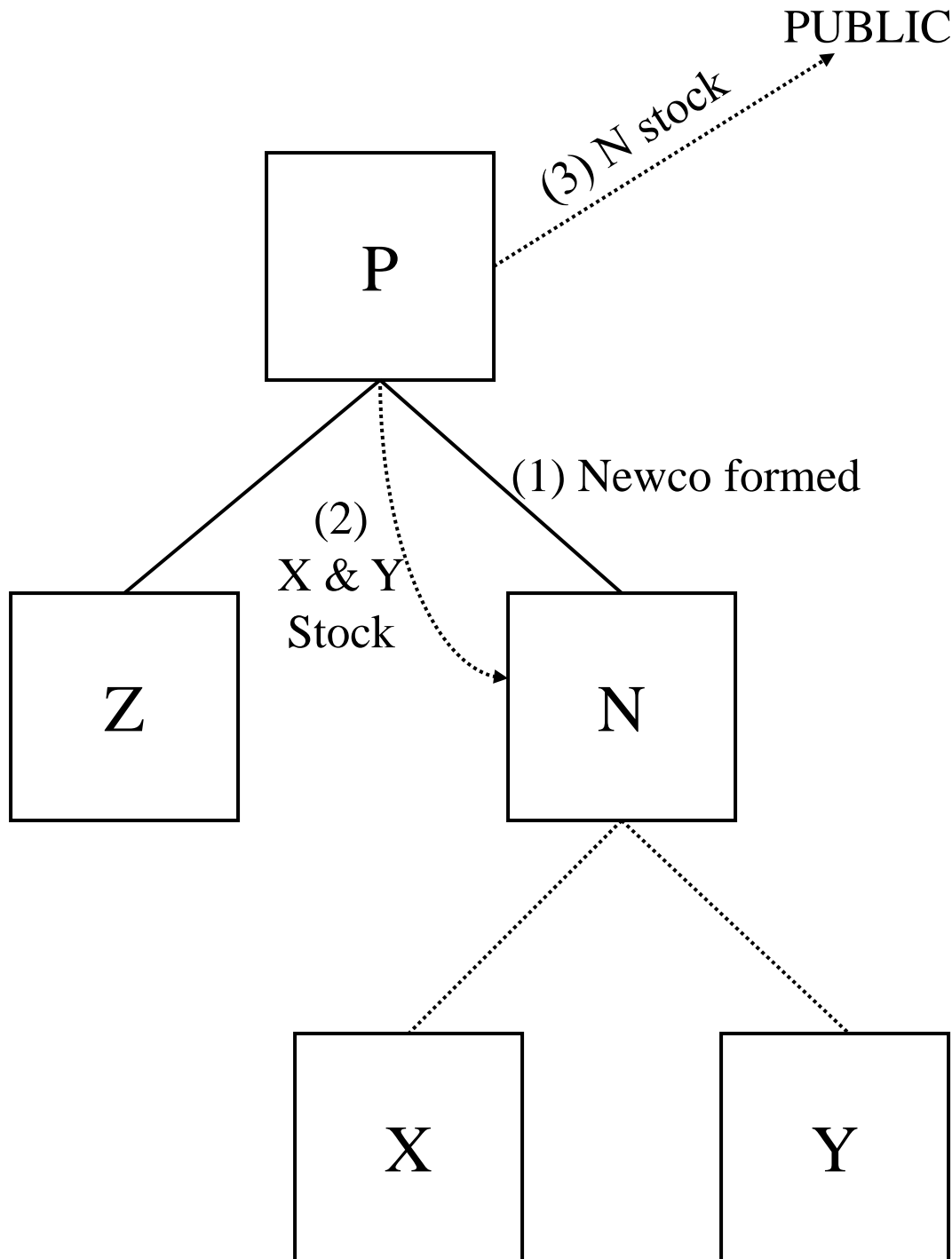
Section 338(h)(10) and “Busted 351” Transaction



Facts

1. P, X, Y, and Z file a consolidated return.
2. P wishes to sell X and Y to the public and to step up the basis of the X and Y assets.

Section 338(h)(10) and “Busted 351” Transaction Continued



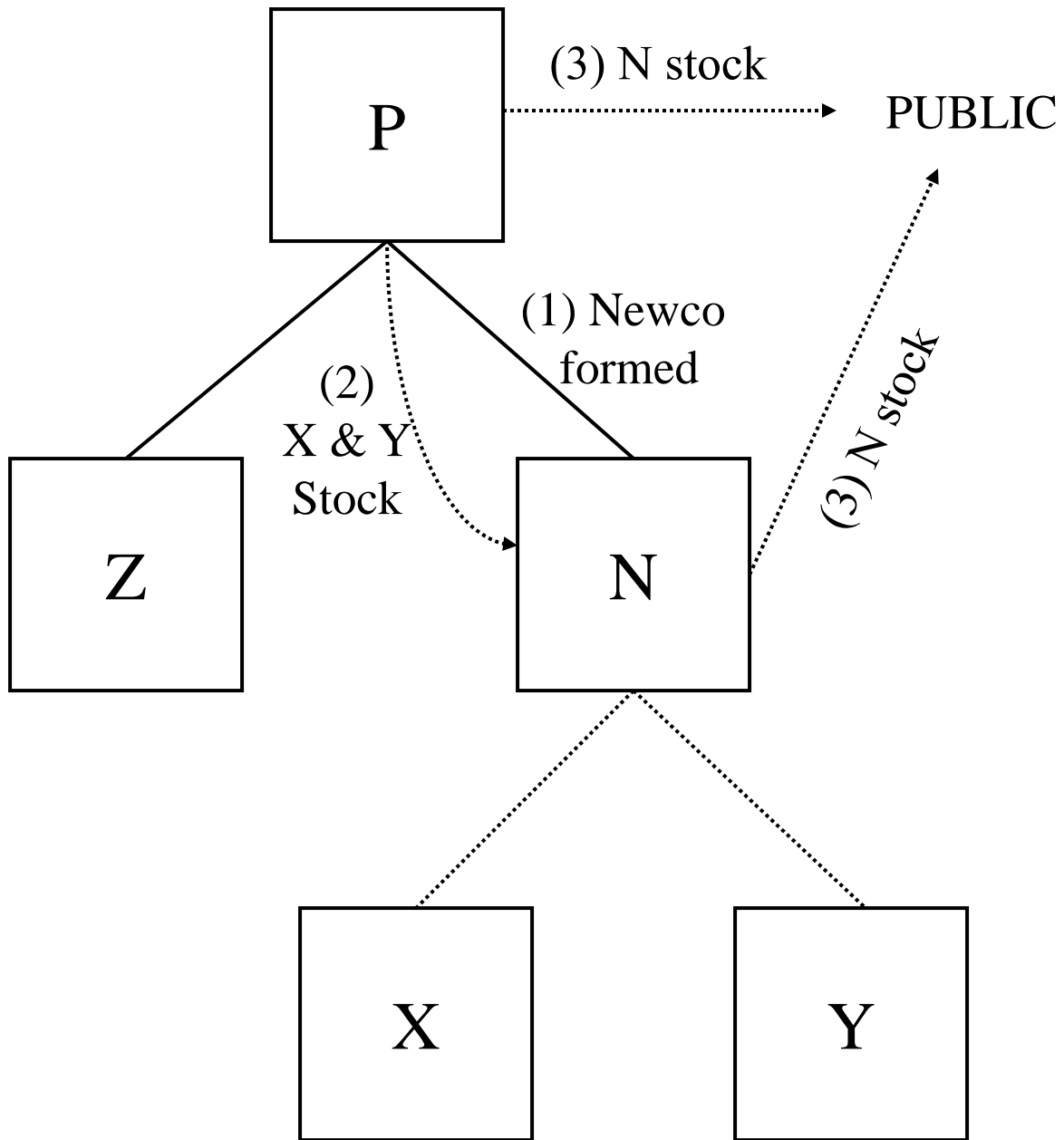
3. P forms Newco (N) and P transfers the X and Y stock to N. Pursuant to a prearranged plan, P sells the N stock to the Public.

Section 338(h)(10) and “Busted 351” Transaction Continued

Results

1. The transfer of the X and Y stock to N should not qualify as a section 351 transaction. P is not in control of N immediately after the transfer. See Rev. Rul. 79-194, 1979-1 C.B. 145; TAM 9747001 (July 1, 1997); PLR 9541039 (July 20, 1995), as modified by PLR 9549036 (Sept. 12, 1995); PLR 9142013 (July 17, 1991).
2. Thus, N is deemed to purchase the X and Y stock.
3. In this event, P and N can file a section 338(h)(10) election to treat the transaction as a sale of assets by X and Y followed by section 332 liquidations.
4. The recently issued final regulations contain a similar example. See Treas. Reg. § 1.338-3(b)(3)(iv), Ex. 1.
5. How much stock does P have to sell?
 - P must sell more than 20% of N stock for section 351 not to apply. See section 351(a) and 368(c).
 - P must sell at least 50% of the N stock so that P and N are not related for purposes of section 338(h)(3)(A)(iii).
 - P must sell more than 80% of the N stock to avoid the application of the anti-churning rules of section 197(f)(9).
 - Prior to the effective date of recently finalized Treas. Reg. § 1.197-2 it was possible that the anti-churning rules could have applied even if P sold all of the N stock because of the momentary relationship between P and N. See Old Prop. Treas. Reg. § 1.197-2(h)(6)(ii).

Section 338(h)(10) and “Busted 351” Transaction Variation



Facts

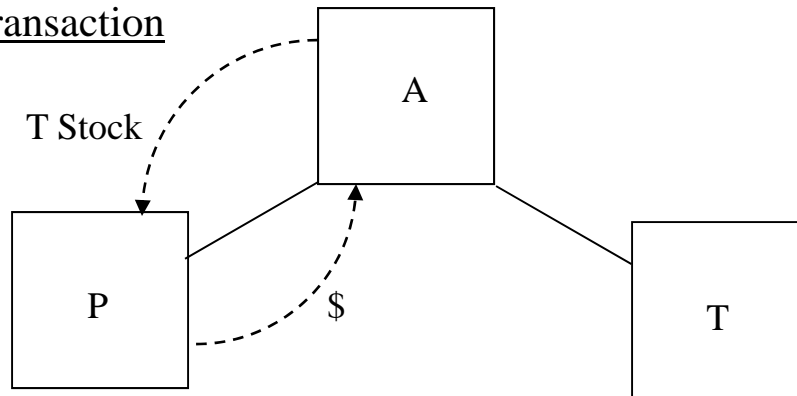
1. Same as above, except that both P and N sell stock to the public.

Results

1. Does section 351 apply? If so, section 338(h)(10) is not available.
2. Does the answer change if P and N each use different investment bankers?

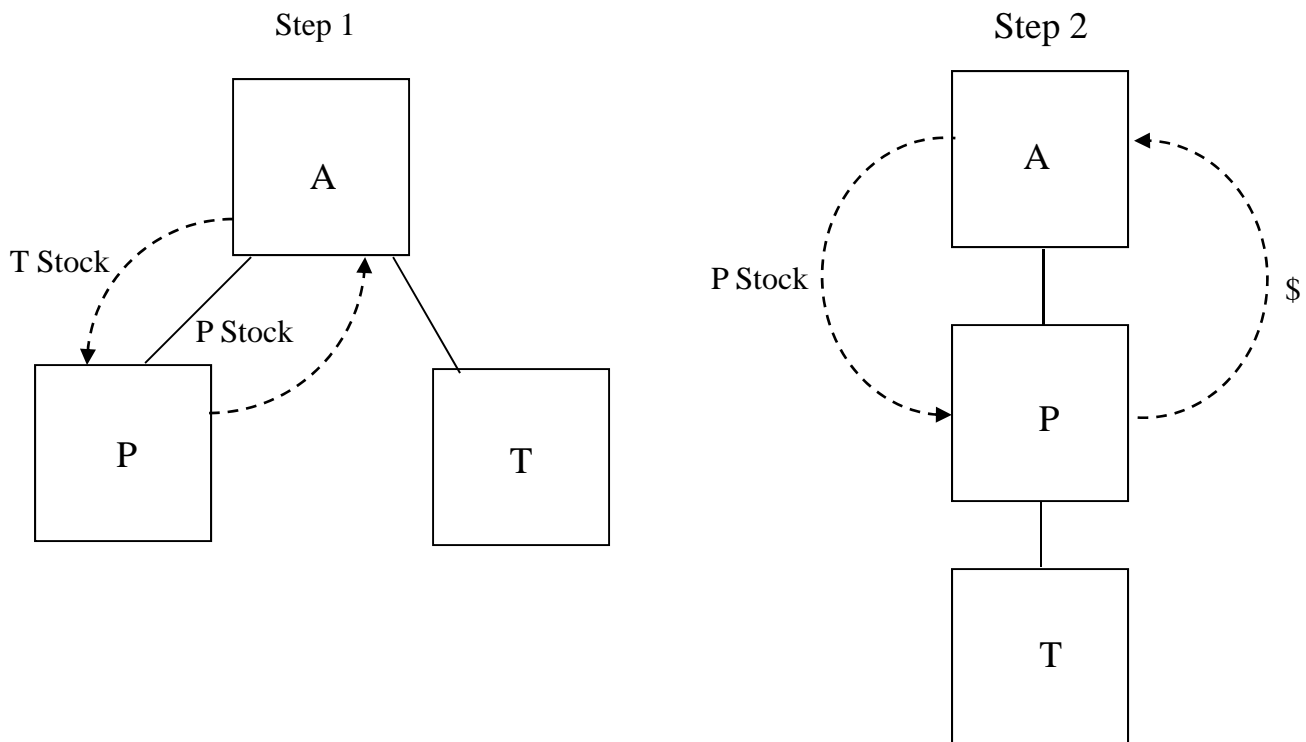
Section 304 and Qualified Stock Purchases

Actual Transaction

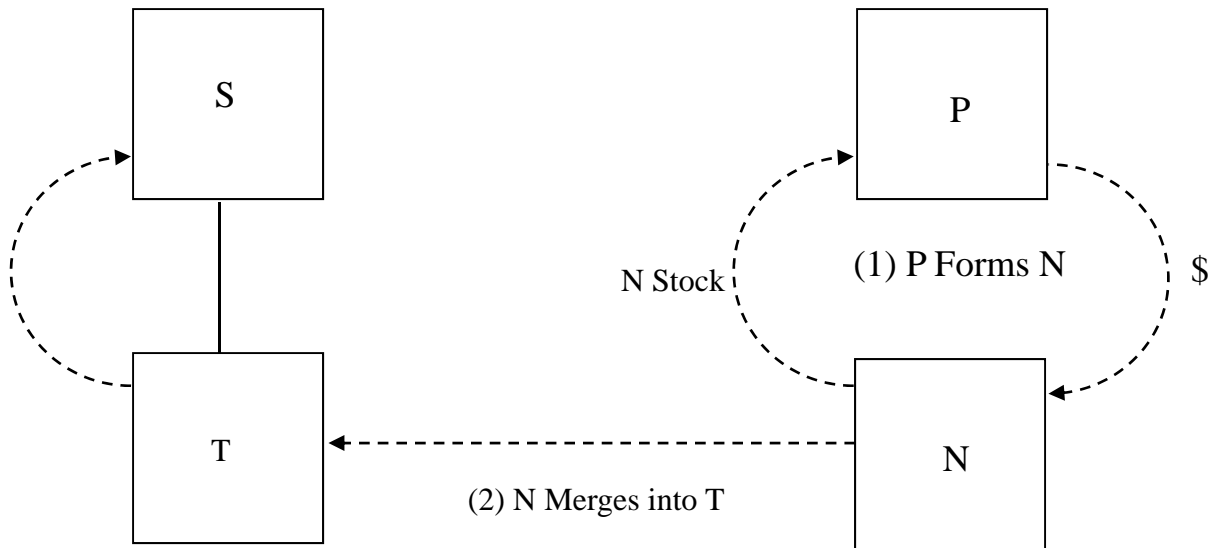


1. A owns all the stock of P and T.
2. A sells the T stock to P.
3. A is treated as if A transferred T stock to P for P Stock and then redeemed the stock it was treated as issuing.
4. P's basis is determined by reference to A's adjusted basis. Therefore, P is not considered to have acquired her stock by purchase.

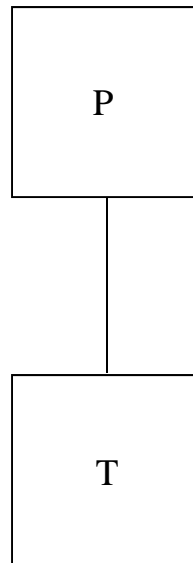
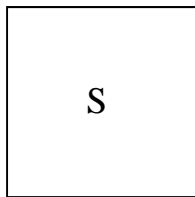
Recharacterized Transaction



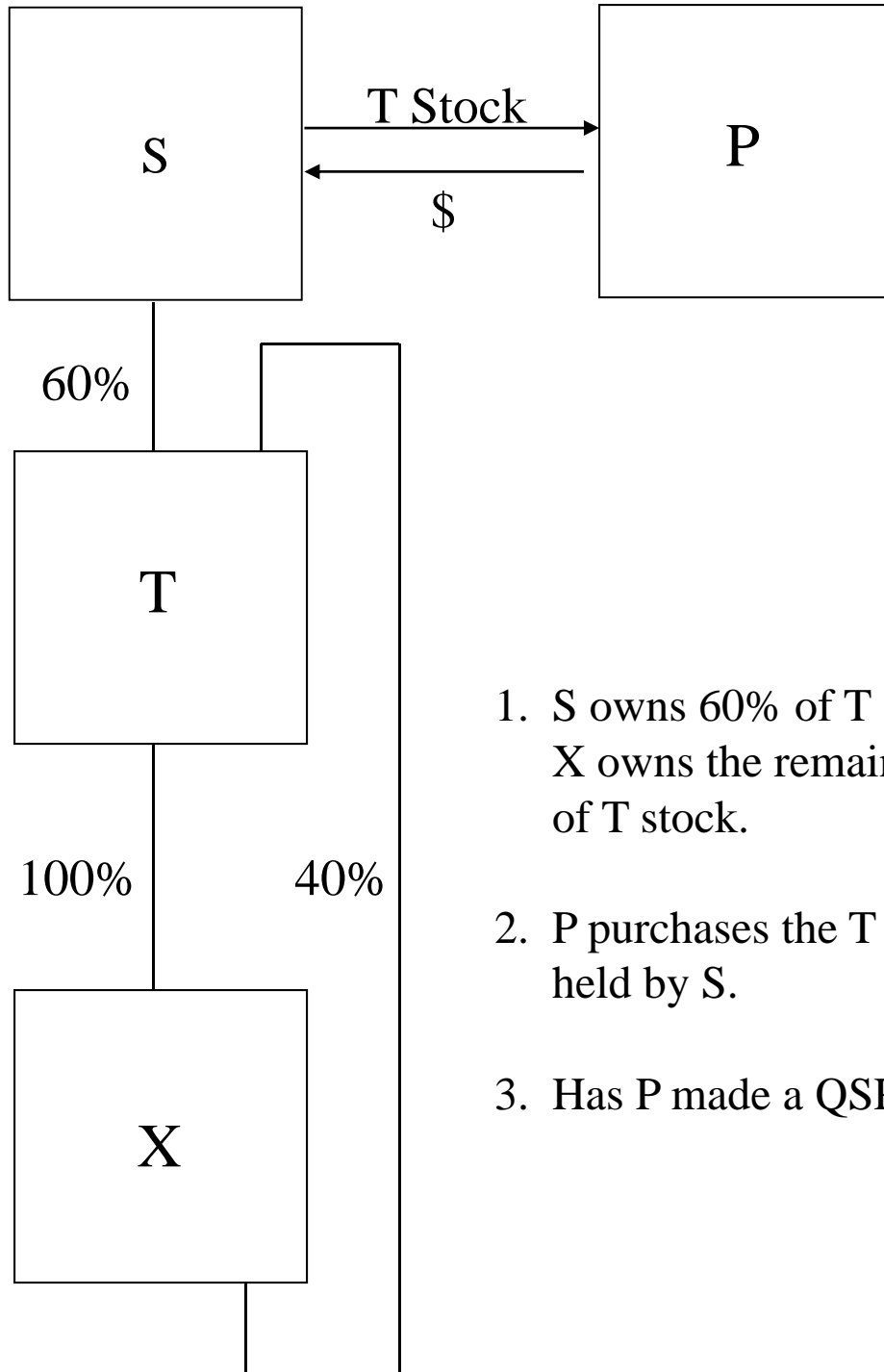
Reverse Subsidiary Mergers and QSPs



1. P forms Newco ("N") and contributes cash to N in exchange for N Stock.
2. N Merges into T, the T shareholder (S) receives cash for its T stock.

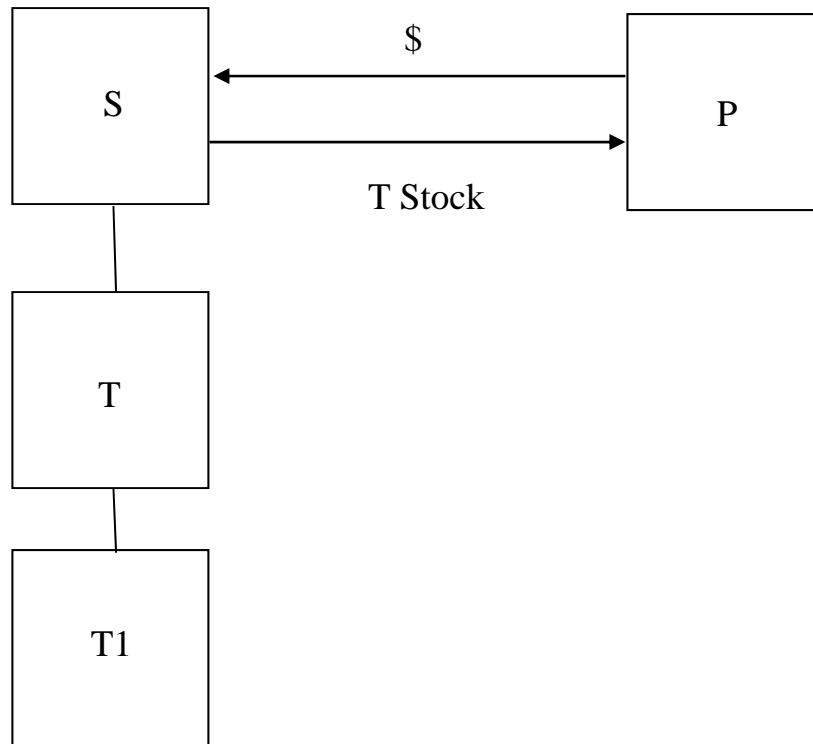


Circular Ownership of T Stock

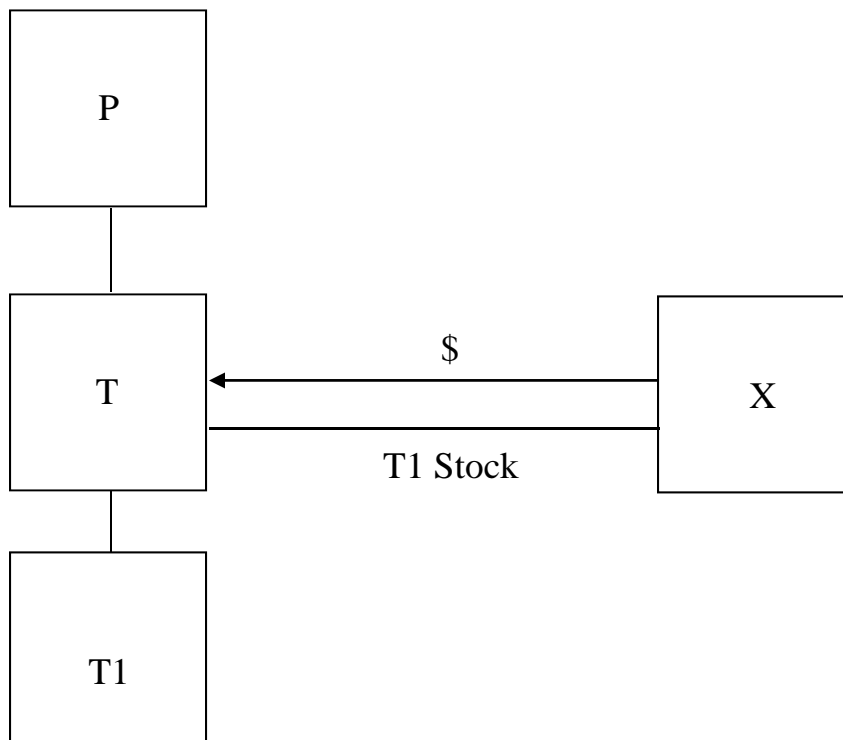


1. S owns 60% of T stock. X owns the remaining 40% of T stock.
2. P purchases the T stock held by S.
3. Has P made a QSP of T?

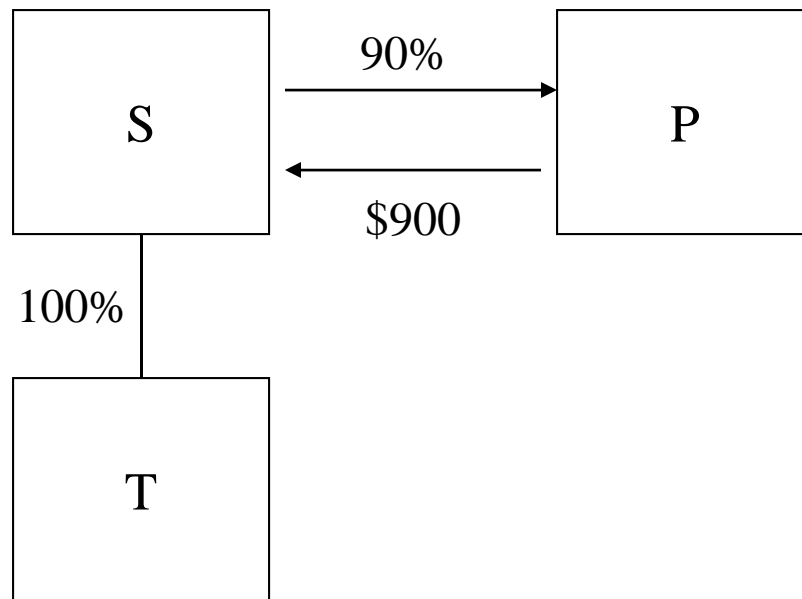
Effect of Post Acquisition Elimination of T



1. On January 1, Year 1, P makes a QSP of T. On that date T owns the Stock of T1.
2. On March 1, Year 1, T sells the T1 stock to an unrelated corporation.
3. On April 1, Year 1, P makes a section 338 election for T.

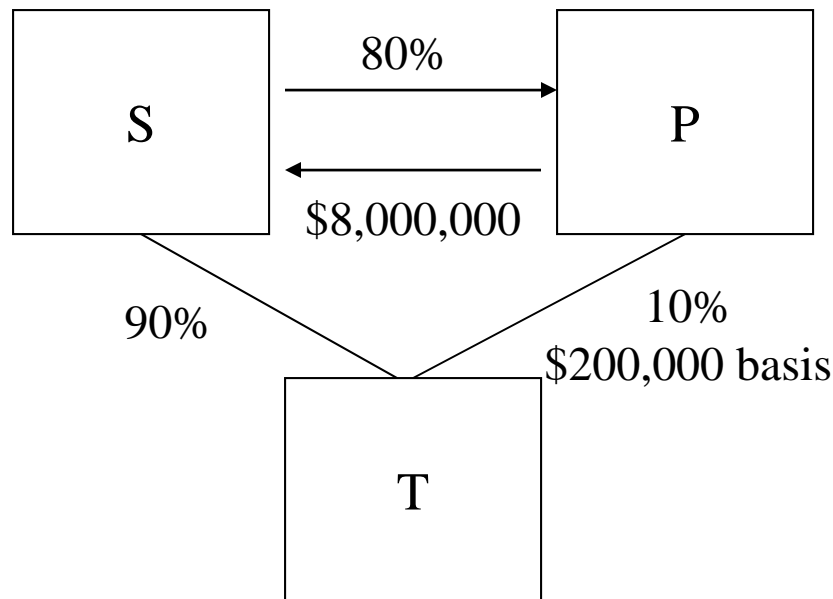


Treatment of Nonrecently Purchased Stock



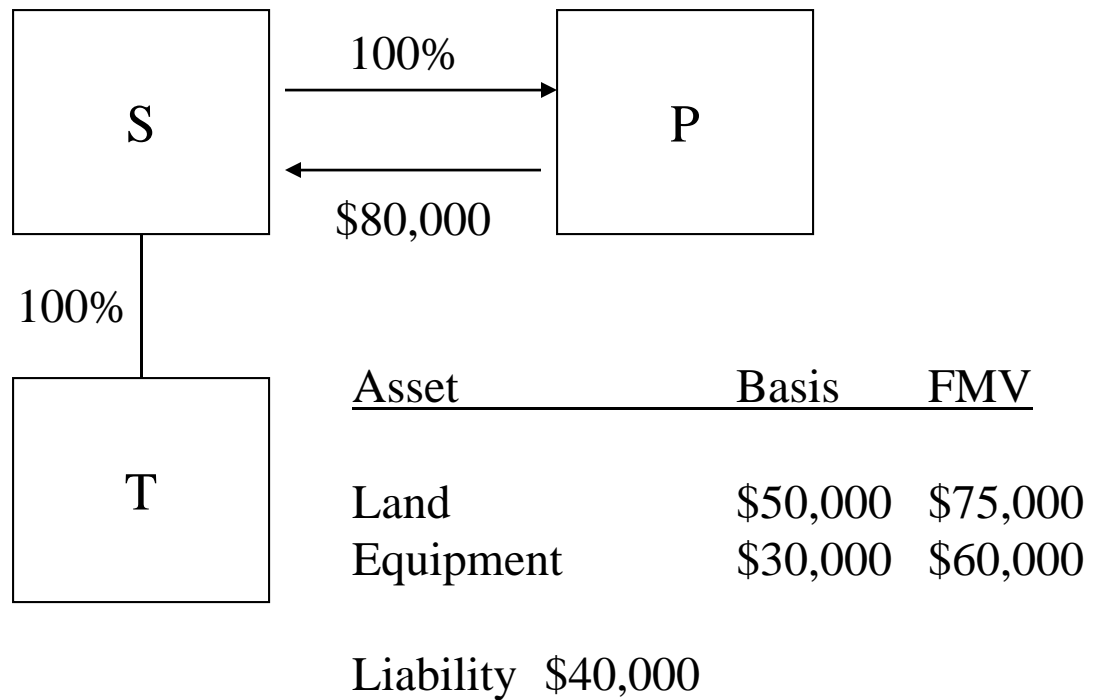
1. P purchases 90% of the T stock from S for \$900.
2. The parties make a joint section 338(h)(10) election.
What is the grossed-up basis of the T stock?

Treatment of Nonrecently Purchased Stock



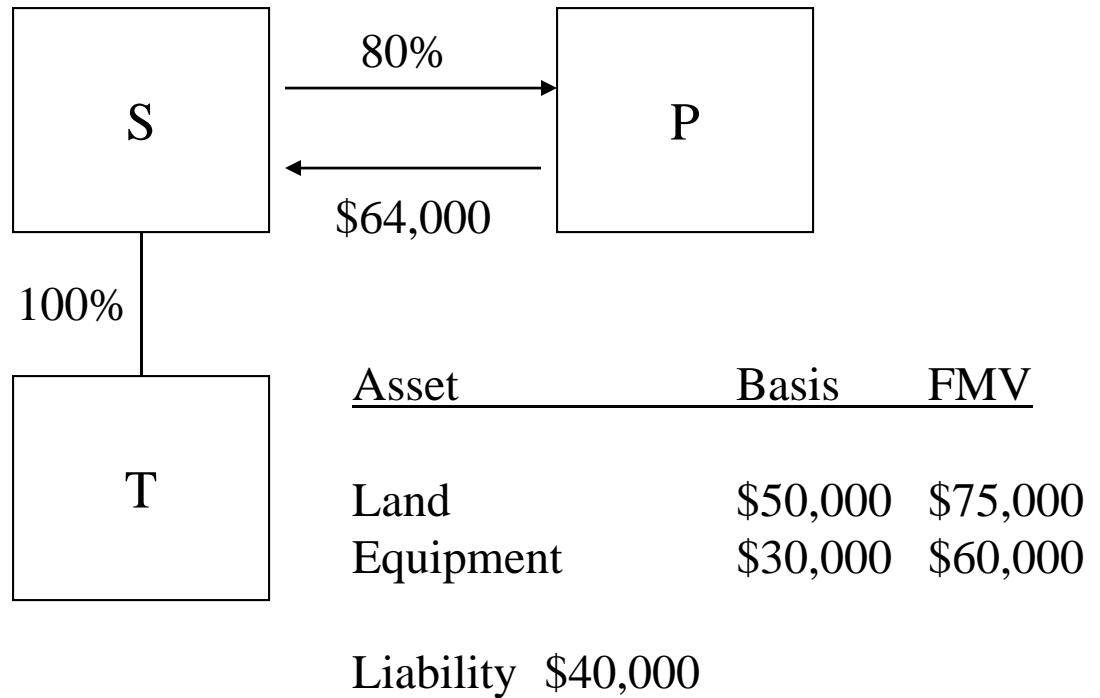
1. P purchases 80% of the T stock from S within a 12 month period. P already holds 10% of the T stock with a basis of \$200,000.
2. What is the grossed-up basis of the recently purchased stock and the nonrecently purchased stock?

Determination of ADSP -- Example 1



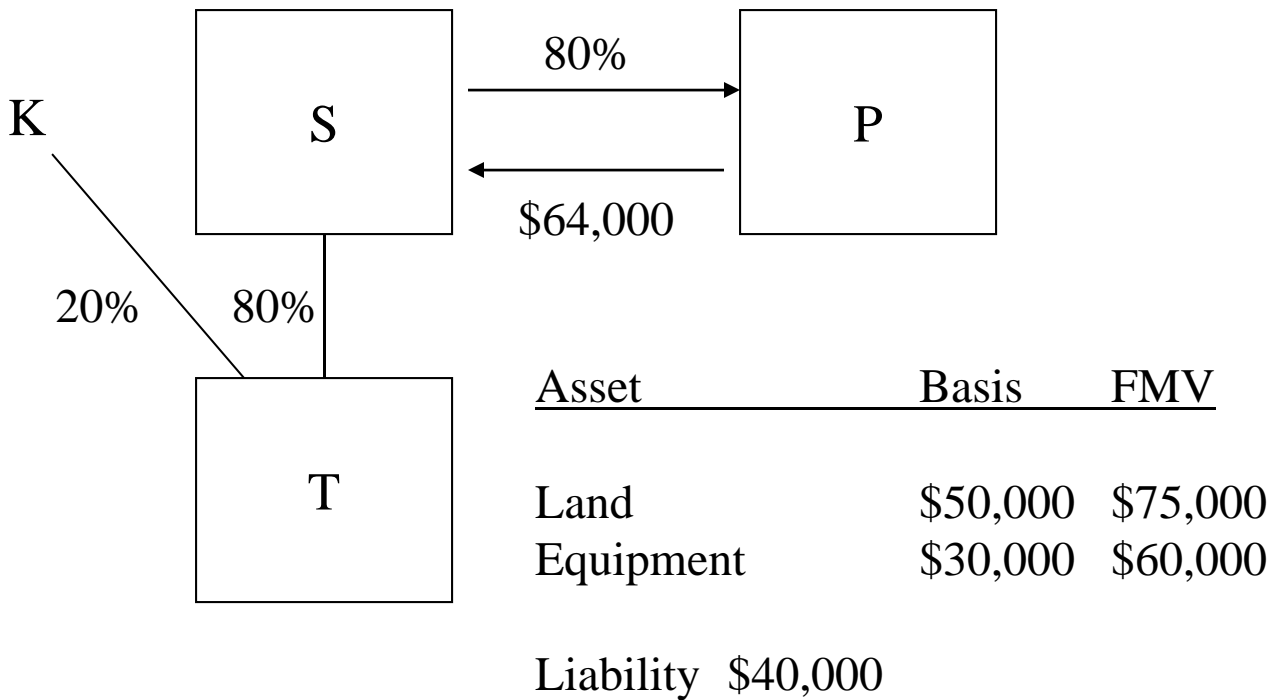
1. What is the ADSP?

Determination of ADSP -- Example 2



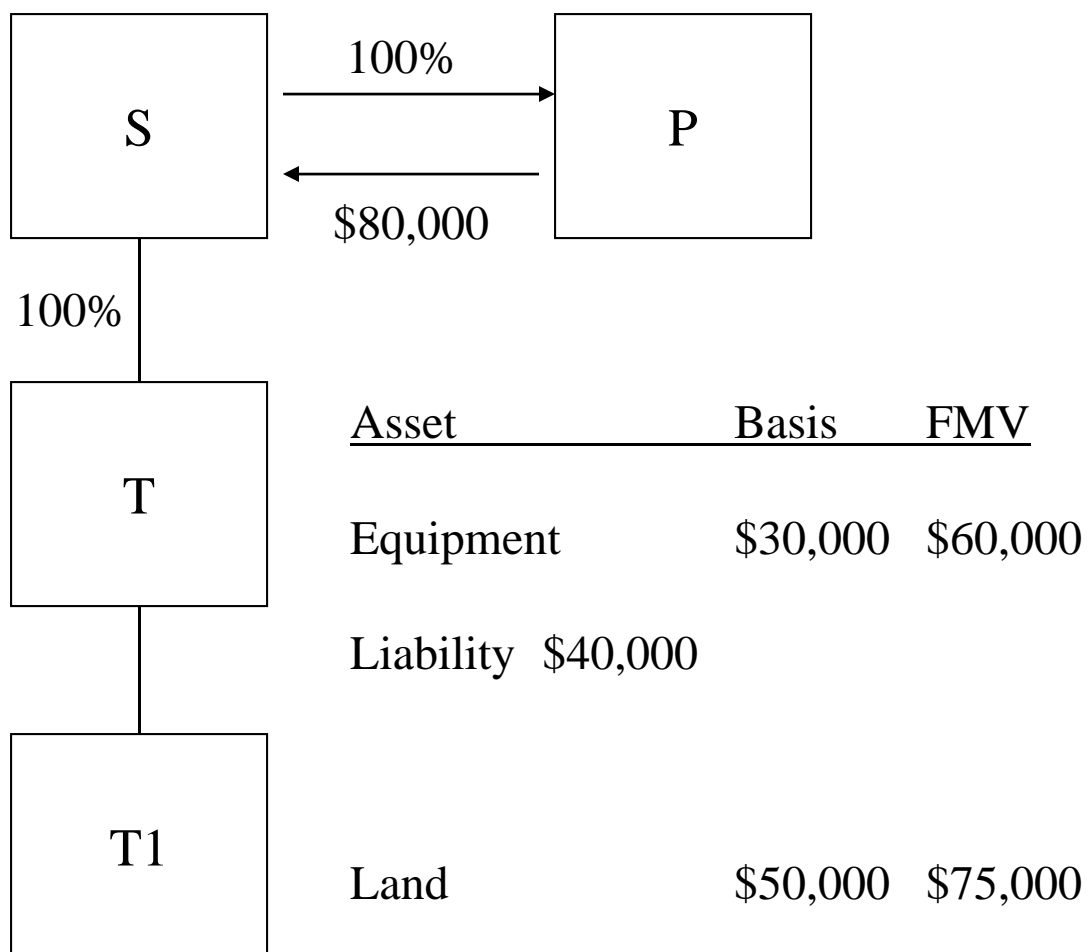
2. What is the ADSP?

Determination of ADSP -- Ex. 3: Unrelated Shareholder

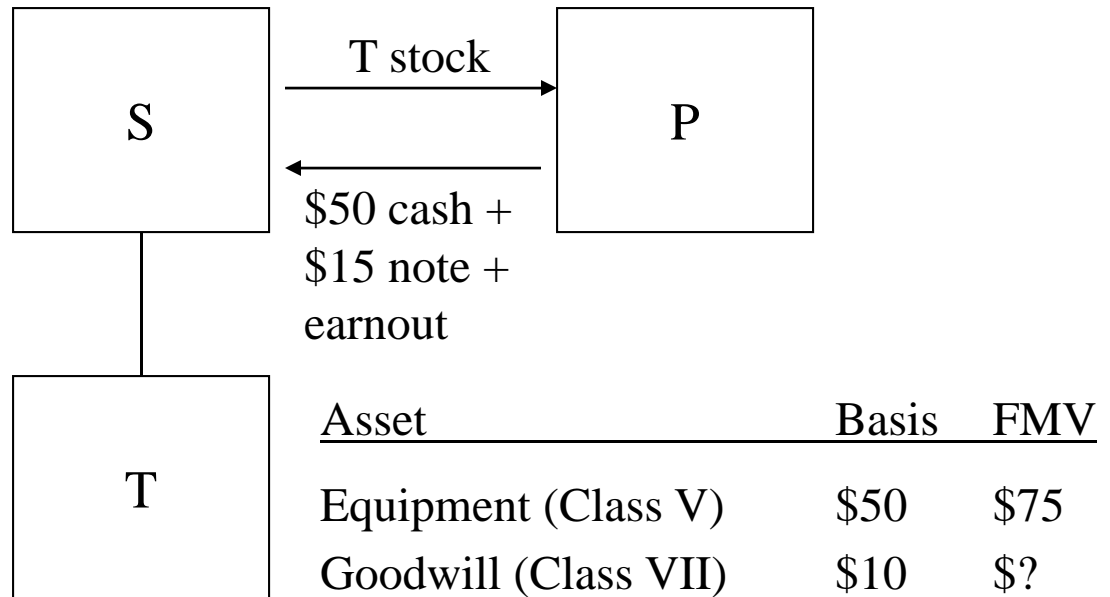


1. What is the impact on K?

Determination of ADSP -- Example 4: Target Affiliate

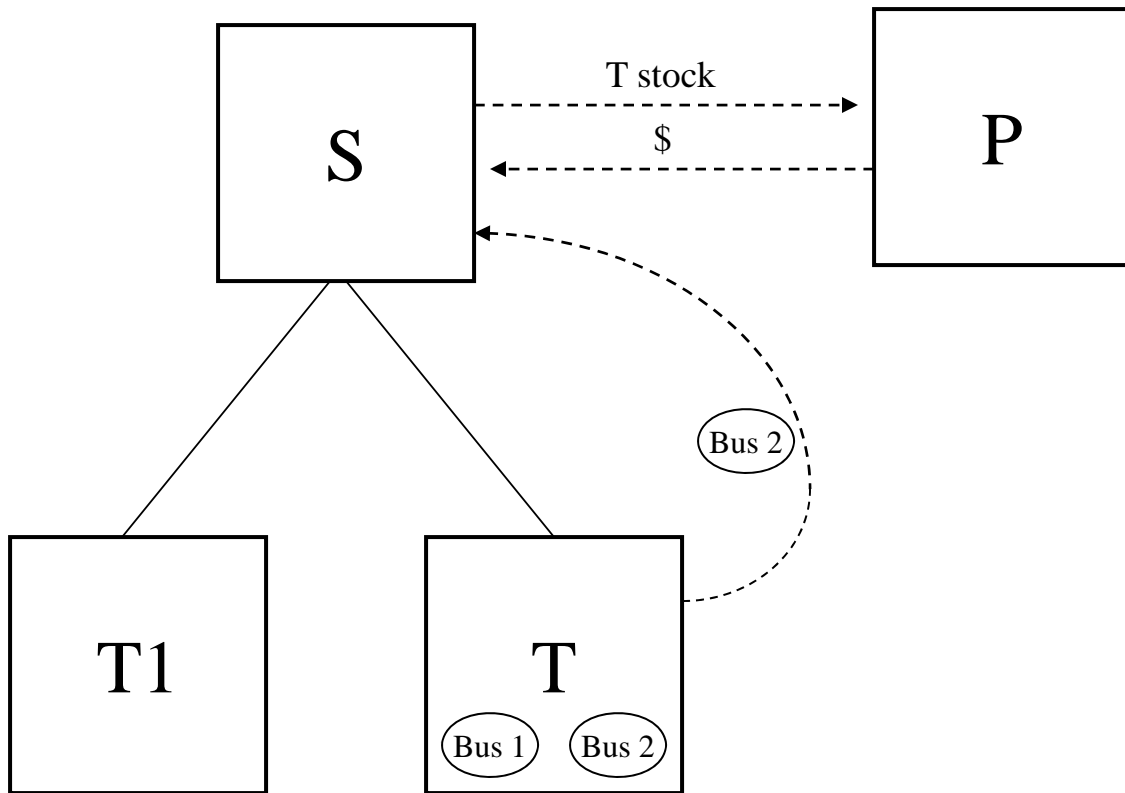


Acquisition for Cash and Contingent Consideration



What is the ADSP? How is it allocated?

The Distribution of Unwanted Assets



Facts

Corporation S owns all the stock of Corporations T and T1. T operates businesses 1 and 2. Corporation P is unrelated to S. P wishes to acquire Business 1 but not any of the other assets owned by S.

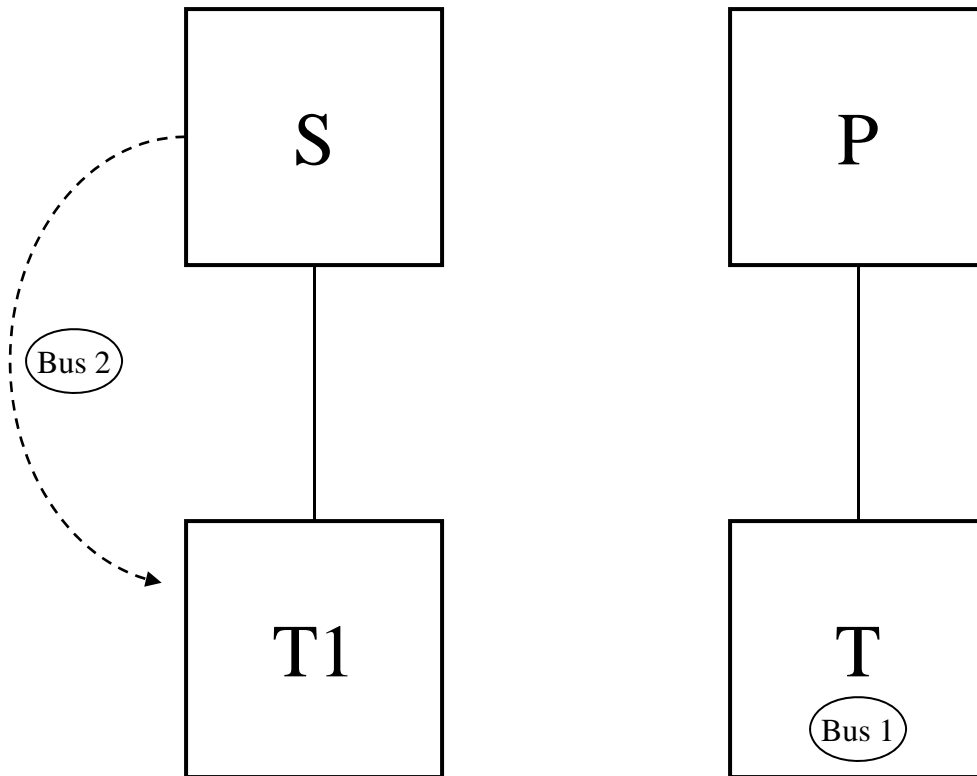
Thus, before the effective date of the recently issued final regulations, the following transactions take place:

- T adopts a plan of complete liquidation.
- T distributes Business 2 to S.
- S sells the T stock to P; S and P make a section 338(h)(10) election.

Questions

1. Does the sale of the T stock qualify for a section 338(h)(10) election?
2. What are the tax consequences of the distribution of Business 2 to S?
3. Does it matter when T's plan of complete liquidation is adopted? What if T does not adopt a plan of complete liquidation?

The Distribution of Unwanted Assets Continued



4. What would be the result if after the distribution by T of Business 2 to S and the stock sale by S, S transferred the Business 2 to T1? Would this affect the deemed liquidation under section 338(h)(10)?
5. What would be the result if it were determined that the deemed liquidation was not in fact a complete liquidation?
6. What would be the result under the recently issued final regulations?

References

Telephone Answering Service Co. v. Commissioner, 63 T.C. 423 (1974), aff'd without opinion, 546 F.2d 423 (4th Cir. 1976), cert. denied, 431 U.S. 914 (1977).

Old Treas. Reg. § 1.338(h)(10)-1(e)(2)(ii)

Treas. Reg. § 1.1502-13(j)(2)

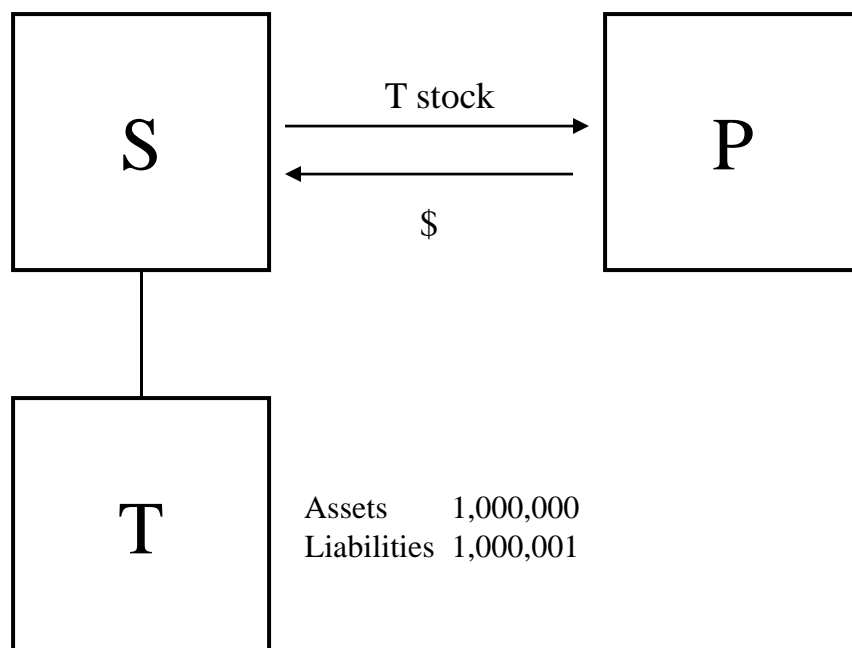
New Treas. Reg. § 1.338(h)(10)-1(d)(4)

New Treas. Reg. § 1.338(h)(10)-1(e), Ex. 2

PLR 9738031, PLR 9735038, PLR 9210041, PLR 9137040,

PLR 9044063, PLR 8938036, PLR 8821047

Application of Section 338(h)(10) to the Purchase of an Insolvent Corporation -- Insolvent Target Corporation



Facts

Corporation T owns assets with a value of \$1,000,000 and has liabilities of \$1,000,001. P purchases all the stock of T from corporation S for \$1 and attempts to make a section 338(h)(10) election with respect to T.

Questions

1. What are the results of this election?
2. Would the results be different under the recently issued final section 338 regulations?

References

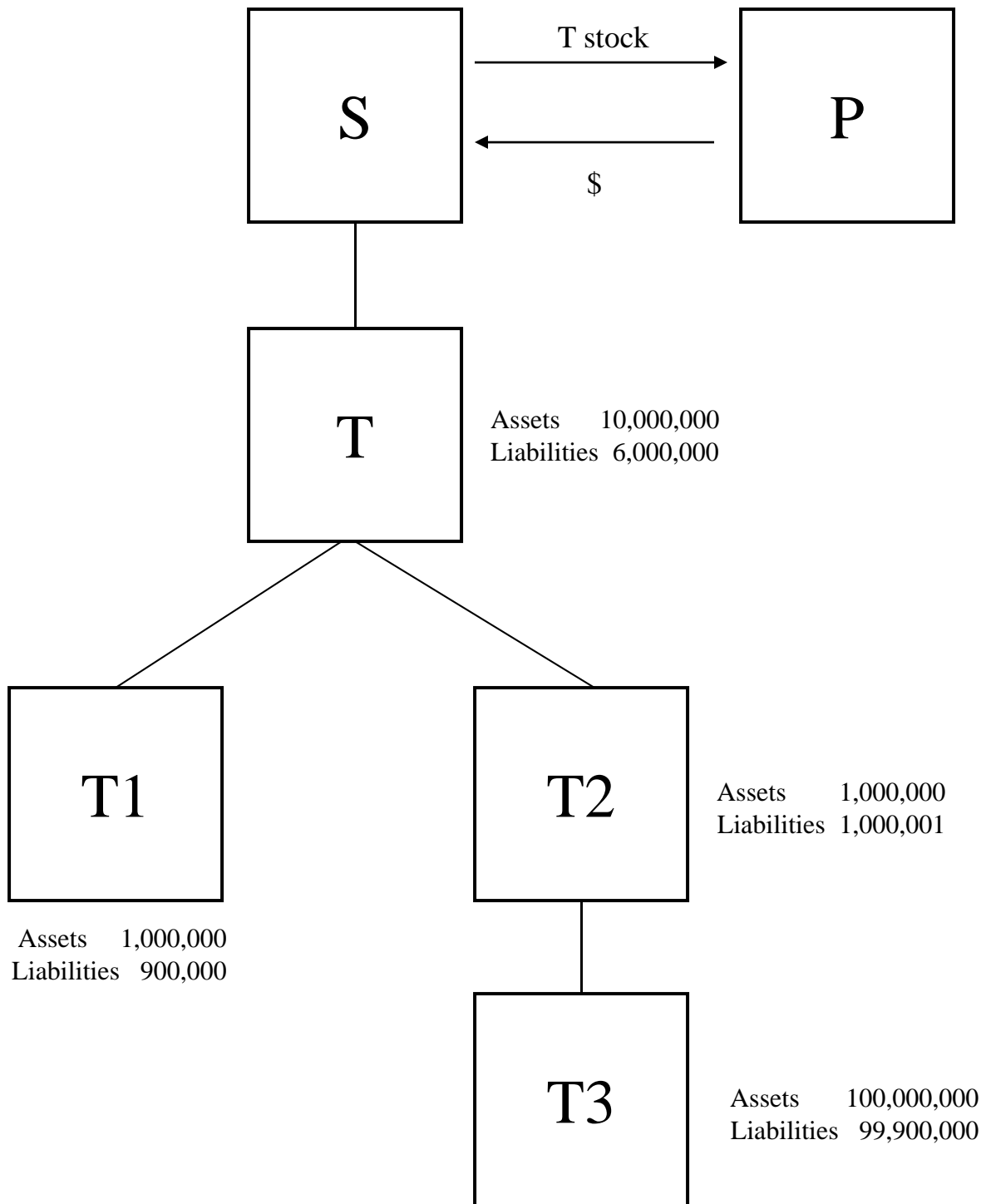
Section 338(h)(3)(A)

Treas. Reg. § 1.332-2(b)

New Treas. Reg. § 1.338-3(b)(2)

Rev. Rul. 56-387, 1956-2 C.B. 189

Application of Section 338(h)(10) to the Purchase of an Insolvent Corporation -- Insolvent Target Subsidiary



Application of Section 338(h)(10) to the Purchase of an Insolvent Corporation -- Insolvent Target Subsidiary Continued

Facts

Corporation T owns assets with a value of \$10 million and has liabilities of \$6 million. Among the assets of T are all of the stock of T1 and T2. The assets of T1 have a value of \$1 million and T1 has liabilities of \$900,000. The assets of T2 have a value of \$1 million and T2 has liabilities of \$1,000,001. Among the assets of T2 is all of the stock of T3. The assets of T3 have a value of \$100 million and T3 has liabilities of \$99,900,000.

P purchases all the stock of T from S and attempts to join with S in a Section 338(h)(10) election with respect to T, T1, T2 and T3.

Questions

1. What are the results of this election under the old section 338 regulations?
2. Would the result in question 1 be different if T2 had no liabilities, but rather had outstanding both common and preferred stock, both held by T, with the preferred stock having a liquidating preference of \$1,100,000?
3. Would the results be different under the recently issued final section 338 regulations?

References

Section 338(h)(3)(A)

Old Treas. Reg. § 1.338(h)(10)-1(e)(2)(ii)

Treas. Reg. § 1.332-2(b)

New Treas. Reg. § 1.338-3(b)(2)

New Treas. Reg. § 1.338(h)(10)-1(d)(4)

Rev. Rul. 56-387, 1956-2 C.B. 189

Comm'r v. Spaulding Bakeries, Inc., 252 F2d 693 (2nd Cir. 1958)

H.K. Porter Co. v. Comm'r, 87 TC 689 (1986).