

§ 1.338-1

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 - (3) Old target election for retroactive election.
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§ 1.338-1 General principles; status of old target and new target.

(a) *In general*—(1) *Deemed transaction.* Elections are available under section 338 when a purchasing corporation acquires the stock of another corporation (the target) in a qualified stock purchase. One type of election, under section 338(g), is available to the purchasing corporation. Another type of election, under section 338(h)(10), is, in more limited circumstances, available jointly to the purchasing corporation and the sellers of the stock. (Rules concerning eligibility for these elections are contained in §§1.338-2, 1.338-3, and 1.338(h)(10)-1.) Although target is a single corporation under corporate law, if a section 338 election is made, then two

separate corporations, old target and new target, generally are considered to exist for purposes of subtitle A of the Internal Revenue Code. Old target is treated as transferring all of its assets to an unrelated person in exchange for consideration that includes the discharge of its liabilities (see §1.1001-2(a)), and new target is treated as acquiring all of its assets from an unrelated person in exchange for consideration that includes the assumption of those liabilities. (Such transaction is, without regard to its characterization for Federal income tax purposes, referred to as the deemed asset sale and the income tax consequences thereof as the deemed sale tax consequences.) If a section 338(h)(10) election is made, old target is deemed to liquidate following the deemed asset sale.

(2) *Application of other rules of law.* Other rules of law apply to determine the tax consequences to the parties as if they had actually engaged in the transactions deemed to occur under section 338 and the regulations thereunder except to the extent otherwise provided in those regulations. See also §1.338-6(c)(2). Other rules of law may characterize the transaction as something other than or in addition to a sale and purchase of assets; however, the transaction between old and new target must be a taxable transaction. For example, if the target is an insurance company for which a section 338 election is made, the deemed asset sale results in an assumption reinsurance transaction for the insurance contracts deemed transferred from old target to new target. See, generally, §1.817-4(d), and for special rules regarding the acquisition of insurance company targets, §1.338-11. See also §1.367(a)-8(k)(13) for a rule applicable to gain recognition agreements (filed under §§1.367(a)-3(b)(1)(ii) and 1.367(a)-8) and deemed asset sales as a result of an election under section 338(g).

(3) *Overview.* Definitions and special nomenclature and rules for making the section 338 election are provided in §1.338-2. Qualification for the section 338 election is addressed in §1.338-3. The amount for which old target is treated as selling all of its assets (the aggregate deemed sale price, or ADSP) is addressed in §1.338-4. The amount for

which new target is deemed to have purchased all its assets (the adjusted grossed-up basis, or AGUB) is addressed in §1.338-5. Section 1.338-6 addresses allocation both of ADSP among the assets old target is deemed to have sold and of AGUB among the assets new target is deemed to have purchased. Section 1.338-7 addresses allocation of ADSP or AGUB when those amounts subsequently change. Asset and stock consistency are addressed in §1.338-8. International aspects of section 338 are covered in §1.338-9. Rules for the filing of returns are provided in §1.338-10. Section 1.338-11 provides special rules for insurance company targets. Eligibility for and treatment of section 338(h)(10) elections is addressed in §1.338(h)(10)-1.

(b) *Treatment of target under other provisions of the Internal Revenue Code—*(1) *General rule for subtitle A.* Except as provided in this section, new target is treated as a new corporation that is unrelated to old target for purposes of subtitle A of the Internal Revenue Code. Thus—

(i) New target is not considered related to old target for purposes of section 168 and may make new elections under section 168 without taking into account the elections made by old target; and

(ii) New target may adopt, without obtaining prior approval from the Commissioner, any taxable year that meets the requirements of section 441 and any method of accounting that meets the requirements of section 446. Notwithstanding §1.441-1T(b)(2), a new target may adopt a taxable year on or before the last day for making the election under section 338 by filing its first return for the desired taxable year on or before that date.

(2) *Exceptions for subtitle A.* New target and old target are treated as the same corporation for purposes of—

(i) The rules applicable to employee benefit plans (including those plans described in sections 79, 104, 105, 106, 125, 127, 129, 132, 137, and 220), qualified pension, profit-sharing, stock bonus and annuity plans (sections 401(a) and 403(a)), simplified employee pensions (section 408(k)), tax qualified stock option plans (sections 422 and 423), welfare benefit funds (sections 419, 419A,

512(a)(3), and 4976), and voluntary employee benefit associations (section 501(c)(9) and the regulations thereunder);

(ii) Sections 1311 through 1314 (relating to the mitigation of the effect of limitations), if a section 338(h)(10) election is not made for target;

(iii) Section 108(e)(5) (relating to the reduction of purchase money debt);

(iv) Section 45A (relating to the Indian Employment Credit), section 51 (relating to the Work Opportunity Credit), section 51A (relating to the Welfare to Work Credit), and section 1396 (relating to the Empowerment Zone Act);

(v) Sections 401(h) and 420 (relating to medical benefits for retirees);

(vi) Section 414 (relating to definitions and special rules); and

(vii) Section 846(e) (relating to an election to use an insurance company's historical loss payment pattern).

(viii) Any other provision designated in the Internal Revenue Bulletin by the Internal Revenue Service. See § 601.601(d)(2)(ii) of this chapter. See, for example, § 1.1001-3(e)(4)(i)(F) providing that an election under section 338 does not result in the substitution of a new obligor on target's debt. See also, for example, § 1.1502-77(e)(4), providing that an election under section 338 does not result in a deemed termination of target's existence for purposes of the rules applicable to the agent for a consolidated group.

(3) *General rule for other provisions of the Internal Revenue Code.* Except as provided in the regulations under section 338 or in the Internal Revenue Bulletin by the Internal Revenue Service (see § 601.601(d)(2)(ii) of this chapter), new target is treated as a continuation of old target for purposes other than subtitle A of the Internal Revenue Code. For example—

(i) New target is liable for old target's Federal income tax liabilities, including the tax liability for the deemed sale tax consequences and those tax liabilities of the other members of any consolidated group that included old target that are attributable to taxable years in which those corporations and old target joined in the same consolidated return (see § 1.1502-6(a));

(ii) Wages earned by the employees of old target are considered wages earned by such employees from new target for purposes of sections 3101 and 3111 (Federal Insurance Contributions Act) and section 3301 (Federal Unemployment Tax Act); and

(iii) Old target and new target must use the same employer identification number.

(c) *Anti-abuse rule—(1) In general.* The rules of this paragraph (c) apply for purposes of applying the residual method as provided for under the regulations under sections 338 and 1060. The Commissioner is authorized to treat any property (including cash) transferred by old target in connection with the transactions resulting in the application of the residual method (and not held by target at the close of the acquisition date) as, nonetheless, property of target at the close of the acquisition date if the property so transferred is, within 24 months after the deemed asset sale, owned by new target, or is owned, directly or indirectly, by a member of the affiliated group of which new target is a member and continues after the acquisition date to be held or used primarily in connection with one or more of the activities of new target. In addition, the Commissioner is authorized to treat any property (including cash) transferred to old target in connection with the transactions resulting in the application of the residual method (and held by target at the close of the acquisition date) as, nonetheless, not being property of target at the close of the acquisition date if the property so transferred is, within 24 months after the deemed asset sale, not owned by new target but owned, directly or indirectly, by a member of the affiliated group of which new target is a member, or owned by new target but held or used primarily in connection with an activity conducted, directly or indirectly, by another member of the affiliated group of which new target is a member in combination with other property retained by or acquired, directly or indirectly, from the transferor of the property (or a member of the same affiliated group) to old target. For purposes of this paragraph (c)(1), an interest in an entity is considered held or used in

connection with an activity if property of the entity is so held or used. The authority of the Commissioner under this paragraph (c)(1) includes the making of any appropriate correlative adjustments (avoiding, to the extent possible, the duplication or omission of any item of income, gain, loss, deduction, or basis).

(2) *Examples.* The following examples illustrate this paragraph (c):

Example 1. Prior to a qualified stock purchase under section 338, target transfers one of its assets to a related party. The purchasing corporation then purchases the target stock and also purchases the transferred asset from the related party. After its purchase of target, the purchasing corporation and target are members of the same affiliated group. A section 338 election is made. Under an arrangement with the purchaser, the separately transferred asset is used primarily in connection with target's activities. Applying the anti-abuse rule of this paragraph (c), the Commissioner may consider target to own the transferred asset for purposes of applying the residual method under section 338.

Example 2. T owns all the stock of T1. T1 leases intellectual property to T, which T uses in connection with its own activities. P, a purchasing corporation, wishes to buy the T-T1 chain of corporations. P, in connection with its planned purchase of the T stock, contracts to consummate a purchase of all the stock of T1 on March 1 and of all the stock of T on March 2. Section 338 elections are thereafter made for both T and T1. Immediately after the purchases, P, T and T1 are members of the same affiliated group. T continues to lease the intellectual property from T1 and that is the primary use of the intellectual property. Thus, an asset of T, the T1 stock, was removed from T's own assets prior to the qualified stock purchase of the T stock, T1's own assets are used after the deemed asset sale in connection with T's own activities, and the T1 stock is after the deemed asset sale owned by P, a member of the same affiliated group of which T is a member. Applying the anti-abuse rule of this paragraph (c), the Commissioner may, for purposes of application of the residual method under section 338 both to T and to T1, consider P to have bought only the stock of T, with T at the time of the qualified stock purchases of both T and T1 (the qualified stock purchase of T1 being triggered by the deemed sale under section 338 of T's assets) owning T1. The Commissioner accordingly would allocate consideration to T's assets as though the T1 stock were one of those assets, and then allocate consideration within T1 based on the amount allocated to the T1 stock at the T level.

(d) *Next day rule for post-closing transactions.* If a target corporation for which an election under section 338 is made engages in a transaction outside the ordinary course of business on the acquisition date after the event resulting in the qualified stock purchase of the target or a higher tier corporation, the target and all persons related thereto (either before or after the qualified stock purchase) under section 267(b) or section 707 must treat the transaction for all Federal income tax purposes as occurring at the beginning of the day following the transaction and after the deemed purchase by new target.

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§ 1.338-2 Nomenclature and definitions; mechanics of the section 338 election.

(a) *Scope.* This section prescribes rules relating to elections under section 338.

(b) *Nomenclature.* For purposes of the regulations under section 338 (except as otherwise provided):

(1) T is a domestic target corporation that has only one class of stock outstanding. Old T refers to T for periods ending on or before the close of T's acquisition date; new T refers to T for subsequent periods.

(2) P is the purchasing corporation.

(3) The P group is an affiliated group of which P is a member.

(4) P1, P2, etc., are domestic corporations that are members of the P group.

(5) T1, T2, etc., are domestic corporations that are target affiliates of T. These corporations (T1, T2, etc.) have only one class of stock outstanding and may also be targets.

(6) S is a domestic corporation (unrelated to P and B) that owns T prior to the purchase of T by P. (S is referred to in cases in which it is appropriate to consider the effects of having all of the outstanding stock of T owned by a domestic corporation.)

(7) A, a U.S. citizen or resident, is an individual (unrelated to P and B) who owns T prior to the purchase of T by P. (A is referred to in cases in which it is