

under section 318(a)(3) is not reattributed from the trust to the other beneficiary. However, stock constructively owned by reason of section 318(a)(2) may be reattributed under section 318(a)(3). Thus, for example, if all the stock of corporations X and Y is owned by A, stock of corporation Z held by X is attributed to Y through A.

(2) Section 318(a)(5)(C) does not prevent reattribution under section 318(a)(2) of stock constructively owned by an entity under section 318(a)(3) if the stock is also constructively owned by the entity under section 318(a)(4). For example, if individuals A and B are beneficiaries of a trust and the trust has an option to buy stock from A, B is considered under section 318(a)(2)(B) as owning a proportionate part of such stock.

(3) Section 318(a)(5)(C) is effective on and after August 31, 1964, except that for purposes of sections 302 and 304 it does not apply with respect to distributions in payment for stock acquisitions or redemptions if such acquisitions or redemptions occurred before August 31, 1964.

[T.D. 6969, 33 FR 11999, Aug. 23, 1968]

CORPORATE LIQUIDATIONS

EFFECTS ON RECIPIENTS

§ 1.331-1 Corporate liquidations.

(a) *In general.* Section 331 contains rules governing the extent to which gain or loss is recognized to a shareholder receiving a distribution in complete or partial liquidation of a corporation. Under section 331(a)(1), it is provided that amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock. Under section 331(a)(2), it is provided that amounts distributed in partial liquidation of a corporation shall be treated as in full or part payment in exchange for the stock. For this purpose, the term *partial liquidation* shall have the meaning ascribed in section 346. If section 331 is applicable to the distribution of property by a corporation, section 301 (relating to the effects on a shareholder of distributions of property) has no application other than to a distribution in complete liquidation to which section

316(b)(2)(B) applies. See paragraph (b)(2) of § 1.316-1.

(b) *Gain or loss.* The gain or loss to a shareholder from a distribution in partial or complete liquidation is to be determined under section 1001 by comparing the amount of the distribution with the cost or other basis of the stock. The gain or loss will be recognized to the extent provided in section 1002 and will be subject to the provisions of parts I, II, and III (section 1201 and following), subchapter P, chapter 1 of the Code.

(c) *Recharacterization.* A liquidation which is followed by a transfer to another corporation of all or part of the assets of the liquidating corporation or which is preceded by such a transfer may, however, have the effect of the distribution of a dividend or of a transaction in which no loss is recognized and gain is recognized only to the extent of "other property." See sections 301 and 356.

(d) *Reporting requirement*—(1) *General rule.* Every significant holder that transfers stock to the issuing corporation in exchange for property from such corporation must include on or with such holder's return for the year of such exchange the statement described in paragraph (d)(2) of this section unless—

(i) The property is part of a distribution made pursuant to a corporate resolution reciting that the distribution is made in complete liquidation of the corporation; and

(ii) The issuing corporation is completely liquidated and dissolved within one year after the distribution.

(2) *Statement.* If required by paragraph (d)(1) of this section, a significant holder must include on or with such holder's return a statement entitled, "STATEMENT PURSUANT TO § 1.331-1(d) BY [INSERT NAME AND TAXPAYER IDENTIFICATION NUMBER (IF ANY) OF TAXPAYER], A SIGNIFICANT HOLDER OF THE STOCK OF [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER (IF ANY) OF ISSUING CORPORATION]." If a significant holder is a controlled foreign corporation (within the meaning of section 957), each United States shareholder (within the meaning of section 951(b)) with respect thereto must

include this statement on or with its return. The statement must include—

(i) The fair market value and basis of the stock transferred by the significant holder to the issuing corporation; and

(ii) A description of the property received by the significant holder from the issuing corporation.

(3) *Definitions.* For purposes of this section:

(i) *Significant holder* means any person that, immediately before the exchange—

(A) Owned at least five percent (by vote or value) of the total outstanding stock of the issuing corporation if the stock owned by such person is publicly traded; or

(B) Owned at least one percent (by vote or value) of the total outstanding stock of the issuing corporation if the stock owned by such person is not publicly traded.

(ii) *Publicly traded stock* means stock that is listed on—

(A) A national securities exchange registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f); or

(B) An interdealer quotation system sponsored by a national securities association registered under section 15A of the Securities Exchange Act of 1934 (15 U.S.C. 78o-3).

(iii) *Issuing corporation* means the corporation that issued the shares of stock, some or all of which were transferred by a significant holder to such corporation in the exchange described in paragraph (d)(1) of this section.

(4) *Cross reference.* See section 6043 of the Code for requirements relating to a return by a liquidating corporation.

(e) *Example.* The provisions of this section may be illustrated by the following example:

Example. A, an individual who makes his income tax returns on the calendar year basis, owns 20 shares of stock of the P Corporation, a domestic corporation, 10 shares of which were acquired in 1951 at a cost of \$1,500 and the remainder of 10 shares in December 1954 at a cost of \$2,900. He receives in April 1955 a distribution of \$250 per share in complete liquidation, or \$2,500 on the 10 shares acquired in 1951, and \$2,500 on the 10 shares acquired in December 1954. The gain of \$1,000 on the shares acquired in 1951 is a long-term capital gain to be treated as provided in parts I, II, and III (section 1201 and

following), subchapter P, chapter 1 of the Code. The loss of \$400 on the shares acquired in 1954 is a short-term capital loss to be treated as provided in parts I, II, and III (section 1201 and following), subchapter P, chapter 1 of the Code.

(f) *Effective/applicability date.* Paragraph (d) of this section applies to any taxable year beginning on or after May 30, 2006. However, taxpayers may apply paragraph (d) of this section to any original Federal income tax return (including any amended return filed on or before the due date (including extensions) of such original return) timely filed on or after May 30, 2006. For taxable years beginning before May 30, 2006, see § 1.331-1 as contained in 26 CFR part 1 in effect on April 1, 2006.

[T.D. 6500, 25 FR 11607, Nov. 26, 1960, as amended by T.D. 6949, 33 FR 5521, Apr. 9, 1968; T.D. 9264, 71 FR 30594, May 30, 2006; T.D. 9329, 72 FR 32797, June 14, 2007]

§ 1.332-1 Distributions in liquidation of subsidiary corporation; general.

Under the general rule prescribed by section 331 for the treatment of distributions in liquidation of a corporation, amounts received by one corporation in complete liquidation of another corporation are treated as in full payment in exchange for stock in such other corporation, and gain or loss from the receipt of such amounts is to be determined as provided in section 1001. Section 332 excepts from the general rule property received, under certain specifically described circumstances, by one corporation as a distribution in complete liquidation of the stock of another corporation and provides for the nonrecognition of gain or loss in those cases which meet the statutory requirements. Section 367 places a limitation on the application of section 332 in the case of foreign corporations. See section 334(b) for the basis for determining gain or loss from the subsequent sale of property received upon complete liquidations such as described in this section. See section 453(d)(4)(A) relative to distribution of installment obligations by subsidiary.

§ 1.332-2 Requirements for non-recognition of gain or loss.

(a) The nonrecognition of gain or loss is limited to the receipt of such property by a corporation which is the actual owner of stock (in the liquidating corporation) possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 percent of the total number of shares of all other classes of stock (except non-voting stock which is limited and preferred as to dividends). The recipient corporation must have been the owner of the specified amount of such stock on the date of the adoption of the plan of liquidation and have continued so to be at all times until the receipt of the property. If the recipient corporation does not continue qualified with respect to the ownership of stock of the liquidating corporation and if the failure to continue qualified occurs at any time prior to the completion of the transfer of all the property, the provisions for the nonrecognition of gain or loss do not apply to any distribution received under the plan.

(b) Section 332 applies only to those cases in which the recipient corporation receives at least partial payment for the stock which it owns in the liquidating corporation. If section 332 is not applicable, see section 165(g) relative to allowance of losses on worthless securities.

(c) To constitute a distribution in complete liquidation within the meaning of section 332, the distribution must be (1) made by the liquidating corporation in complete cancellation or redemption of all of its stock in accordance with a plan of liquidation, or (2) one of a series of distributions in complete cancellation or redemption of all its stock in accordance with a plan of liquidation. Where there is more than one distribution, it is essential that a status of liquidation exist at the time the first distribution is made under the plan and that such status continue until the liquidation is completed. Liquidation is completed when the liquidating corporation and the receiver or trustees in liquidation are finally divested of all the property (both tangible and intangible). A status of liquidation exists when the corporation

ceases to be a going concern and its activities are merely for the purpose of winding up its affairs, paying its debts, and distributing any remaining balance to its shareholders. A liquidation may be completed prior to the actual dissolution of the liquidating corporation. However, legal dissolution of the corporation is not required. Nor will the mere retention of a nominal amount of assets for the sole purpose of preserving the corporation's legal existence disqualify the transaction. (See 26 CFR (1939) 39.22(a)-20 (Regulations 118).)

(d) If a transaction constitutes a distribution in complete liquidation within the meaning of the Internal Revenue Code of 1954 and satisfies the requirements of section 332, it is not material that it is otherwise described under the local law. If a liquidating corporation distributes all of its property in complete liquidation and if pursuant to the plan for such complete liquidation a corporation owning the specified amount of stock in the liquidating corporation receives property constituting amounts distributed in complete liquidation within the meaning of the Code and also receives other property attributable to shares not owned by it, the transfer of the property to the recipient corporation shall not be treated, by reason of the receipt of such other property, as not being a distribution (or one of a series of distributions) in complete cancellation or redemption of all of the stock of the liquidating corporation within the meaning of section 332, even though for purposes of those provisions relating to corporate reorganizations the amount received by the recipient corporation in excess of its ratable share is regarded as acquired upon the issuance of its stock or securities in a tax-free exchange as described in section 361 and the cancellation or redemption of the stock not owned by the recipient corporation is treated as occurring as a result of a tax-free exchange described in section 354.

(e) The application of these rules may be illustrated by the following example:

Example. On September 1, 1954, the M Corporation had outstanding capital stock consisting of 3,000 shares of common stock, par

value \$100 a share, and 1,000 shares of preferred stock, par value \$100 a share, which preferred stock was limited and preferred as to dividends and had no voting rights. On that date, and thereafter until the date of dissolution of the M Corporation, the O Corporation owned 2,500 shares of common stock of the M Corporation. By statutory merger consummated on October 1, 1954, pursuant to a plan of liquidation adopted on September 1, 1954, the M Corporation was merged into the O Corporation, the O Corporation under the plan issuing stock which was received by the other holders of the stock of the M Corporation. The receipt by the O Corporation of the properties of the M Corporation is a distribution received by the O Corporation in complete liquidation of the M Corporation within the meaning of section 332, and no gain or loss is recognized as the result of the receipt of such properties.

§ 1.332-3 Liquidations completed within one taxable year.

If in a liquidation completed within one taxable year pursuant to a plan of complete liquidation, distributions in complete liquidation are received by a corporation which owns the specified amount of stock in the liquidating corporation and which continues qualified with respect to the ownership of such stock until the transfer of all the property within such year is completed (see paragraph (a) of § 1.332-2), then no gain or loss shall be recognized with respect to the distributions received by the recipient corporation. In such case no waiver or bond is required of the recipient corporation under section 332.

§ 1.332-4 Liquidations covering more than one taxable year.

(a) If the plan of liquidation is consummated by a series of distributions extending over a period of more than one taxable year, the nonrecognition of gain or loss with respect to the distributions in liquidation shall, in addition to the requirements of § 1.332-2, be subject to the following requirements:

(1) In order for the distribution in liquidation to be brought within the exception provided in section 332 to the general rule for computing gain or loss with respect to amounts received in liquidation of a corporation, the entire property of the corporation shall be transferred in accordance with a plan of liquidation, which plan shall include a statement showing the period within which the transfer of the property of

the liquidating corporation to the recipient corporation is to be completed. The transfer of all the property under the liquidation must be completed within three years from the close of the taxable year during which is made the first of the series of distributions under the plan.

(2) For each of the taxable years which falls wholly or partly within the period of liquidation, the recipient corporation shall, at the time of filing its return, file with the district director of internal revenue a waiver of the statute of limitations on assessment. The waiver shall be executed on such form as may be prescribed by the Commissioner and shall extend the period of assessment of all income and profits taxes for each such year to a date not earlier than one year after the last date of the period for assessment of such taxes for the last taxable year in which the transfer of the property of such liquidating corporation to the controlling corporation may be completed in accordance with section 332. Such waiver shall also contain such other terms with respect to assessment as may be considered by the Commissioner to be necessary to insure the assessment and collection of the correct tax liability for each year within the period of liquidation.

(3) For each of the taxable years which falls wholly or partly within the period of liquidation, the recipient corporation may be required to file a bond, the amount of which shall be fixed by the district director. The bond shall contain all terms specified by the Commissioner, including provisions unequivocally assuring prompt payment of the excess of income and profits taxes (plus penalty, if any, and interest) as computed by the district director without regard to the provisions of sections 332 and 334(b) over such taxes computed with regard to such provisions, regardless of whether such excess may or may not be made the subject of a notice of deficiency under section 6212 and regardless of whether it may or may not be assessed. Any bond required under section 332 shall have such surety or sureties as the Commissioner may require. However, see 6 U.S.C. 15, providing that where a bond is required by law or regulations, in

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lieu of surety or sureties there may be deposited bonds or notes of the United States. Only surety companies holding certificates of authority from the Secretary as acceptable sureties on Federal bonds will be approved as sureties. The bonds shall be executed in triplicate so that the Commissioner, the taxpayer, and the surety or the depository may each have a copy. On and after September 1, 1953, the functions of the Commissioner with respect to such bonds shall be performed by the district director for the internal revenue district in which the return was filed and any bond filed on or after such date shall be filed with such district director.

(b) Pending the completion of the liquidation, if there is a compliance with paragraph (a) (1), (2), and (3) of this section and § 1.332-2 with respect to the nonrecognition of gain or loss, the income and profits tax liability of the recipient corporation for each of the years covered in whole or in part by the liquidation shall be determined without the recognition of any gain or loss on account of the receipt of the distributions in liquidation. In such determination, the basis of the property or properties received by the recipient corporation shall be determined in accordance with section 334(b). However, if the transfer of the property is not completed within the three-year period allowed by section 332 or if the recipient corporation does not continue qualified with respect to the ownership of stock of the liquidating corporation as required by that section, gain or loss shall be recognized with respect to each distribution and the tax liability for each of the years covered in whole or in part by the liquidation shall be recomputed without regard to the provisions of section 332 or section 334(b) and the amount of any additional tax due upon such recomputation shall be promptly paid.

§ 1.332-5 Distributions in liquidation as affecting minority interests.

Upon the liquidation of a corporation in pursuance of a plan of complete liquidation, the gain or loss of minority shareholders shall be determined without regard to section 332, since it does not apply to that part of distributions

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in liquidation received by minority shareholders.

§ 1.332-6 Records to be kept and information to be filed with return.

(a) *Statement filed by recipient corporation.* If any recipient corporation received a liquidating distribution from the liquidating corporation pursuant to a plan (whether or not that recipient corporation has received or will receive other such distributions from the liquidating corporation in other tax years as part of the same plan) during the current tax year, such recipient corporation must include a statement entitled, "STATEMENT PURSUANT TO SECTION 332 BY [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER (IF ANY) OF TAXPAYER], A CORPORATION RECEIVING A LIQUIDATING DISTRIBUTION," on or with its return for such year. If any recipient corporation is a controlled foreign corporation (within the meaning of section 957), each United States shareholder (within the meaning of section 951(b)) with respect thereto must include this statement on or with its return. The statement must include—

(1) The name and employer identification number (if any) of the liquidating corporation;

(2) The date(s) of all distribution(s) (whether or not pursuant to the plan) by the liquidating corporation during the current tax year;

(3) The aggregate fair market value and basis, determined immediately before the liquidation, of all of the assets of the liquidating corporation that have been or will be transferred to any recipient corporation;

(4) The date and control number of any private letter ruling(s) issued by the Internal Revenue Service in connection with the liquidation;

(5) The following representation: THE PLAN OF COMPLETE LIQUIDATION WAS ADOPTED ON [INSERT DATE (mm/dd/yyyy)]; and

(6) A representation by such recipient corporation either that—

(i) THE LIQUIDATION WAS COMPLETED ON [INSERT DATE (mm/dd/yyyy)]; or

(ii) THE LIQUIDATION IS NOT COMPLETE AND THE TAXPAYER HAS TIMELY FILED [INSERT EITHER

FORM 952, "Consent To Extend the Time to Assess Tax Under Section 332(b)," OR NUMBER AND NAME OF THE SUCCESSOR FORM].

(b) *Filings by the liquidating corporation.* The liquidating corporation must timely file Form 966, "Corporate Dissolution or Liquidation," (or its successor form) and its final Federal corporate income tax return. See also section 6043 of the Code.

(c) *Definitions.* For purposes of this section:

(1) *Plan* means the plan of complete liquidation within the meaning of section 332.

(2) *Recipient corporation* means the corporation described in section 332(b)(1).

(3) *Liquidating corporation* means the corporation that makes a distribution of property to a recipient corporation pursuant to the plan.

(4) *Liquidating distribution* means a distribution of property made by the liquidating corporation to a recipient corporation pursuant to the plan.

(d) *Substantiation information.* Under §1.6001-1(e), taxpayers are required to retain their permanent records and make such records available to any authorized Internal Revenue Service officers and employees. In connection with a liquidation described in this section, these records should specifically include information regarding the amount, basis, and fair market value of all distributed property, and relevant facts regarding any liabilities assumed or extinguished as part of such liquidation.

(e) *Effective/applicability date.* This section applies to any taxable year beginning on or after May 30, 2006. However, taxpayers may apply this section to any original Federal income tax return (including any amended return filed on or before the due date (including extensions) of such original return) timely filed on or after May 30, 2006. For taxable years beginning before May 30, 2006, see §1.332-6 as contained in 26 CFR part 1 in effect on April 1, 2006.

[T.D. 9329, 72 FR 32797, June 14, 2007]

§ 1.332-7 Indebtedness of subsidiary to parent.

If section 332(a) is applicable to the receipt of the subsidiary's property in complete liquidation, then no gain or loss shall be recognized to the subsidiary upon the transfer of such properties even though some of the properties are transferred in satisfaction of the subsidiary's indebtedness to its parent. However, any gain or loss realized by the parent corporation on such satisfaction of indebtedness, shall be recognized to the parent corporation at the time of the liquidation. For example, if the parent corporation purchased its subsidiary's bonds at a discount and upon liquidation of the subsidiary the parent corporation receives payment for the face amount of such bonds, gain shall be recognized to the parent corporation. Such gain shall be measured by the difference between the cost or other basis of the bonds to the parent and the amount received in payment of the bonds.

§ 1.334-1 Basis of property received in liquidations.

(a) *In general.* Section 334 sets forth rules prescribing the basis of property received in a distribution in partial or complete liquidation of a corporation. The general rule of section 334 is set forth in section 334(a) to the effect that if property is received in a distribution in partial or complete liquidation and if gain or loss is recognized on the receipt of such property, then the basis of the property in the hands of the distributee shall be the fair market value of such property at the time of the distribution. Such general rule has no application to a liquidation to which section 332 or section 333 applies. See section 334 (b) and (c).

(b) *Transferor's basis.* Unless section 334(b)(2) and subsection (c) of this section apply, property received by a parent corporation in a complete liquidation to which section 332 is applicable shall, under section 334(b)(1), have the same basis in the hands of the parent as its adjusted basis in the hands of the subsidiary. The rule stated above is applicable even though the subsidiary was indebted to the parent on the date the plan of liquidation was adopted and part of such property was received in

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satisfaction of such indebtedness in a transfer to which section 332(c) is applicable. See § 1.460-4(k)(3)(iv)(B)(2) for rules relating to adjustments to the basis of certain contracts accounted for using a long-term contract method of accounting that are acquired in certain liquidations described in section 332.

[T.D. 7231, 37 FR 28287, Dec. 22, 1972, as amended at T.D. 8474, 58 FR 25557, Apr. 27, 1993; T.D. 8995, 67 FR 34605, May 15, 2002]

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[T.D. 9619, 78 FR 28474, May 15, 2013]

§ 1.336-1 General principles, nomenclature, and definitions for a section 336(e) election.

- (a) *Overview*—(1) *In general.* Section 336(e) authorizes the promulgation of

regulations under which, in certain circumstances, a sale, exchange, or distribution of the stock of a corporation may be treated as an asset sale. This section and §§ 1.336-2 through 1.336-5 provide the rules for and consequences of making such election. This section provides the definitions and nomenclature. Generally, except to the extent inconsistent with section 336(e), the results of section 336(e) should coincide with those of section 338(h)(10). Accordingly, to the extent not inconsistent with section 336(e) or these regulations, the principles of section 338 and the regulations under section 338 apply for purposes of these regulations. For example, § 1.338(h)(10)-1(d)(8), concerning the availability of the section 453 installment method, may apply with respect to section 336(e).

(2) *Consistency rules.* In general, the principles of § 1.338-8, concerning asset and stock consistency, apply with respect to section 336(e). However, for this purpose, the application of § 1.338-8(b)(1) is modified such that § 1.338-8(b)(1)(iii) applies to an asset if the asset is owned, immediately after its acquisition and on the disposition date, by a person or by a related person (as defined in § 1.336-1(b)(12)) to a person that acquires, by sale, exchange, distribution, or any combination thereof, five percent or more, by value, of the stock of target in the qualified stock disposition.

(b) *Definitions.* For purposes of §§ 1.336-1 through 1.336-5 (except as otherwise provided):

(1) *Seller.* The term *seller* means any domestic corporation that makes a qualified stock disposition of stock of another corporation. Seller includes both a transferor and a distributor of target stock. Generally, all members of a consolidated group that dispose of target stock are treated as a single seller. See § 1.336-2(g)(2).

(2) *Purchaser.* The term *purchaser* means one or more persons that acquire or receive the stock of another corporation in a qualified stock disposition. A purchaser includes both a transferee and a distributee of target stock.

(3) *Target; S corporation target; old target; new target.* The term *target* means any domestic corporation the stock of

which is sold, exchanged, or distributed in a qualified stock disposition. An *S corporation target* is a target that is an S corporation immediately before the disposition date; any other target is a *non-S corporation target*. Except as the context otherwise requires, a reference to target includes a reference to an S corporation target. In the case of a transaction not described in section 355(d)(2) or (e)(2), *old target* refers to target for periods ending on or before the close of target's disposition date and *new target* refers to target for subsequent periods. In the case of a transaction described in section 355(d)(2) or (e)(2), *old target* refers to target for periods ending on or before the disposition date as well as for subsequent periods.

(4) *S corporation shareholders*. *S corporation shareholders* are the S corporation target's shareholders. Unless otherwise provided, a reference to S corporation shareholders refers both to S corporation shareholders who dispose of and those who do not dispose of their S corporation target stock.

(5) *Disposed of; disposition*—(i) *In general*. The term *disposed of* refers to a transfer of stock in a disposition. The term *disposition* means any sale, exchange, or distribution of stock, but only if—

(A) The basis of the stock in the hands of the purchaser is not determined in whole or in part by reference to the adjusted basis of such stock in the hands of the person from whom the stock is acquired or under section 1014(a) (relating to property acquired from a decedent);

(B) Except as provided in paragraph (b)(5)(ii) of this section, the stock is not sold, exchanged, or distributed in a transaction to which section 351, 354, 355, or 356 applies and is not sold, exchanged, or distributed in any transaction described in regulations in which the transferor does not recognize the entire amount of the gain or loss realized in the transaction; and

(C) The stock is not sold, exchanged, or distributed to a related person.

(ii) *Exception for disposition of stock in certain section 355 transactions*. Notwithstanding paragraph (b)(5)(i)(B) of this section, a distribution of stock to a person who is not a related person in a

transaction in which the full amount of stock gain would be recognized pursuant to section 355(d)(2) or (e)(2) shall be considered a disposition.

(iii) *Transactions with related persons*. In determining whether stock is sold, exchanged, or distributed to a related person, the principles of section 338(h)(3)(C) and § 1.338-3(b)(3) shall apply.

(iv) *No consideration paid*. Stock in target may be considered disposed of if, under general principles of tax law, seller is considered to sell, exchange, or distribute stock of target notwithstanding that no amount may be paid for (or allocated to) the stock.

(v) *Disposed of stock reacquired by certain persons*. Stock disposed of by seller to another person under this section that is reacquired by seller or a member of seller's consolidated group during the 12-month disposition period shall not be considered as disposed of. Similarly, stock disposed of by an S corporation shareholder to another person under this section that is reacquired by the S corporation shareholder or by a person related (within the meaning of paragraph (b)(12) of this section) to the S corporation shareholder during the 12-month disposition period shall not be considered as disposed of.

(6) *Qualified stock disposition*—(i) *In general*. The term *qualified stock disposition* means any transaction or series of transactions in which stock meeting the requirements of section 1504(a)(2) of a domestic corporation is either sold, exchanged, or distributed, or any combination thereof, by another domestic corporation or by the S corporation shareholders in a disposition, within the meaning of paragraph (b)(5) of this section, during the 12-month disposition period.

(ii) *Overlap with qualified stock purchase*—(A) *In general*. Except as provided in paragraph (b)(6)(ii)(B) of this section, a transaction satisfying the definition of a qualified stock disposition under paragraph (b)(6)(i) of this section, which also qualifies as a qualified stock purchase (as defined in section 338(d)(3)), will not be treated as a qualified stock disposition.

(B) *Exception.* If, as a result of the deemed sale of old target's assets pursuant to a section 336(e) election, there would be, but for paragraph (b)(6)(ii)(A) of this section, a qualified stock disposition of the stock of a subsidiary of target, then paragraph (b)(6)(ii)(A) shall not apply to the disposition of the stock of the subsidiary.

(7) *12-month disposition period.* The term *12-month disposition period* means the 12-month period beginning with the date of the first sale, exchange, or distribution of stock included in a qualified stock disposition.

(8) *Disposition date.* The term *disposition date* means, with respect to any corporation, the first day on which there is a qualified stock disposition with respect to the stock of such corporation.

(9) *Disposition date assets.* *Disposition date assets* are the assets of target held at the beginning of the day after the disposition date (but see § 1.338-1(d) (regarding certain transactions on the disposition date)).

(10) *Domestic corporation.* The term *domestic corporation* has the same meaning as in § 1.338-2(c)(9).

(11) *Section 336(e) election.* A section 336(e) election is an election to apply section 336(e) to target. A section 336(e) election is made by making an election for target under § 1.336-2(h).

(12) *Related persons.* Two persons are related if stock of a corporation owned by one of the persons would be attributed under section 318(a), other than section 318(a)(4), to the other. However, neither section 318(a)(2)(A) nor section 318(a)(3)(A) apply to attribute stock ownership from a partnership to a partner, or from a partner to a partnership, if such partner owns, directly or indirectly, interests representing less than five percent of the value of the partnership.

(13) *Liquidation.* Any reference to a liquidation is treated as a reference to the transfer described in § 1.336-2(b)(1)(iii) notwithstanding its ultimate characterization for Federal income tax purposes.

(14) *Deemed asset disposition.* The deemed sale of old target's assets is, without regard to its characterization for Federal income tax purposes, re-

ferred to as the deemed asset disposition.

(15) *Deemed disposition tax consequences.* Deemed disposition tax consequences refers to, in the aggregate, the Federal income tax consequences (generally, the income, gain, deduction, and loss) of the deemed asset disposition. Deemed disposition tax consequences also refers to the Federal income tax consequences of the transfer of a particular asset in the deemed asset disposition.

(16) *80-percent purchaser.* An 80-percent purchaser is any purchaser that, after application of the attribution rules of section 318(a), other than section 318(a)(4), owns 80 percent or more of the voting power or value of target stock.

(17) *Recently disposed stock.* The term *recently disposed stock* means any stock in target that is not held by seller, a member of seller's consolidated group, or an S corporation shareholder immediately after the close of the disposition date and that was disposed of by seller, a member of seller's consolidated group, or an S corporation shareholder during the 12-month disposition period.

(18) *Nonrecently disposed stock.* The term *nonrecently disposed stock* means stock in target that is held on the disposition date by a purchaser or a person related (as described in § 1.336-1(b)(12)) to the purchaser who owns, on the disposition date, with the application of section 318(a), other than section 318(a)(4), at least 10 percent of the total voting power or value of the stock of target and that is not recently disposed stock.

(c) *Nomenclature.* For purposes of §§ 1.336-1 through 1.336-5, except as otherwise provided, Parent, Seller, Target, Sub, S Corporation Target, and Target Subsidiary are domestic corporations and A, B, C, and D are individuals, none of whom are related to Parent, Seller, Target, Sub, S Corporation Target, Target Subsidiary, or each other.

[T.D. 9619, 78 FR 28474, May 15, 2013]

§ 1.336-2 Availability, mechanics, and consequences of section 336(e) election.

(a) *Availability of election.* A section 336(e) election is available if seller or S

corporation shareholder(s) dispose of stock of another corporation (target) in a qualified stock disposition (as defined in § 1.336-1(b)(6)). A section 336(e) election is irrevocable. A section 336(e) election is not available for transactions described in section 336(e) that do not constitute qualified stock dispositions.

(b) *Deemed transaction*—(1) *Dispositions not described in section 355(d)(2) or (e)(2)*—(i) *Old target—deemed asset disposition*—(A) *In general*. This paragraph (b)(1) provides the Federal income tax consequences of a section 336(e) election made with respect to a qualified stock disposition not described, in whole or in part, in section 355(d)(2) or (e)(2). For the Federal income tax consequences of a section 336(e) election made with respect to a qualified stock disposition described, in whole or in part, in section 355(d)(2) or (e)(2), see paragraph (b)(2) of this section. In general, if a section 336(e) election is made, seller (or S corporation shareholders) are treated as not having sold, exchanged, or distributed the stock disposed of in the qualified stock disposition. Instead, old target is treated as selling its assets to an unrelated person in a single transaction at the close of the disposition date (but before the deemed liquidation described in paragraph (b)(1)(iii) of this section) in exchange for the aggregate deemed asset disposition price (ADADP) as determined under § 1.336-3. ADADP is allocated among the disposition date assets in the same manner as the aggregate deemed sale price (ADSP) is allocated under §§ 1.338-6 and 1.338-7 in order to determine the amount realized from each of the sold assets. Old target realizes the deemed disposition tax consequences from the deemed asset disposition before the close of the disposition date while old target is owned by seller or the S corporation shareholders. If old target is an S corporation target, old target's S election continues in effect through the close of the disposition date (including the time of the deemed asset disposition and the deemed liquidation) notwithstanding section 1362(d)(2)(B). Also, if old target is an S corporation target (but not a qualified subchapter S subsidiary), any direct or indirect subsidiaries of old

target that old target has elected to treat as qualified subchapter S subsidiaries under section 1361(b)(3) remain qualified subchapter S subsidiaries through the close of the disposition date.

(B) *Gains and losses*—(1) *Gains*. Except as provided in § 1.338(h)(10)–1(d)(8) (regarding the installment method), old target shall recognize all of the gains realized on the deemed asset disposition.

(2) *Losses*—(i) *In general*. Except as provided in paragraphs (b)(1)(i)(B)(2)(ii), (iii), and (iv) of this section, old target shall recognize all of the losses realized on the deemed asset disposition.

(ii) *Stock distributions*. Notwithstanding paragraphs (b)(1)(i)(A) and (b)(1)(iii)(A) of this section, for purposes of determining the amount of target's losses that are disallowed on the deemed asset disposition, seller is still treated as selling, exchanging, or distributing its target stock disposed of in the 12-month disposition period. If target's losses realized on the deemed sale of all of its assets exceed target's gains realized (a net loss), the portion of such net loss attributable to a distribution of target stock during the 12-month disposition period is disallowed. The total amount of disallowed loss and the allocation of disallowed loss is determined in the manner provided in paragraphs (b)(1)(i)(B)(2)(iii) and (iv) of this section.

(iii) *Amount and allocation of disallowed loss*. The total disallowed loss pursuant to paragraph (b)(1)(i)(B)(2)(ii) of this section shall be determined by multiplying the net loss realized on the deemed asset disposition by the disallowed loss fraction. The numerator of the disallowed loss fraction is the value of target stock, determined on the disposition date, distributed by seller during the 12-month disposition period, whether or not a part of the qualified stock disposition (for example, stock distributed to a related person), and the denominator of the disallowed loss fraction is the sum of the value of target stock, determined on the disposition date, disposed of by sale or exchange in the qualified stock disposition during the 12-month disposition period and the value of target stock,

determined on the disposition date, distributed by seller during the 12-month disposition period, whether or not a part of the qualified stock disposition. The amount of the disallowed loss allocated to each asset disposed of in the deemed asset disposition is determined by multiplying the total amount of the disallowed loss by the loss allocation fraction. The numerator of the loss allocation fraction is the amount of loss realized with respect to the asset and the denominator of the loss allocation fraction is the sum of the amount of losses realized with respect to each loss asset disposed of in the deemed asset disposition. To the extent old target's losses from the deemed asset disposition are not disallowed under this paragraph, such losses may be disallowed under other provisions of the Internal Revenue Code or general principles of tax law, in the same manner as if such assets were actually sold to an unrelated person.

(iv) *Tiered targets.* If an asset of target is the stock of a subsidiary corporation of target for which a section 336(e) election is made, any gain or loss realized on the deemed sale of the stock of the subsidiary corporation is disregarded in determining the amount of disallowed loss. For purposes of determining the amount of disallowed loss on the deemed asset disposition by a subsidiary of target for which a section 336(e) election is made, the amount of subsidiary stock deemed sold in the deemed asset disposition of target's assets multiplied by the disallowed loss fraction with respect to the corporation that is deemed to have disposed of stock of the subsidiary is considered to have been distributed. In determining the disallowed loss fraction with respect to the deemed asset disposition of any subsidiary of target, disregard any sale, exchange, or distribution of its stock that was made after the disposition date if such stock was included in the deemed asset disposition of the corporation deemed to have disposed of the subsidiary stock.

(3) *Examples.* The following examples illustrate this paragraph (b)(1)(i)(B).

Example 1. (i) *Facts.* Parent owns 60 of the 100 outstanding shares of the common stock of Seller, Seller's only class of stock outstanding. The remaining 40 shares of the

common stock of Seller are held by shareholders unrelated to Seller or each other. Seller owns 95 of the 100 outstanding shares of Target common stock, and all 100 shares of Target preferred stock that is described in section 1504(a)(4). The remaining 5 shares of Target common stock are owned by A. On January 1 of Year 1, Seller sells 72 shares of Target common stock to B for \$3,520. On July 1 of Year 1, Seller distributes 12 shares of Target common stock to Parent and 8 shares to its unrelated shareholders in a distribution described in section 301. Seller retains 3 shares of Target common stock and all 100 shares of Target preferred stock immediately after July 1. The value of Target common stock on July 1 is \$60 per share. The value of Target preferred stock on July 1 is \$36 per share. Target has three assets, Asset 1, a Class IV asset, with a basis of \$1,776 and a fair market value of \$2,000, Asset 2, a Class V asset, with a basis of \$2,600 and a fair market value of \$2,750, and Asset 3, a Class V asset, with a basis of \$3,900 and a fair market value of \$3,850. Seller incurred no selling costs on the sale of the 72 shares of Target common stock to B. Target has no liabilities. A section 336(e) election is made.

(ii) *Consequences—Deemed Asset Sale.* Because at least 80 percent ((72 + 8)/100) of Target stock, other than stock described in section 1504(a)(4), was disposed of (within the meaning of § 1.336-1(b)(5)) by Seller during the 12-month disposition period, a qualified stock disposition occurred. July 1 of Year 1, the first day on which there was a qualified stock disposition with respect to Target stock, is the disposition date. Accordingly, pursuant to the section 336(e) election, for Federal income tax purposes, Seller generally is not treated as selling the 72 shares of Target common stock sold to B or distributing the 8 shares of Target common stock distributed to its unrelated shareholders. However, Seller is still treated as distributing the 12 shares of Target common stock distributed to Parent because Seller and Parent are related persons within the meaning of § 1.336-1(b)(12) and accordingly the 12 shares are not part of the qualified stock disposition. Target is treated as if, on July 1, it sold all of its assets to an unrelated person in exchange for the ADADP, \$8,000, which is allocated \$2,000 to Asset 1, \$2,500 to Asset 2, and \$3,500 to Asset 3 (see *Example 1* of § 1.336-3(g) for the determination and allocation of ADADP).

(iii) *Consequences—Amount and Allocation of Disallowed Loss.* Old Target realized a net loss of \$276 on the deemed asset disposition (\$224 gain realized on Asset 1, \$100 loss realized on Asset 2, and \$400 loss realized on Asset 3). However, 20 shares of Target common stock were distributed by Seller during the 12-month disposition period (8 shares distributed to Seller's unrelated shareholders in the qualified stock disposition plus 12 shares

distributed to Parent that were not part of the qualified stock disposition). Therefore, because there was a net loss realized on the deemed asset disposition and a portion of the stock of Target was distributed during the 12-month disposition period, a portion of the loss on the deemed sale of each of Target's loss assets is disallowed. The total amount of disallowed loss equals \$60 (\$276 net loss realized on the deemed disposition of Assets 1, 2, and 3 multiplied by the disallowed loss fraction, the numerator of which is \$1,200, the value on July 1, the disposition date, of the 20 shares of Target common stock distributed during the 12-month disposition period, and the denominator of which is \$5,520, the sum of \$4,320, the value on July 1 of the 72 shares of Target common stock sold to B and \$1,200, the value on July 1 of the 20 shares of Target common stock distributed during the 12-month disposition period). The portion of the disallowed loss allocated to Asset 2 is \$12 (\$60 total disallowed loss multiplied by the loss allocation fraction, the numerator of which is \$100, the loss realized on the deemed disposition of Asset 2 and the denominator of which is \$500, the sum of the losses realized on the deemed disposition of Assets 2 and 3). The portion of the disallowed loss allocated to Asset 3 is \$48 (\$60 total disallowed loss multiplied by the loss allocation fraction, the numerator of which is \$400, the loss realized on the deemed disposition of Asset 3 and the denominator of which is \$500, the sum of the losses realized on the deemed disposition of Assets 2 and 3). Accordingly, Old Target recognizes \$224 of gain on Asset 1, recognizes \$88 of loss on Asset 2 (realized loss of \$100 less allocated disallowed loss of \$12), and recognizes \$352 of loss on Asset 3 (realized loss of \$400 less allocated disallowed loss of \$48) or a recognized net loss of \$216 on the deemed asset disposition.

Example 2. (i) *Facts.* The facts are the same as in *Example 1* except that Asset 2 is the stock of Target Subsidiary, a corporation of which Target owns 100 of the 110 shares of common stock, the only outstanding class of Target Subsidiary stock. The remaining 10 shares of Target Subsidiary stock are owned by D. The value of Target Subsidiary stock on July 1 is \$27.50 per share. Target Subsidiary has two assets, Asset 4, a Class IV asset, with a basis of \$800 and a fair market value of \$1,000, and Asset 5, a Class IV asset, with a basis of \$2,200 and a fair market value of \$2,025. Target Subsidiary has no liabilities. A section 336(e) election with respect to Target Subsidiary is also made.

(ii) *Consequences—Target.* The ADADP on the deemed sale of Target's assets is determined and allocated in the same manner as in *Example 1*. However, Target's loss realized on the deemed sale of Target Subsidiary is disregarded in determining the amount of disallowed loss on the deemed asset disposition of Target's assets. Thus, the net loss is

only \$176 (\$224 gain realized on Asset 1 and \$400 loss realized on Asset 3), and the amount of disallowed loss equals \$38.26 (\$176 net loss multiplied by the disallowed loss fraction with respect to Target stock, \$1,200/\$5,520). The entire disallowed loss is allocated to Asset 3.

(iii) *Consequences—Target Subsidiary.* The deemed sale of the stock of Target Subsidiary is disregarded and instead Target Subsidiary is deemed to sell all of its assets to an unrelated person. The ADADP on the deemed asset disposition of Target Subsidiary is \$2,750, which is allocated \$909 to Asset 4 and \$1,841 to Asset 5 (see *Example 2* of § 1.336-3(g) for the determination and allocation of ADADP). Old Target Subsidiary realized \$109 of gain on Asset 4 and realized \$359 of loss on Asset 5 in the deemed asset disposition. Although Old Target Subsidiary realized a net loss of \$250 on the deemed asset disposition (\$109 gain on Asset 4 and \$359 loss on Asset 5), a portion of this net loss is disallowed because a portion of Target stock was distributed during the 12-month disposition period. For purposes of determining the amount of disallowed loss on the deemed sale of the assets of Target Subsidiary, the portion of the 100 shares of Target Subsidiary stock deemed sold by Target pursuant to the section 336(e) election for Target Subsidiary multiplied by the disallowed loss fraction with respect to Target stock is treated as having been distributed. Thus, for purposes of determining the amount of disallowed loss on the deemed asset disposition of Target Subsidiary's assets, 21.74 shares of Target Subsidiary stock (100 shares of Target Subsidiary stock owned by Target multiplied by the disallowed loss fraction with respect to Target stock, \$1,200/\$5,520) are treated as having been distributed by Target during the 12-month disposition period. The total amount of disallowed loss with respect to the deemed asset disposition of Target Subsidiary's assets equals \$54 (\$250 net loss realized on the deemed disposition of Assets 4 and 5 multiplied by the disallowed loss fraction with respect to Target Subsidiary, the numerator of which is \$598, the value on July 1, the disposition date, of the 21.74 shares of Target Subsidiary stock deemed distributed during the 12-month disposition period (21.74 shares \times \$27.50) and the denominator of which is \$2,750 (the sum of \$2,152, the value on July 1 of the 78.26 shares of Target Subsidiary stock deemed sold in the qualified stock disposition pursuant to the section 336(e) election for Target Subsidiary (78.26 shares \times \$27.50) and \$598, the value on July 1 of the 21.74 shares of Target Subsidiary stock deemed distributed during the 12-month disposition period)). (The 10 shares of Target Subsidiary owned by D are not part of the qualified stock disposition and therefore are not included in the denominator of the disallowed loss fraction.) All of the disallowed

loss is allocated to Asset 5, the only loss asset. Accordingly, Old Target Subsidiary recognizes \$109 of gain on Asset 4 and recognizes \$305 of loss on Asset 5 (realized loss of \$359 less disallowed loss of \$54) or a net loss of \$196 on the deemed asset disposition.

Example 3. (i) *Facts.* The facts are the same as in *Example 2* except that on August 1 of Year 1, Target sells 50 of its shares of Target Subsidiary stock and distributes the remaining 50 shares.

(ii) *Consequences.* Because the 100 shares of Target Subsidiary stock that were sold and distributed on August 1 were deemed disposed of on July 1 in the deemed asset disposition of Target, the August 1 sale and distribution of Target Subsidiary stock are disregarded in determining the amount of disallowed loss. Accordingly, the consequences are the same as in *Example 2*.

(C) *Tiered targets.* In the case of parent-subsidiary chains of corporations making section 336(e) elections, the deemed asset disposition of a higher-tier subsidiary is considered to precede the deemed asset disposition of a lower-subsidiary.

(ii) *New target—deemed purchase.* New target is treated as acquiring all of its assets from an unrelated person in a single transaction at the close of the disposition date (but before the deemed liquidation) in exchange for an amount equal to the adjusted grossed-up basis (AGUB) as determined under § 1.336-4. New target allocates the consideration deemed paid in the transaction in the same manner as new target would under §§ 1.338-6 and 1.338-7 in order to determine the basis in each of the purchased assets. If new target qualifies as a small business corporation within the meaning of section 1361(b) and wants to be an S corporation, a new election under section 1362(a) must be made. Notwithstanding paragraph (b)(1)(iii) of this section (deemed liquidation of old target), new target remains liable for the tax liabilities of old target (including the tax liability for the deemed disposition tax consequences). For example, new target remains liable for the tax liabilities of the members of any consolidated group that are attributable to taxable years in which those corporations and old target joined in the same consolidated return. See § 1.1502-6(a).

(iii) *Old target and seller—deemed liquidation—(A) In general.* If old target is an S corporation, S corporation share-

holders (whether or not they sell or exchange their stock) take their pro rata share of the deemed disposition tax consequences into account under section 1366 and increase or decrease their basis in target stock under section 1367. Old target and seller (or S corporation shareholders) are treated as if, before the close of the disposition date, after the deemed asset disposition described in paragraph (b)(1)(i)(A) of this section, and while target is owned by seller or S corporation shareholders, old target transferred all of the consideration deemed received from new target in the deemed asset disposition to seller or S corporation shareholders, any S corporation election for old target terminated, and old target ceased to exist. The transfer from old target to seller or S corporation shareholders is characterized for Federal income tax purposes in the same manner as if the parties had actually engaged in the transactions deemed to occur because of this section and taking into account other transactions that actually occurred or are deemed to occur. For example, the transfer may be treated as a distribution in pursuance of a plan of reorganization, a distribution in complete cancellation or redemption of all of its stock, one of a series of distributions in complete cancellation or redemption of all of its stock in accordance with a plan of liquidation, or part of a circular flow of cash. In most cases, the transfer will be treated as a distribution in complete liquidation to which sections 331 or 332 and sections 336 or 337 apply.

(B) *Tiered targets.* In the case of parent-subsidiary chains of corporations making section 336(e) elections, the deemed liquidation of a lower-tier subsidiary corporation is considered to precede the deemed liquidation of a higher-tier subsidiary.

(iv) *Seller—distribution of target stock.* In the case of a distribution of target stock in a qualified stock disposition, seller (the distributor) is deemed to purchase from an unrelated person, on the disposition date, immediately after the deemed liquidation of old target, the amount of stock distributed in the qualified stock disposition (new target stock) and to have distributed such new target stock to its shareholders.

Seller recognizes no gain or loss on the distribution of such stock.

(v) *Seller—retention of target stock.* If seller or an S corporation shareholder retains any target stock after the disposition date, seller or the S corporation shareholder is treated as purchasing the stock so retained from an unrelated person (new target stock) on the day after the disposition date for its fair market value. The holding period for the retained stock starts on the day after the disposition date. For purposes of this paragraph (b)(1)(v), the fair market value of all of the target stock equals the grossed-up amount realized on the sale, exchange, or distribution of recently disposed stock of target (see § 1.336-3(c)).

(2) *Dispositions described in section 355(d)(2) or (e)(2)*—(i) *Old target—deemed asset disposition*—(A) *In general.* This paragraph (b)(2) provides the Federal income tax consequences of a section 336(e) election made with respect to a qualified stock disposition resulting, in whole or in part, from a disposition described in section 355(d)(2) or (e)(2). Old target is treated as selling its assets to an unrelated person in a single transaction at the close of the disposition date in exchange for the ADADP as determined under § 1.336-3. ADADP is allocated among the disposition date assets in the same manner as ADSP is allocated under §§ 1.338-6 and 1.338-7 in order to determine the amount realized from each of the sold assets. Old target realizes the deemed disposition tax consequences from the deemed asset disposition before the close of the disposition date while old target is owned by seller.

(1) *Old target not deemed to liquidate.* In general, unlike a section 338(h)(10) election or a section 336(e) election made with respect to a qualified stock disposition not described, in whole or in part, in section 355(d)(2) or (e)(2), old target is not deemed to liquidate after the deemed asset disposition.

(2) *Exception.* If an election is made under § 1.1502-13(f)(5)(ii)(E), then solely for purposes of § 1.1502-13(f)(5)(ii)(C), immediately after the deemed asset disposition of old target, old target is deemed to liquidate into seller.

(B) *Gains and losses*—(1) *Gains.* Except as provided in § 1.338(h)(10)-1(d)(8) (re-

garding the installment method), old target shall recognize all of the gains realized on the deemed asset disposition.

(2) *Losses*—(i) *In general.* Except as provided in paragraphs (b)(2)(i)(B)(2)(ii), (iii), and (iv) of this section, old target shall recognize all of the losses realized on the deemed asset disposition.

(ii) *Stock distributions.* If target's losses realized on the deemed sale of all of its assets exceed target's gains realized (a net loss), the portion of such net loss attributable to a distribution of target stock during the 12-month disposition period is disallowed. The total amount of disallowed loss and the allocation of disallowed loss is determined in the manner provided in paragraphs (b)(2)(i)(B)(2)(iii) and (iv) of this section.

(iii) *Amount and allocation of disallowed loss.* The total disallowed loss pursuant to paragraph (b)(2)(i)(B)(2)(ii) of this section shall be determined by multiplying the net loss realized on the deemed asset disposition by the disallowed loss fraction. The numerator of the disallowed loss fraction is the value of target stock, determined on the disposition date, distributed by seller during the 12-month disposition period, whether or not a part of the qualified stock disposition (for example, stock distributed to a related person), and the denominator of the disallowed loss fraction is the sum of the value of target stock, determined on the disposition date, disposed of by sale or exchange in the qualified stock disposition during the 12-month disposition period and the value of target stock, determined on the disposition date, distributed by seller during the 12-month disposition period, whether or not a part of the qualified stock disposition. The amount of the disallowed loss allocated to each asset disposed of in the deemed asset disposition is determined by multiplying the total amount of the disallowed loss by the loss allocation fraction. The numerator of the loss allocation fraction is the amount of loss realized with respect to the asset and the denominator of the loss allocation fraction is the sum of the amount of losses realized with respect to each loss asset disposed of in the deemed asset disposition. To the extent old target's

losses from the deemed asset disposition are not disallowed under this paragraph, such losses may be disallowed under other provisions of the Internal Revenue Code or general principles of tax law, in the same manner as if such assets were actually sold to an unrelated person.

(iv) *Tiered targets.* If an asset of target is the stock of a subsidiary corporation of target for which a section 336(e) election is made, any gain or loss realized on the deemed sale of the stock of the subsidiary corporation is disregarded in determining the amount of disallowed loss. For purposes of determining the amount of disallowed loss on the deemed asset disposition by a subsidiary of target for which a section 336(e) election is made, see paragraph (b)(1)(i)(B)(2) of this section.

(3) *Examples.* The following examples illustrate this paragraph (b)(2)(i)(B).

Example 1. (i) *Facts.* Seller owns 90 of the 100 outstanding shares of Target common stock, the only class of Target stock outstanding. The remaining 10 shares of Target common stock are owned by C. On January 1 of Year 1, Seller sells 10 shares of Target common stock to D for \$910. On July 1, in an unrelated transaction, Seller distributes its remaining 80 shares of Target common stock to its unrelated shareholders in a distribution described in section 355(d)(2) or (e)(2). On July 1, the value of Target common stock is \$100 per share. Target has three assets, Asset 1 with a basis of \$1,220, Asset 2 with a basis of \$3,675, and Asset 3 with a basis of \$5,725. Seller incurred no selling costs on the sale of the 10 shares of Target common stock to D. Target has no liabilities. A section 336(e) election is made.

(ii) *Consequences.* Because at least 80 percent of Target stock ((10 + 80)/100) was disposed of (within the meaning of § 1.336-1(b)(5)) by Seller during the 12-month disposition period, a qualified stock disposition occurred. July 1 of Year 1, the first day on which there was a qualified stock disposition with respect to Target, is the disposition date. Accordingly, pursuant to the section 336(e) election, for Federal income tax purposes, Target is treated as if, on July 1, it sold all of its assets to an unrelated person in exchange for the ADADP, \$9,900, as determined under § 1.336-3. Assume that the ADADP is allocated \$2,000 to Asset 1, \$3,300 to Asset 2, and \$4,600 to Asset 3 under § 1.336-3. Old Target realized a net loss of \$720 on the deemed asset disposition (\$780 gain realized on Asset 1, \$375 loss realized on Asset 2, and \$1,125 loss realized on Asset 3). However, because a portion of Target stock was distrib-

uted during the 12-month disposition period and there was a net loss on the deemed asset disposition, a portion of the loss on each of the loss assets is disallowed. The total amount of disallowed loss equals \$640 (\$720 net loss realized on the deemed disposition of Assets 1, 2, and 3 multiplied by the disallowed loss fraction, the numerator of which is \$8,000, the value on July 1, the disposition date, of the 80 shares of Target common stock distributed by Seller during the 12-month disposition period, and the denominator of which is \$9,000, the sum of \$1,000, the value on July 1 of the 10 shares of Target common stock sold to D, and \$8,000, the value on July 1 of the 80 shares of Target common stock distributed by Seller during the 12-month disposition period). The portion of the disallowed loss allocated to Asset 2 is \$160 (\$640 total disallowed loss on the deemed asset disposition multiplied by the loss allocation fraction, the numerator of which is \$375, the loss realized on the deemed disposition of Asset 2, and the denominator of which is \$1,500, the sum of the losses realized on the deemed disposition of Assets 2 and 3). The portion of the disallowed loss allocated to Asset 3 is \$480 (\$640 total disallowed loss on the deemed asset disposition multiplied by the loss allocation fraction, the numerator of which is \$1,125, the loss realized on the deemed disposition of Asset 3, and the denominator of which is \$1,500, the sum of the losses realized on the deemed disposition of Assets 2 and 3). Accordingly, Old Target recognizes \$780 of gain on Asset 1, recognizes \$215 of loss on Asset 2 (realized loss of \$375 less allocated disallowed loss of \$160), and recognizes \$645 of loss on Asset 3 (realized loss of \$1,125 less allocated disallowed loss of \$480) or a recognized net loss of \$80 on the deemed asset disposition.

Example 2. (i) *Facts.* The facts are the same as in *Example 1* except that Asset 2 is 100 shares of common stock of Target Subsidiary, a wholly-owned subsidiary of Target. The value of Target Subsidiary common stock on July 1 is \$40 per share. Target Subsidiary has two assets, Asset 4 with a basis of \$500 and Asset 5 with a basis of \$3,000. Target Subsidiary has no liabilities. A section 336(e) election is also made with respect to Target Subsidiary.

(ii) *Consequences—Target.* The ADADP on the deemed sale of Target's assets is determined and allocated in the same manner as in *Example 1*. However, Old Target's loss realized on the deemed sale of Target Subsidiary is disregarded in determining the amount of the disallowed loss on the deemed asset disposition of Old Target's assets. Thus, the realized net loss is only \$345 (\$780 gain on Asset 1 and \$1,125 loss on Asset 3), and the amount of disallowed loss equals \$307, the \$345 realized net loss multiplied by the disallowed loss fraction with respect to Target stock,

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\$8,000/\$9,000. The entire disallowed loss is allocated to Asset 3. Accordingly, Old Target recognizes \$780 of gain on Asset 1 and recognizes \$818 of loss on Asset 3 (realized loss of \$1,125 less allocated disallowed loss of \$307) or a recognized net loss of \$38 on the deemed asset disposition.

(iii) *Consequences—Target Subsidiary.* Because the deemed sale of Target Subsidiary is not a transaction described in section 355(d)(2) or (e)(2), the tax consequences of the deemed sale of Target Subsidiary are determined under paragraph (b)(1) of this section and not this paragraph (b)(2). The deemed sale of the stock of Target Subsidiary is disregarded and instead Target Subsidiary is deemed to sell all of its assets to an unrelated person. The ADADP on the deemed asset disposition of Target Subsidiary as determined under § 1.336-3 is \$3,300. Assume that the ADADP is allocated \$900 to Asset 4 and \$2,400 to Asset 5 under § 1.336-3. Old Target Subsidiary realized a net loss of \$200 on the deemed asset disposition (\$400 gain realized on Asset 4 and \$600 loss realized on Asset 5). However, because a portion of Target stock was distributed during the 12-month disposition period, for purposes of determining the amount of disallowed loss on the deemed sale of the assets of Target Subsidiary, the portion of the 100 shares of Target Subsidiary stock deemed sold pursuant to the section 336(e) election for Target Subsidiary multiplied by the disallowed loss fraction with respect to Target stock are treated as having been distributed. Thus, for purposes of determining the amount of disallowed loss on the deemed asset disposition of Target Subsidiary's assets, 88.89 shares of Target Subsidiary common stock (100 shares owned by Target multiplied by the disallowed loss fraction with respect to Target stock, \$8,000/\$9,000) are treated as distributed during the 12-month disposition period. The total amount of disallowed loss with respect to the deemed asset disposition of Target Subsidiary's assets equals \$177.78 (\$200 net loss realized on the deemed disposition of Assets 4 and 5 multiplied by the disallowed loss fraction with respect to Target Subsidiary, the numerator of which is \$3,556, the value on July 1, the disposition date, of the 88.89 shares of Target Subsidiary common stock deemed distributed during the 12-month disposition period (88.89 shares × \$40) and the denominator of which is \$4,000 (the sum of \$444, the value on July 1 of the 11.11 shares of Target Subsidiary common stock deemed sold in the qualified stock disposition pursuant to the section 336(e) election for Target Subsidiary (11.11 shares × \$40) and \$3,556, the value on July 1 of the 88.89 shares of Target Subsidiary common stock deemed distributed during the 12-month disposition period)). All of the disallowed loss is allocated to Asset 5, the only loss asset. Accordingly, Old Target Subsidiary recognizes \$400 of gain

on Asset 4 and recognizes \$422.22 of loss on Asset 5 (realized loss of \$600 less allocated disallowed loss of \$177.78) or a recognized net loss of \$22.22 on the deemed asset disposition.

(C) *Tiered targets.* In the case of parent-subsidiary chains of corporations making section 336(e) elections, the deemed asset disposition of a higher-tier subsidiary is considered to precede the deemed asset disposition of a lower-tier subsidiary.

(ii) *Old target—deemed purchase—(A) In general.* Immediately after the deemed asset disposition described in paragraph (b)(2)(i)(A) of this section, old target is treated as acquiring all of its assets from an unrelated person in a single, separate transaction at the close of the disposition date (but before the distribution described in paragraph (b)(2)(iii)(A) of this section) in exchange for an amount equal to the AGUB as determined under § 1.336-4. Old target allocates the consideration deemed paid in the transaction in the same manner as new target would under §§ 1.338-6 and 1.338-7 in order to determine the basis in each of the purchased assets.

(B) *Tiered targets.* In the case of parent-subsidiary chains of corporations making section 336(e) elections with respect to a qualified stock disposition described, in whole or in part, in section 355(d)(2) or (e)(2), old target's deemed purchase of all its assets is considered to precede the deemed asset disposition of a lower-tier subsidiary.

(C) *Application of section 197(f)(9), section 1091, and other provisions to old target.* Solely for purposes of section 197(f)(9), section 1091, and any other provision designated in the Internal Revenue Bulletin by the Internal Revenue Service (see § 601.601(d)(2)(ii) of this chapter), old target, in its capacity as seller of assets in the deemed asset disposition described in paragraph (b)(2)(i)(A) of this section, shall be treated as a separate and distinct taxpayer from, and unrelated to, old target in its capacity as acquirer of assets in the deemed purchase described in paragraph (b)(2)(ii)(A) of this section and for subsequent periods.

(iii) *Seller—distribution of target stock—(A) In general.* Immediately after old target's deemed purchase of its assets described in paragraph (b)(2)(ii) of

this section, seller is treated as distributing the stock of old target actually distributed to its shareholders in the qualified stock disposition. No gain or loss is recognized by seller on the distribution. Additionally, if stock of target is sold, exchanged, or distributed outside of the section 355 transaction but still as part of a qualified stock disposition described, in whole or in part, in section 355(d)(2) or (e)(2), no gain or loss is recognized by seller on such sale, exchange, or distribution.

(B) *Tiered targets.* In the case of parent-subsidary chains of corporations making section 336(e) elections with respect to a qualified stock disposition described, in whole or in part, in section 355(d)(2) or (e)(2), the Federal income tax consequences of the section 336(e) election for a subsidiary of target shall be determined under paragraph (b)(1) of this section unless the stock of the subsidiary of target is actually disposed of in a qualified stock disposition described, in whole or in part, in section 355(d)(2) or (e)(2). The deemed liquidation of a lower-tier subsidiary pursuant to paragraph (b)(1)(iii) of this section is considered to precede the deemed liquidation of a higher-tier subsidiary. The deemed liquidation of the highest tier subsidiary of target is considered to precede the distribution of old target stock described in paragraph (b)(2)(iii)(A) of this section.

(iv) *Seller—retention of target stock.* If seller retains any target stock after the disposition date, seller is treated as having disposed of the old target stock so retained, on the disposition date, in a transaction in which no gain or loss is recognized, and then, on the day after the disposition date, purchasing the stock so retained from an unrelated person for its fair market value. The holding period for the retained stock starts on the day after the disposition date. For purposes of this paragraph (b)(2)(iv), the fair market value of all of the target stock equals the grossed-up amount realized on the sale, exchange, or distribution of recently disposed stock of target (see § 1.336-3(c)).

(v) *Qualification under section 355.* Old target's deemed sale of all its assets to an unrelated person and old target's deemed purchase of all its assets from

an unrelated person will not cause the distribution of old target to fail to satisfy the requirements of section 355. Similarly, any deemed transactions under paragraph (b)(1) or (b)(2) of this section that a subsidiary of target is treated as engaging in will not cause the distribution of old target to fail to satisfy the requirements of section 355. For purposes of applying section 355(a)(1)(D), seller is treated as having disposed of any stock disposed of in the qualified stock disposition on the date seller actually sold, exchanged, or distributed such stock. Further, seller's deemed disposition of retained old target stock under paragraph (b)(2)(iv) of this section is disregarded for purposes of applying section 355(a)(1)(D).

(vi) *Earnings and profits.* The earnings and profits of seller and target shall be determined pursuant to § 1.312-10 and, if applicable, § 1.1502-33(e). For this purpose, target will not be treated as a newly created controlled corporation and any increase or decrease in target's earnings and profits pursuant to the deemed asset disposition will increase or decrease, as the case may be, target's earnings and profits immediately before the allocation described in § 1.312-10.

(c) *Purchaser.* Generally, the making of a section 336(e) election will not affect the Federal income tax consequences to which purchaser would have been subject with respect to the acquisition of target stock if a section 336(e) election was not made. Thus, notwithstanding §§ 1.336-2(b)(1)(i)(A), 1.336-2(b)(1)(iv), and 1.336-2(b)(2)(iii)(A), purchaser will still be treated as having purchased, received in an exchange, or received in a distribution, the stock of target so acquired on the date actually acquired. However, see section 1223(1)(B) with respect to the holding period for stock acquired pursuant to a distribution qualifying under section 355 (or so much of section 356 that relates to section 355). The Federal income tax consequences of the deemed asset disposition and liquidation of target may affect purchaser's consequences. For example, if seller distributes the stock of target to its shareholders in a qualified stock disposition for which a section 336(e) election is made, any increase in seller's

earnings and profits as a result of old target's deemed asset disposition and liquidation into seller may increase the amount of a distribution to the shareholders constituting a dividend under section 301(c)(1).

(d) *Minority shareholders*—(1) *In general.* This paragraph (d) describes the treatment of shareholders of old target other than seller, a member of seller's consolidated group, and S corporation shareholders (whether or not they sell or exchange their stock of target). A shareholder to which this paragraph (d) applies is referred to as a minority shareholder.

(2) *Sale, exchange, or distribution of target stock by a minority shareholder.* A minority shareholder recognizes gain or loss (as permitted under the general principles of tax law) on its sale, exchange, or distribution of target stock.

(3) *Retention of target stock by a minority shareholder.* A minority shareholder who retains its target stock does not recognize gain or loss under this section with respect to its shares of target stock. The minority shareholder's basis and holding period for that target stock are not affected by the section 336(e) election. Notwithstanding this treatment of the minority shareholder, if a section 336(e) election is made, target will still be treated as disposing of all of its assets in the deemed asset disposition.

(e) *Treatment consistent with an actual asset disposition.* Except as otherwise provided, no provision in this section shall produce a Federal income tax result under subtitle A of the Internal Revenue Code that would not occur if the parties had actually engaged in the transactions deemed to occur because of this section, taking into account other transactions that actually occurred or are deemed to occur. See § 1.338-1(a)(2) regarding the application of other rules of law.

(f) *Treatment of target under other provisions of the Internal Revenue Code.* The provisions § 1.338-1(b) apply with respect to the treatment of new target after a section 336(e) election, treating any reference to section 338 or 338(h)(10) as a reference to section 336(e).

(g) *Special rules*—(1) *Target as two corporations.* Although target is a single

corporation under corporate law, if a section 336(e) election is made, then, except with respect to a distribution described in section 355(d)(2) or (e)(2) and as provided in § 1.338-1(b)(2), two separate corporations, old target and new target, generally are considered to exist for purposes of subtitle A of the Internal Revenue Code.

(2) *Treatment of members of a consolidated group.* For purposes of §§ 1.336-1 through 1.336-5, all members of seller's consolidated group are treated as a single seller, regardless of which member or members actually dispose of any stock. Accordingly, any dispositions of stock made by members of the same consolidated group shall be treated as made by one corporation, and any stock owned by members of the same consolidated group and not disposed of will be treated as stock retained by seller.

(3) *International provisions*—(i) *Source and foreign tax credit.* The principles of section 338(h)(16) apply to section 336(e) elections for targets with foreign operations to ensure that the source and foreign tax credit limitation are properly determined.

(ii) *Allocation of foreign taxes*—(A) *General rule.* Except as provided in paragraph (g)(3)(ii)(B) of this section, if a section 336(e) election is made for target and target's taxable year under foreign law (if any) does not close at the end of the disposition date, foreign tax paid or accrued by new target with respect to such foreign taxable year is allocated between old target and new target. If there is more than one section 336(e) election with respect to target during target's foreign taxable year, foreign tax paid or accrued with respect to that foreign taxable year is allocated among all old targets and new targets. The allocation is made based on the respective portions of the taxable income (as determined under foreign law) for the foreign taxable year that are attributable under the principles of § 1.1502-76(b) to the period of existence of each old target and new target during the foreign taxable year.

(B) *Taxes imposed on partnerships and disregarded entities.* If a section 336(e) election is made for target and target holds an interest in a disregarded entity or partnership, the rules of § 1.901-

2(f)(4) apply to determine the person who is considered for U.S. Federal income tax purposes to pay foreign tax imposed at the entity level on the income of the disregarded entity or partnership.

(iii) *Disallowance of foreign tax credits under section 901(m)*. For rules that may apply to disallow foreign tax credits with respect to income not subject to United States taxation by reason of a covered asset acquisition, see section 901(m).

(h) *Making the section 336(e) election—(1) Consolidated group*. If seller(s) and target are members of the same consolidated group, a section 336(e) election is made by completing the following requirements:

(i) Seller(s) and target must enter into a written, binding agreement, on or before the due date (including extensions) of the consolidated group's consolidated Federal income tax return for the taxable year that includes the disposition date, to make a section 336(e) election;

(ii) The common parent of the consolidated group must retain a copy of the written agreement;

(iii) The common parent of the consolidated group must attach the section 336(e) election statement, described in paragraphs (h)(5) and (6) of this section, to the group's timely filed (including extensions) consolidated Federal income tax return for the taxable year that includes the disposition date; and

(iv) The common parent of the consolidated group must provide a copy of the section 336(e) election statement to target on or before the due date (including extensions) of the consolidated group's consolidated Federal income tax return.

(2) *Non-consolidated/non-S corporation target*. If target is neither a member of the same consolidated group as seller nor an S corporation, a section 336(e) election is made by completing the following requirements:

(i) Seller and target must enter into a written, binding agreement, on or before the due date (including extensions) of seller's or target's Federal income tax return for the taxable year that includes the disposition date, whichever

is earlier, to make a section 336(e) election;

(ii) Seller and target each must retain a copy of the written agreement; and

(iii) Seller and target each must attach the section 336(e) election statement, described in paragraphs (h)(5) and (6) of this section, to its timely filed (including extensions) Federal income tax return for the taxable year that includes the disposition date. However, seller's section 336(e) election statement may disregard paragraph (h)(6)(xii) of this section (concerning a gain recognition election).

(3) *S corporation target*. A section 336(e) election for an S corporation target is made by completing the following requirements:

(i) All of the S corporation shareholders, including those who do not dispose of any stock in the qualified stock disposition, and the S corporation target must enter into a written, binding agreement, on or before the due date (including extensions) of the Federal income tax return of the S corporation target for the taxable year that includes the disposition date, to make a section 336(e) election;

(ii) S corporation target must retain a copy of the written agreement; and

(iii) S corporation target must attach the section 336(e) election statement, described in paragraphs (h)(5) and (6) of this section, to its timely filed (including extensions) Federal income tax return for the taxable year that includes the disposition date.

(4) *Tiered targets*. In the case of parent-subsidiary chains of corporations making section 336(e) elections, in order to make a section 336(e) election for a lower-tier target (target subsidiary), the requirements described in paragraph (h)(1) or (h)(2), of this section, whichever is applicable to the qualified stock disposition of target subsidiary, must be satisfied. The written agreement described in paragraph (h)(1) or (h)(2) of this section for the section 336(e) election with respect to target subsidiary may be either a separate written agreement between target subsidiary and the corporation deemed

to dispose of the stock of target subsidiary or may be included in the written agreement between seller(s) (or the S corporation shareholders) and target.

(5) *Section 336(e) election statement*—(i) *In general.* The section 336(e) election statement must be entitled “THIS IS AN ELECTION UNDER SECTION 336(e) TO TREAT THE DISPOSITION OF THE STOCK OF [insert name and employer identification number of target] AS A DEEMED SALE OF SUCH CORPORATION’S ASSETS.” The section 336(e) election statement must include the information described in paragraph (h)(6) of this section. The relevant information for each S corporation shareholder and, notwithstanding paragraph (g)(2) of this section, each consolidated group member that disposes of or retains target stock must be set forth individually, not in the aggregate.

(ii) *Target subsidiaries.* In the case of a section 336(e) election for a target subsidiary, a separate statement must be filed for each target subsidiary. In preparing the section 336(e) election statement with respect to a target subsidiary, any reference to seller in paragraph (h)(6) of this section should be considered a reference to the corporation deemed to dispose of the stock of the target subsidiary and any reference to target in paragraphs (h)(5)(i) and (h)(6) of this section should be considered a reference to the target subsidiary.

(6) *Contents of section 336(e) election statement.* The section 336(e) election statement must include:

(i) The name, address, taxpayer identifying number (TIN), taxable year, and state of incorporation (if any) of the seller(s) or the S corporation shareholder(s);

(ii) The name, address, employer identification number (EIN), taxable year, and state of incorporation of the common parent, if any, of seller(s);

(iii) The name, address, EIN, taxable year, and state of incorporation of target;

(iv) The name, address, TIN, taxable year, and state of incorporation (if any) of any 80-percent purchaser;

(v) The name, address, TIN, taxable year, and state of incorporation (if any) of any purchaser that holds non-

recently disposed stock within the meaning of § 1.336-1(b)(18);

(vi) The disposition date;

(vii) The percentage of target stock that was disposed of by each seller or S corporation shareholder in the qualified stock disposition;

(viii) The percentage of target stock that was disposed of by each seller or S corporation shareholder in the qualified stock disposition on or before the disposition date;

(ix) A statement regarding whether target realized a net loss on the deemed asset disposition;

(x) If target realized a net loss on the deemed asset disposition, a statement regarding whether any stock of target or that of any higher-tier corporation up through the highest-tier corporation for which a section 336(e) election was made by any seller(s) or S corporation shareholder(s) was distributed during the 12-month disposition period. If so, also provide a statement regarding whether any stock of target or that of any higher-tier corporation up through the highest-tier corporation for which a section 336(e) election was made was actually sold or exchanged (rather than deemed sold in a deemed asset disposition) by any seller(s) or S corporation shareholder(s) in a qualified stock disposition;

(xi) The percentage of target stock that was retained by each seller or S corporation shareholder after the disposition date;

(xii) The name, address, and TIN of any purchaser that made a gain recognition election pursuant to § 1.336-4(c). A copy of the gain recognition election statement must be retained by the filer of the section 336(e) election statement designated as the appropriate party in § 1.336-4(c)(3); and

(xiii) A statement that each of the seller(s) or S corporation shareholder(s) (as applicable) and target have executed a written, binding agreement to make a section 336(e) election.

(7) *Asset Allocation Statement.* Old target and new target must report information concerning the deemed sale of target’s assets on Form 8883, “Asset Allocation Statement Under Section 338,” (making appropriate adjustments to report the results of the section 336(e) election), or on any successor

form prescribed by the Internal Revenue Service, in accordance with forms, instructions, or other appropriate guidance provided by the Internal Revenue Service. In addition, in the case of a section 336(e) election as the result of a transaction described in section 355(d)(2) or (e)(2), old target should file two Forms 8883, (or successor forms), one in its capacity as the seller of the assets in the deemed asset disposition described in paragraph (b)(2)(i) of this section and one in its capacity as the purchaser of the assets in the deemed purchase described in paragraph (b)(2)(ii) of this section.

(8) *Examples.* The following examples illustrate the provisions of paragraph (h) of this section.

Example 1. (i) *Facts.* Seller owns all of the stock of Target and Target owns all of the stock of Target Subsidiary. Seller is the common parent of a consolidated group that includes Target. However, Target Subsidiary is not included in the consolidated group pursuant to section 1504(a)(3). On Date 1, Seller sells 80 percent of its Target stock to A and distributes the remaining 20 percent of Target stock to Seller's unrelated shareholders.

(ii) *Making of election for Target.* Because Seller and Target are members of a consolidated group, in order to make a section 336(e) election for the qualified stock disposition of Target, the requirements of paragraph (h)(1) of this section must be satisfied. On or before the due date of Seller group's consolidated Federal income tax return that includes Date 1, Seller and Target must enter into a written, binding agreement to make a section 336(e) election; Seller must retain a copy of the written agreement; Seller must attach the section 336(e) election statement to the group's timely filed consolidated return for the taxable year that includes Date 1, and Seller must provide a copy of the section 336(e) election statement to Target on or before the due date (including extensions) of the consolidated return.

(iii) *Making of election for Target Subsidiary.* Because Target and Target Subsidiary do not join in the filing of a consolidated Federal income tax return and Target Subsidiary is not an S corporation, in order to make a section 336(e) election for the qualified stock disposition of Target Subsidiary, the requirements of paragraph (h)(2) of this section must be satisfied. On or before the due date of Seller group's consolidated Federal income tax return that includes Date 1, or Target Subsidiary's Federal income tax return that includes Date 1, whichever is earlier, either Target Subsidiary must join in the written agreement described in paragraph (ii) of

this *Example 1* to make a section 336(e) election with respect to the qualified stock disposition of Target Subsidiary or Target and Target Subsidiary must enter into a separate written, binding agreement to make a section 336(e) election with respect to the qualified stock disposition of Target Subsidiary; Seller (as agent of the consolidated group that includes Target) and Target Subsidiary each must retain a copy of the written agreement; and Seller (as agent of the consolidated group that includes Target) and Target Subsidiary each must attach the section 336(e) election statement with respect to the qualified stock disposition of Target Subsidiary to its timely filed Federal income tax return for the taxable year that includes Date 1. In preparing the section 336(e) election statement, paragraph (i) of the statement should include the relevant information for Target, paragraph (ii) of the statement should include the relevant information for Seller, paragraph (iii) of the statement should include the relevant information for Target Subsidiary, paragraphs (vii) through (xi) of the statement should provide information for both Seller's actual sale and distribution of Target stock as well as information for Target's deemed sale of Target Subsidiary stock, and paragraph (xiii) of the statement should include a statement that Seller, Target, and Target Subsidiary, or Target and Target Subsidiary, whichever is appropriate, have executed a written, binding agreement to make a section 336(e) election with respect to the qualified stock disposition of Target Subsidiary.

Example 2. (i) *Facts.* A and B each own 45 percent and C owns the remaining 10 percent of the stock of S Corporation Target, an S corporation. S Corporation Target owns 80 percent of the stock of Target Subsidiary and D owns the remaining 20 percent. On Date 1, A and B each sell all of their S Corporation Target stock to an unrelated individual. C retains his 10 percent of the stock of S Corporation Target.

(ii) *Making of election for S Corporation Target.* Because S Corporation Target is an S Corporation Target, in order to make a section 336(e) election for the qualified stock disposition of S Corporation Target, the requirements of paragraph (h)(3) of this section must be satisfied. On or before the due date of S Corporation Target's Federal income tax return that includes Date 1, A, B, C, and S Corporation Target must enter into a written, binding agreement to make a section 336(e) election; S Corporation Target must retain a copy of the written agreement; and S Corporation Target must attach the section 336(e) election statement to its timely filed Federal income tax return for the taxable year that includes Date 1.

(iii) *Making of election for Target Subsidiary.* Because Target Subsidiary is neither a member of the same consolidated group as S Corporation Target nor is an S corporation, in order to make a section 336(e) election for the qualified stock disposition of Target Subsidiary, the requirements of paragraph (h)(2) of this section must be satisfied. On or before the due date of S Corporation Target's Federal income tax return that includes Date 1, or Target Subsidiary's Federal income tax return that includes Date 1, whichever is earlier, either Target Subsidiary must join in the written agreement described in paragraph (ii) of this *Example 2* to make a section 336(e) election with respect to the qualified stock disposition of Target Subsidiary or S Corporation Target and Target Subsidiary must enter into a separate written, binding agreement to make a section 336(e) election with respect to the qualified stock disposition of Target Subsidiary; S Corporation Target and Target Subsidiary each must retain a copy of the written agreement; and S Corporation Target and Target Subsidiary each must attach the section 336(e) election statement to its timely filed Federal income tax return for the taxable year that includes Date 1. In preparing the section 336(e) election statement, paragraph (i) of the statement should include the relevant information for S Corporation Target, paragraph (iii) of the statement should include the relevant information for Target Subsidiary, paragraphs (vii) through (xi) of the statement should provide information for both A's and B's actual sale and C's actual retention of S Corporation Target stock as well as information for S Corporation Target's deemed sale of Target Subsidiary stock, and paragraph (xiii) of the statement should include a statement that A, B, C, S Corporation Target, and Target Subsidiary, or S Corporation Target and Target Subsidiary, whichever is appropriate, have executed a written, binding agreement to make a section 336(e) election with respect to the qualified stock disposition of Target Subsidiary.

(i) [Reserved]

(j) *Protective section 336(e) election.* Taxpayers may make a protective election under section 336(e) in connection with a transaction. Such an election will have no effect if the transaction does not constitute a qualified stock disposition, as defined in § 1.336-1(b)(6), but will otherwise be binding and irrevocable.

(k) *Examples.* The following examples illustrate the provisions of this section.

Example 1. Sale of 100 percent of Target stock.

(i) *Facts.* Parent owns all 100 shares of Target's only class of stock. Target's only assets

are two parcels of land. Parcel 1 has a basis of \$5,000 and Parcel 2 has a basis of \$4,000. Target has no liabilities. On July 1 of Year 1, Parent sells all 100 shares of Target stock to A for \$100 per share. Parent incurs no selling costs and A incurs no acquisition costs. On July 1, the value of Parcel 1 is \$7,000 and the value of Parcel 2 is \$3,000. A section 336(e) election is made.

(ii) *Consequences.* The sale of Target stock constitutes a qualified stock disposition. July 1 of Year 1 is the disposition date. Accordingly, pursuant to the section 336(e) election, for Federal income tax purposes, rather than treating Parent as selling the stock of Target to A, the following events are deemed to occur. Target is treated as if, on July 1, it sold all of its assets to an unrelated person in exchange for the ADADP of \$10,000, which is allocated \$7,000 to Parcel 1 and \$3,000 to Parcel 2 (see §§ 1.336-3 and 1.336-6 for determination of amount and allocation of ADADP). Target recognizes gain of \$2,000 on Parcel 1 and loss of \$1,000 on Parcel 2. New Target is then treated as acquiring all its assets from an unrelated person in a single transaction in exchange for the amount of the AGUB of \$10,000, which is allocated \$7,000 to Parcel 1 and \$3,000 to Parcel 2 (see §§ 1.336-4, 1.338-5, and 1.338-6 for determination of amount and allocation of AGUB). Old Target is treated as liquidating into Parent immediately thereafter, distributing the \$10,000 deemed received in exchange for Parcel 1 and Parcel 2 in a transaction qualifying under section 332. Parent recognizes no gain or loss on the liquidation. A's basis in New Target stock is \$100 per share, the amount paid for the stock.

Example 2. Sale of 80 percent of Target stock.

(i) *Facts.* The facts are the same as in *Example 1* except that Parent only sells 80 shares of its Target stock to A and retains the other 20 shares.

(ii) *Consequences.* The results are the same as in *Example 1* except that Parent also is treated as purchasing from an unrelated person on July 2, the day after the disposition date, the 20 shares of Target stock (New Target stock) not sold to A, for their fair market value as determined under § 1.336-2(b)(1)(v) of \$2,000 (\$100 per share).

Example 3. Distribution of 100 percent of Target stock.

(i) *Facts.* The facts are the same as in *Example 1* except that instead of on July 1 Parent selling 100 shares of Target stock to A, Parent distributes 100 shares to its shareholders, all of whom are unrelated to Parent, in a transaction that does not qualify under section 355. The value of Target stock on July 1 is \$100 per share.

(ii) *Consequences.* The distribution of Target stock constitutes a qualified stock disposition. July 1 of Year 1 is the disposition date. Accordingly, pursuant to the section

336(e) election, for Federal income tax purposes, rather than treating Parent as distributing the stock of Target to its shareholders, the following events are deemed to occur. Target is treated as if, on July 1, it sold all of its assets to an unrelated person in exchange for the ADADP of \$10,000, which is allocated \$7,000 to Parcel 1 and \$3,000 to Parcel 2 (see §§ 1.336-3 and 1.338-6 for determination of amount and allocation of ADADP). Target recognizes gain of \$2,000 on Parcel 1 and loss of \$1,000 on Parcel 2. Because Target's losses realized on the deemed asset disposition do not exceed Target's gains realized on the deemed asset disposition, Target can recognize all of the losses from the deemed asset disposition (see § 1.336-2(b)(1)(i)(B)). New Target is then treated as acquiring all its assets from an unrelated person in a single transaction in exchange for the amount of the AGUB of \$10,000, which is allocated \$7,000 to Parcel 1 and \$3,000 to Parcel 2 (see §§ 1.336-4, 1.338-5, and 1.338-6 for determination of amount and allocation of AGUB). Old Target is treated as liquidating into Parent immediately thereafter, distributing the \$10,000 deemed received in exchange for Parcel 1 and Parcel 2 in a transaction qualifying under section 332. Parent recognizes no gain or loss on the liquidation. On July 1, immediately after the deemed liquidation of Target, Parent is deemed to purchase from an unrelated person 100 shares of New Target stock and distribute those New Target shares to its shareholders. Parent recognizes no gain or loss on the deemed distribution of the shares under § 1.336-2(b)(1)(iv). The shareholders receive New Target stock as a distribution pursuant to section 301 and their basis in New Target stock received is its fair market value pursuant to section 301(d).

Example 4. Distribution of 80 percent of Target stock. (i) *Facts.* The facts are the same as in *Example 3* except that Parent distributes only 80 shares of Target stock to its shareholders and retains the other 20 shares.

(ii) *Consequences.* The results are the same as in *Example 3* except that Parent is treated as purchasing on July 1 only 80 shares of New Target stock and as distributing only 80 shares of New Target stock to its shareholders and then as purchasing (and retaining) on July 2, the day after the disposition date, 20 shares of New Target stock at their fair market value as determined under § 1.336-2(b)(1)(v), \$2,000 (\$100 per share).

Example 5. Part sale, part distribution. (i) *Facts.* Parent owns all 100 shares of Target's only class of stock. Target has two assets, both of which are buildings used in its business. Building 1 has a basis of \$6,000 and Building 2 has a basis of \$5,100. Target has no liabilities. On January 1 of Year 1, Parent sells 50 shares of Target to A for \$88 per share. Parent incurred no selling costs with respect to the sale of Target stock and A incurred no acquisition costs with respect to

the purchase. On July 1 of Year 1, when the value of Target stock is \$120 per share, Parent distributes 30 shares of Target to Parent's unrelated shareholders. Parent retains the remaining 20 shares. On July 1, the value of Building 1 is \$7,800 and the value of Building 2 is \$4,200. A section 336(e) election is made.

(ii) *Consequences.* Because the sale of the 50 shares and the distribution of the 30 shares occurred within a 12-month disposition period, the 80 shares of Target stock sold and distributed were disposed of in a qualified stock disposition. July 1 of Year 1 is the disposition date. On July 1, Target is treated as if it sold its assets to an unrelated person in exchange for the ADADP, \$10,000 ((50 shares × \$88) + (30 shares × \$120))/80 (\$9,600 (80 shares × \$120)/\$12,000 (100 shares × \$120))), which is allocated to Buildings 1 and 2 in proportion to their fair market values, \$6,500 to Building 1 and \$3,500 to Building 2 (see §§ 1.336-3 and 1.338-6 for determination of amount and allocation of ADADP). Target realizes a gain of \$500 on the deemed sale of Building 1 (\$6,500-\$6,000). Target realizes a loss of \$1,600 on the deemed sale of Building 2 (\$3,500-\$5,100). Target recognizes all of its gains on the deemed asset disposition. However, because 30 shares of Target stock were distributed during the 12-month disposition period and there was a net loss of \$1,100 realized on the deemed disposition of Buildings 1 and 2, \$413 of the loss on the deemed sale is disallowed (see § 1.336-2(b)(1)(i)(B)(2) for the determination of the disallowed loss amount). New Target is then treated as acquiring all its assets from an unrelated person in a single transaction in exchange for the amount of the AGUB, \$10,000 ((50 shares × \$88) + (30 shares × \$120)) × 1.25 ((100-0)/80)), which is allocated to Buildings 1 and 2 in proportion to their fair market values, \$6,500 to Building 1 and \$3,500 to Building 2 (see §§ 1.336-4, 1.338-5, and 1.338-6 for determination of amount and allocation of AGUB). Old Target is treated as liquidating into Parent immediately after the deemed asset disposition, distributing the \$10,000 deemed received in exchange for its assets in a transaction qualifying under section 332. Parent recognizes no gain or loss on the liquidation. Parent is then deemed to purchase 30 shares of New Target stock from an unrelated person on July 1, and to distribute those 30 New Target shares to its shareholders. Parent recognizes no gain or loss on the deemed distribution of the 30 shares under § 1.336-2(b)(1)(iv). Parent is then deemed to purchase (and retain) on July 2, the day after the disposition date, 20 shares of New Target stock at their fair market value as determined under § 1.336-2(b)(1)(v), \$2,000 (\$100 per share (20 shares multiplied by \$100 fair market value per share (\$10,000 grossed-up amount realized on the sale and

distribution of 80 shares of target stock divided by 100 shares)). A is treated as having purchased the 50 shares of New Target stock on January 1 of Year 1 at a cost of \$88 per share, the same as if no section 336(e) election had been made. Parent's shareholders are treated as receiving New Target stock on July 1 of Year 1 as a distribution pursuant to section 301 and their basis in New Target stock received is \$120 per share, its fair market value, pursuant to section 301(d), the same as if no section 336(e) election had been made.

Example 6. Sale of Target stock by consolidated group members. (i) *Facts.* Parent owns all of the stock of Sub and 50 of the 100 outstanding shares of Target stock. Sub owns the remaining 50 shares of Target stock. Target's assets have an aggregate basis of \$9,000. Target has no liabilities. Parent, Sub, and Target file a consolidated Federal income tax return. On February 1 of Year 1, Parent sells 30 shares of its Target stock to A for \$2,400. On March 1 of Year 1, Sub sells all 50 shares of its Target stock to B for \$5,600. Neither Parent nor Sub incurred any selling costs. Neither A nor B incurred any acquisition costs. A section 336(e) election is made.

(ii) *Consequences.* Because Parent and Sub are members of the same consolidated group, their sale of Target stock is treated as made by one seller (see paragraph (g)(2) of this section), and the sales of Target stock constitute a qualified stock disposition. March 1 of Year 1 is the disposition date. For Federal income tax purposes, Parent and Sub are not treated as selling the stock of Target to A and B, respectively. Instead, the following events are deemed to occur. Old Target is treated as if, on March 1, it sold all its assets to unrelated person in exchange for the ADADP, \$10,000 (see § 1.336-3 for determination of ADADP), recognizing a net gain of \$1,000. New Target is then treated as acquiring all its assets from an unrelated person in a single transaction in exchange for the amount of the AGUB, \$10,000 (see §§ 1.336-4 and 1.338-5 for the determination of AGUB). Old Target is treated as liquidating into Parent and Sub immediately thereafter, distributing the \$10,000 deemed received in exchange for its assets in a transaction qualifying under section 332 (see § 1.1502-34). Neither Parent nor Sub recognizes gain or loss on the liquidation. Parent is then treated as purchasing from an unrelated person on March 2, the day after the disposition date, the 20 shares of Target stock (New Target stock) retained for their fair market value as determined under § 1.336-2(b)(1)(v), \$2,000 (\$100 per share). A is treated as having purchased 30 shares of New Target stock on February 1 of Year 1 at a cost of \$2,400 (\$80 per share), the same as if no section 336(e) election had been made. B is treated as having purchased 50 shares of New Target stock on March 1 of Year 1 at a cost of \$5,600 (\$112 per share), the

same as if no section 336(e) election had been made.

Example 7. Sale of Target stock by non-consolidated group members. (i) *Facts.* The facts are the same as in *Example 6* except that Parent, Sub, and Target do not join in the filing of a consolidated Federal income tax return.

(ii) *Consequences.* Because Parent and Sub do not join in the filing of a consolidated Federal income tax return and no single seller sells, exchanges, or distributes Target stock meeting the requirements of section 1504(a)(2), the transaction does not constitute a qualified stock disposition. The section 336(e) election made with respect to the disposition of Target stock has no effect.

Example 8. Distribution of 80 percent of Target stock in complete redemption of a greater-than-50-percent shareholder. (i) *Facts.* A and B own 51 and 49 shares, respectively, of Seller's only class of stock. Seller owns all 100 shares of Target's only class of stock. Seller distributes 80 shares of Target stock to A in complete redemption of A's 51 shares of Seller in a transaction that does not qualify under section 355. A section 336(e) election is made.

(ii) *Consequences.* Prior to the redemption, Seller and A would be related persons because, under section 318(a)(2)(C), any stock of a corporation that is owned by Seller would be attributed to A because A owns 50 percent or more of the value of the stock of Seller. However, for purposes of §§ 1.336-1 through 1.336-5, the determination of whether Seller and A are related is made immediately after the redemption of A's stock. See §§ 1.336-1(b)(5)(iii) and 1.338-3(b)(3)(ii)(A). After the redemption, A no longer owns any stock of Seller. Accordingly, A and Seller are not related persons, as defined in § 1.336-1(b)(12), and the distribution of Target stock constitutes a qualified stock disposition. For Federal income tax purposes, rather than Seller distributing the stock of Target to A, the following is deemed to occur. Old Target is treated as if it sold its assets to an unrelated person. New Target is then treated as acquiring all its assets from an unrelated person in a single transaction. Immediately thereafter, Old Target is treated as liquidating into Seller in a transaction qualifying under section 332. Seller recognizes no gain or loss on the liquidation. Seller is then treated as purchasing 80 shares of New Target stock from an unrelated person and then distributing the 80 shares of New Target stock to A in exchange for A's 51 shares of Seller stock. Seller recognizes no gain or loss on the distribution of New Target stock pursuant to § 1.336-2(b)(1)(iv). Seller is then treated as purchasing from an unrelated person on the day after the disposition date the 20 shares of Target stock (New Target stock) retained for their fair market value as determined under § 1.336-2(b)(1)(v). The Federal income tax consequences to A are the same as if no section 336(e) election had been made.

Example 9. Pro-rata distribution of 80 percent of Target stock. (i) *Facts.* A and B own 60 and 40 shares, respectively, of Seller's only class of stock. Seller owns all 100 shares of Target's only class of stock. Seller distributes 48 shares of Target stock to A and 32 shares of Target stock to B in a transaction that does not qualify under section 355. A section 336(e) election is made.

(ii) *Consequences.* Any stock of a corporation that is owned by Seller would be attributed to A under section 318(a)(2)(C) because, after the distribution, A owns 50 percent or more of the value of the stock of Seller. Therefore, after the distribution, A and Seller are related persons, as defined in § 1.336-1(b)(12), and the distribution of Target stock to A is not a disposition. Because only 32 percent of Target stock was sold, exchanged, or distributed to unrelated persons, there has not been a qualified stock disposition. Accordingly, the section 336(e) election made with respect to the distribution of Target stock has no effect.

(h) *Effective/applicability date.* Paragraph (d)(3)(ii) of this section is applicable to any qualified stock purchase or qualified stock disposition (as defined in § 1.336-1(b)(6)) for which the acquisition date or disposition date (as defined in § 1.336-1(b)(8)), respectively, is on or after May 15, 2013.

(h) *Effective/applicability date.* Paragraph (d)(3)(ii) of this section is applicable to any qualified stock purchase or qualified stock disposition (as defined in § 1.336-1(b)(6)) for which the acquisition date or disposition date (as defined in § 1.336-1(b)(8)), respectively, is on or after May 15, 2013.

[T.D. 9619, 78 FR 28474, May 15, 2013; 78 FR 53027, Aug. 28, 2013]

§ 1.336-3 Aggregate deemed asset disposition price; various aspects of taxation of the deemed asset disposition.

(a) *Scope.* This section provides rules under section 336(e) to determine the aggregate deemed asset disposition price (ADADP) for Target. ADADP is the amount for which old Target is deemed to have sold all of its assets in the deemed asset disposition. ADADP is allocated among Target's assets in the same manner as the aggregate deemed sale price (ADSP) is allocated under § 1.338-6 to determine the amount for which each asset is deemed to have been sold. If a subsequent increase or decrease is required under general prin-

ciples of tax law with respect to an element of ADADP, the redetermined ADADP is allocated among Target's assets in the same manner as redetermined ADSP is allocated under § 1.338-7.

(b) *Determination of ADADP—(1) General rule.* ADADP is the sum of—

(i) The grossed-up amount realized on the sale, exchange, or distribution of recently disposed stock of Target; and

(ii) The liabilities of old Target.

(2) *Time and amount of ADADP—(i) Original determination.* ADADP is initially determined at the beginning of the day after the disposition date of Target. General principles of tax law apply in determining the timing and amount of the elements of ADADP.

(ii) *Redetermination of ADADP.* ADADP is redetermined at such time and in such amount as an increase or decrease would be required, under general principles of tax law, for the elements of ADADP. For example, ADADP is redetermined because of an increase or decrease in the amount realized on the sale or exchange of recently disposed stock of Target or because liabilities not originally taken into account in determining ADADP are subsequently taken into account. Increases or decreases with respect to the elements of ADADP result in the reallocation of ADADP among Target's assets in the same manner as ADSP under § 1.338-7.

(c) *Grossed-up amount realized on the disposition of recently disposed stock of Target—(1) Determination of amount.* The grossed-up amount realized on the disposition of recently disposed stock of Target is an amount equal to—

(i) The sum of—

(A) With respect to recently disposed of stock of Target that is not distributed in the qualified stock disposition, the amount realized on the sale or exchange of such recently disposed stock of Target, determined as if seller or S corporation shareholders were required to use old Target's accounting methods and characteristics and the installment method were not available and determined without regard to the selling costs taken into account under paragraph (c)(1)(iii) of this section, and

(B) With respect to recently disposed of stock of Target that is distributed in

the qualified stock disposition, the fair market value of such recently disposed stock of Target determined on the date of each distribution;

(ii) Divided by the percentage of Target stock (by value, determined on the disposition date) attributable to the recently disposed stock;

(iii) Less the selling costs incurred by seller or S corporation shareholders in connection with the sale or exchange of recently disposed stock that reduce its amount realized on the sale or exchange of the stock (for example, brokerage commissions and any similar costs to sell the stock).

(2) *Example.* The following example illustrates this paragraph (c):

Example. Target has two classes of stock outstanding, voting common stock and preferred stock described in section 1504(a)(4). Seller owns all 100 shares of each class of stock. On March 1 of Year 1, Seller sells 10 shares of Target voting common stock to A for \$75. On April 1 of Year 2, Seller distributes 15 shares of Target voting common stock with a fair market value of \$120 to B. On May 1 of Year 2, Seller distributes 10 shares of Target voting common stock with a fair market value of \$110 to C. On July 1 of Year 2, Seller sells 55 shares of Target voting common stock to D for \$550. On July 1 of Year 2, the fair market value of all the Target voting common stock is \$1,000 (\$10 per share) and the fair market value of all the preferred stock is \$600 (\$6 per share). Seller incurs \$20 of selling costs with respect to the sale to A and \$60 of selling costs with respect to the sale to D. The grossed-up amount realized on the sale, exchange, or distribution of recently disposed stock of Target is calculated as follows: The sum of the amount realized on the sale or exchange of recently disposed stock sold or exchanged (without regard to selling costs) and the fair market value of the recently disposed stock distributed is \$780 (\$120 + \$110 + \$550) (the 10 shares sold to A on March 1 of Year 1 is not recently disposed stock because it was not disposed of during the 12-month disposition period). The percentage of Target stock by value on the disposition date attributable to recently disposed stock equals 50% (\$800 (80 shares of recently disposed stock × \$10, the fair market value of each share of Target common stock on the disposition date)/\$1,600 (\$1,000 (the total value of Target's common stock on the disposition date) + \$600 (the total value of Target's preferred stock on the disposition date))). The grossed-up amount realized equals \$1,500 (((\$780/.50) - \$60 selling costs).

(d) *Liabilities of old Target—(1) In general.* In general, the liabilities of old

Target are measured as of the beginning of the day after the disposition date. However, if a Target for which a section 336(e) election is made engages in a transaction outside the ordinary course of business on the disposition date after the event resulting in the qualified stock disposition of Target or a higher-tier corporation, Target and all persons related thereto (either before or after the qualified stock disposition) 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 disposition by old Target. In order to be taken into account in ADADP, a liability must be a liability of Target that is properly taken into account in amount realized under general principles of tax law that would apply if old Target had sold its assets to an unrelated person for consideration that included the discharge of its liabilities. See § 1.1001-2(a). Such liabilities may include liabilities for the tax consequences resulting from the deemed asset disposition.

(2) *Time and amount of liabilities.* The time for taking into account liabilities of old Target in determining ADADP and the amount of the liabilities taken into account is determined as if old Target had sold its assets to an unrelated person for consideration that included the discharge of the liabilities by the unrelated person. For example, if no amount of a Target liability is properly taken into account in amount realized as of the beginning of the day after the disposition date, the liability is not initially taken into account in determining ADADP, but it may be taken into account at some later date.

(e) *Deemed disposition tax consequences.* Gain or loss on each asset in the deemed asset disposition is computed by reference to the ADADP allocated to that asset. ADADP is allocated in the same manner as is ADSP under § 1.338-6. Although deemed disposition tax consequences may increase or decrease ADADP by creating or reducing a tax liability, the amount of the tax liability itself may be a function of the size of the deemed disposition tax consequences. Thus, these

determinations may require trial and error computations.

(f) *Other rules apply in determining ADADP.* ADADP may not be applied in such a way as to contravene other applicable rules. For example, a capital loss cannot be applied to reduce ordinary income in calculating the tax liability on the deemed asset disposition for purposes of determining ADADP.

(g) *Examples.* The following examples illustrate this section.

Example 1. (i) *Facts.* The facts are the same as in *Example 1* of § 1.336-2(b)(1)(i)(B)(3), that is, Parent owns 60 of the 100 outstanding shares of the common stock of Seller, Seller's only class of stock outstanding. The remaining 40 shares of the common stock of Seller are held by shareholders unrelated to Seller or each other. Seller owns 95 of the 100 outstanding shares of Target common stock, and all 100 shares of Target preferred stock that is described in section 1504(a)(4). The remaining 5 shares of Target common stock are owned by A. On January 1 of Year 1, Seller sells 72 shares of Target common stock to B for \$3,520. On July 1 of Year 1, Seller distributes 12 shares of Target common stock to Parent and 8 shares to its unrelated shareholders in a distribution described in section 301. Seller retains 3 shares of Target common stock and all 100 shares of Target preferred stock immediately after July 1. The value of Target common stock on July 1 is \$60 per share. The value of Target preferred stock on July 1 is \$36 per share. Target has three assets, Asset 1, a Class IV asset, with a basis of \$1,776 and a fair market value of \$2,000, Asset 2, a Class V asset, with a basis of \$2,600 and a fair market value of \$2,750, and Asset 3, a Class V asset, with a basis of \$3,900 and a fair market value of \$3,850. Seller incurred no selling costs on the sale of the 72 shares of Target common stock to B. Target has no liabilities. A section 336(e) election is made.

(ii) *Determination of ADADP.* The ADADP on the deemed asset disposition of Target is determined as follows. The grossed-up amount realized on the sale, exchange, or distribution of recently disposed stock of Target is \$8,000, the sum of \$3,520, the amount realized on the sale to B of the 72 shares of Target common stock and \$480, the fair market value on the date distributed of the 8 shares of Target common stock distributed to Seller's unrelated shareholders in the qualified stock disposition, divided by .50, the percentage of Target stock by value, determined on the disposition date, attributable to the recently disposed stock (\$4,800 (80 shares of Target common stock disposed of in the qualified stock disposition \times \$60, the value of a share of Target common stock on the disposition date) divided by \$9,600 ((100, the total number of shares of Target com-

mon stock \times \$60, the value of a share of Target common stock on the disposition date) + (100, the total number of shares of Target preferred stock \times \$36, the value of a share of Target preferred stock on the disposition date))), minus \$0, Seller's selling costs in connection with the sale of the 72 shares of Target common stock sold to B. The \$8,000 grossed-up amount realized on the sale, exchange, or distribution of recently disposed stock of Target is then added to the liabilities of Old Target, \$0, to arrive at the ADADP, \$8,000.

(iii) *Allocation of ADADP.* The ADADP of \$8,000 is allocated first to Asset 1, the Class IV asset, but not in excess of Asset 1's fair market value, \$2,000. The remaining ADADP of \$6,000 is allocated between Assets 2 and 3, both Class V assets, in proportion to their fair market values, but not in excess of their fair market values. Because the total fair market value of Assets 2 and 3, \$6,600, exceeds the ADADP remaining after allocation of a portion of the ADADP to Asset 1, the \$6,000 remaining ADADP is allocated to Assets 2 and 3 in proportion to their respective fair market values. Accordingly, \$2,500 is allocated to Asset 2 ($\$6,000 \times (\$2,750 / (\$2,750 + \$3,850))$) and \$3,500 is allocated to Asset 3 ($\$6,000 \times (\$3,850 / (\$2,750 + \$3,850))$).

Example 2. (i) *Facts.* The facts are the same as in *Example 1* except that Asset 2 is the stock of Target Subsidiary, a corporation of which Target owns 100 of the 110 shares of common stock, the only outstanding class of Target Subsidiary stock. The remaining 10 shares of Target Subsidiary stock are owned by D. The value of Target Subsidiary stock on July 1 is \$27.50 per share. Target Subsidiary has two assets, Asset 4, a Class IV asset, with a basis of \$800 and a fair market value of \$1,000, and Asset 5, a Class IV asset, with a basis of \$2,200 and a fair market value of \$2,025. Target Subsidiary has no liabilities. A section 336(e) election with respect to Target Subsidiary is also made.

(ii) *Determination of ADADP.* The ADADP on the deemed asset disposition of Target Subsidiary is determined as follows. The grossed-up amount realized on the sale, exchange, or distribution of recently disposed stock of Target Subsidiary is \$2,750, (\$2,500 ADADP allocable to Asset 2, the 100 shares of the stock of Target Subsidiary owned by Target, divided by .909, the percentage of Target Subsidiary stock by value, determined on the disposition date, attributable to the recently disposed stock (\$2,750 (100 shares of the stock of Target Subsidiary deemed disposed in the qualified stock disposition \times \$27.50, the value of a share of Target Subsidiary stock on the disposition date) divided by \$3,025 (110, the total number of shares of Target Subsidiary stock \times \$27.50, the value of a share of Target Subsidiary stock on the disposition date)), minus \$0, Seller's selling costs in connection with the

deemed sale of the 100 shares of Target Subsidiary stock). The \$2,750 grossed-up amount realized on the sale, exchange, or distribution of recently disposed stock of Target Subsidiary is then added to the liabilities of Old Target Subsidiary, \$0, to arrive at the ADADP of Target Subsidiary, \$2,750.

(iii) *Allocation of ADADP.* Because Assets 4 and 5 are each assets of the same class, and the total fair market value of Assets 4 and 5 exceeds the \$2,750 ADADP of Target Subsidiary, the \$2,750 ADADP is allocated to Assets 4 and 5 in proportion to their respective fair market values. Accordingly, \$909 is allocated to Asset 4 ($\$2,750 \times (\$1,000/(\$1,000 + \$2,025))$) and \$1,841 is allocated to Asset 5 ($\$2,750 \times (\$2,025/(\$1,000 + \$2,025))$).

Example 3. (i) Seller owns all 100 of the outstanding shares of the common stock of Target, the only class of Target stock outstanding. On January 1 of Year 1, Seller sells 10 shares of Target stock to A for \$6,000 (\$600 per share). On August 1 of Year 1, Seller distributes the remaining 90 shares of Target stock to its unrelated shareholders in a transaction described in section 355(d)(2) or (e)(2). The value of Target stock on August 1 is \$560 per share. Target has two assets, Asset 1, which is stock in trade of Target, a Class IV asset, with a basis of \$15,000 and a value of \$50,000, and Asset 2, which is stock in a publicly traded, unrelated corporation, a Class II asset, with a basis of \$38,000 and a value of \$16,000. Target has no liabilities other than any liabilities for Federal tax on account of the deemed asset disposition. Assume Target's Federal tax rate for any gain or income on the deemed asset disposition is 34 percent. Seller had no selling costs in connection with its sale of the 10 shares of Target stock. A section 336(e) election is made.

(ii) Because at least 80 percent of Target stock was disposed of (within the meaning of § 1.336-1(b)(5)) by Seller during the 12-month disposition period, a qualified stock disposition occurred. August 1 of Year 1 is the disposition date. Accordingly, pursuant to the section 336(e) election, for Federal income tax purposes, Target is treated as if, on August 1, it sold all of its assets to an unrelated person in exchange for the ADADP.

(iii) Under these facts, although a portion of the qualified stock disposition was the result of a stock distribution, because the grossed-up amount realized on the disposition of recently disposed stock of Target, \$56,400 ($\$6,000 + (\$560 \times 90)$)/1 exceeds Target's total basis in its assets, none of the losses realized on the deemed asset disposition are disallowed under § 1.336-2(b)(2)(i)(B)(2). Because the grossed-up amount realized on the disposition of recently disposed stock of Target exceeds the value of Asset 2, the ADADP allocated to Asset 2 equals the value of Asset 2, \$16,000, and Target realizes a \$22,000 loss on the deemed disposition of Asset 2. None of this

loss is disallowed under section 1091. See § 1.336-2(b)(2)(ii)(C). Accordingly, Target recognizes a \$22,000 loss on the deemed disposition of Asset 2.

(iv) The ADADP allocated to Asset 1 is determined as follows (for purposes of this *Example 3*, TotADADP is the total ADADP for the deemed asset disposition, A1ADADP is the tentative amount of the total ADADP allocated to Asset 1, A2ADADP is the amount of the total ADADP allocated to Asset 2, G is the grossed-up amount realized on the disposition of recently disposed stock of Target, L is Target's liabilities other than Target's tax liability for the deemed disposition tax consequences, T_R is the applicable tax rate, and B1 is the adjusted basis of Asset 1 and B2 is the adjusted basis of Asset 2):

$$\begin{aligned} \text{TotADADP} &= G + L + (T_R \times (\text{TotADADP} - B1 - B2)) \\ \text{A1ADADP} &= \text{TotADADP} - \text{A2ADADP} \\ \text{A2ADADP} &= \$16,000 \\ \text{A1ADADP} &= \text{TotADADP} - \$16,000 \\ G &= (\$6,000 + (\$560 \times 90))/1 \\ G &= \$56,400 \\ \text{TotADADP} &= \$56,400 + 0 + (.34 \times (\text{TotADADP} - \$15,000 - \$38,000)) \\ \text{TotADADP} &= \$56,400 + .34\text{TotADADP} - \$18,020 \\ .66\text{TotADADP} &= \$38,380 \\ \text{TotADADP} &= \$58,152 \\ \text{A1ADADP} &= \$42,152 \end{aligned}$$

(v) Because A1ADADP, \$42,152, does not exceed the value of Asset 1, \$50,000, the entire A1ADADP is allocated to Asset 1. Old Target thus realizes and recognizes a gain of \$27,152 on the deemed disposition of Asset 1 ($\$42,152 - \$15,000$).

[T.D. 9619, 78 FR 28474, May 15, 2013]

§ 1.336-4 Adjusted grossed-up basis.

(a) *Scope.* Except as provided in paragraphs (b) and (c) of this section or as the context otherwise requires, the principles of paragraphs (b) through (g) of § 1.338-5 apply in determining the adjusted grossed-up basis (AGUB) for target and the consequences of a gain recognition election. AGUB is the amount for which new target is deemed to have purchased all of its assets in the deemed purchase under § 1.336-2(b)(1)(ii) or the amount for which old target is deemed to have purchased all of its assets in the deemed purchase under § 1.336-2(b)(2)(ii). AGUB is allocated among target's assets in accordance with § 1.338-6 to determine the price at which the assets are deemed to have been purchased. If a subsequent increase or decrease with respect to an element of AGUB is required under

general principles of tax law, redetermined AGUB is allocated among target's assets in accordance with §1.338-7.

(b) *Modifications to the principles in §1.338-5.* Solely for purposes of applying §§1.336-1 through 1.336-4, the principles of §1.338-5 are modified as follows—

(1) *Purchasing corporation; purchaser.* Any reference to the *purchasing corporation* shall be treated as a reference to a purchaser, as defined in §1.336-1(b)(2).

(2) *Acquisition date; disposition date.* Any reference to the *acquisition date* shall be treated as a reference to the disposition date, as defined in §1.336-1(b)(8).

(3) *Section 338 election; section 338(h)(10) election; section 336(e) election.* Any reference to a *section 338 election* or a *section 338(h)(10) election* shall be treated as a reference to a section 336(e) election, as defined in §1.336-1(b)(11).

(4) *New target; old target.* In the case of a disposition described in section 355(d)(2) or (e)(2), any reference to *new target* shall be treated as a reference to *old target* in its capacity as the purchaser of assets pursuant to the section 336(e) election.

(5) *Recently purchased stock; recently disposed stock.* Any reference to *recently purchased stock* shall be treated as a reference to recently disposed stock, as defined in §1.336-1(b)(17). In the case of a distribution of stock, for purposes of determining the purchaser's grossed-up basis of recently disposed stock, the purchaser's basis in recently disposed stock shall be deemed to be such stock's fair market value on the date it was acquired.

(6) *Nonrecently purchased stock; non-recently disposed stock.* Any reference to *nonrecently purchased stock* shall be treated as a reference to nonrecently disposed stock, as defined in §1.336-1(b)(18).

(c) *Gain recognition election—(1) In general.* Any holder of nonrecently disposed stock of target may make a gain recognition election. The gain recognition election is irrevocable. Each owner of nonrecently disposed stock determines its basis amount, and therefore the gain recognized pursuant to the gain recognition election, by ap-

plying §§1.338-5(c) and 1.338-5(d)(3)(ii) by reference to its own recently disposed stock and nonrecently disposed stock, and not by reference to all recently disposed stock and nonrecently disposed stock.

(2) *80-percent purchaser.* If a section 336(e) election is made for target, any 80-percent purchaser and all persons related to the 80-percent purchaser are automatically deemed to have made a gain recognition election for its non-recently disposed target stock.

(3) *Non-80-percent purchaser.* If not automatically deemed made under paragraph (c)(2) of this section, a gain recognition election is made by a non-80-percent purchaser providing, on or before the due date for filing the section 336(e) election statement by the appropriate party, a gain recognition election statement, as described in paragraph (c)(4) of this section, to the appropriate party. If seller and target are members of the same consolidated group, seller is the appropriate party and the common parent of the consolidated group must retain the gain recognition election statement. If seller and target are members of the same affiliated group but do not join in the filing of a consolidated Federal income tax return, or if target is an S corporation, target is the appropriate party and target must retain the gain recognition election statement. If a non-80-percent purchaser makes a gain recognition election, all related persons to the non-80-percent purchaser must also make a gain recognition election. Otherwise, the gain recognition election for the non-80-percent purchaser will have no effect.

(4) *Gain recognition election statement.* A gain recognition election statement must include the following declarations (or substantially similar declarations):

(i) [Insert name, address, and taxpayer identifying number of person for whom gain recognition election is actually being made] has elected to recognize gain under §1.336-4(c) with respect to [his, hers, or its] nonrecently disposed stock.

(ii) [Insert name of person for whom gain recognition election is actually being made] agrees to report any gain under the gain recognition election on

[his, hers, or its] Federal income tax return (including an amended return, if necessary) for the taxable year that includes the disposition date of [insert name and employer identification number of target].

(d) *Examples.* The following examples illustrate the provisions of this section.

Example 1. On January 1 of Year 1, Seller owns 85 shares of Target stock, A owns 8 shares, B owns 4 shares, and C owns the remaining 3 shares. Each of A's 8 shares, B's 4 shares, and C's 3 shares have a \$5 basis. Assume that Target has no liabilities. On July 1 of Year 2, Seller sells 70 shares of Target stock to A for \$10 per share. On September 1 of Year 2, Seller sells 5 shares of Target stock to B and 5 shares of Target stock to C for \$14 per share. A section 336(e) election is made. A does not make a gain recognition election. A incurs \$25 of acquisition costs and B and C each incur \$10 of acquisition costs in connection with their respective Year 2 purchases. These costs are capitalized in the basis of Target stock. September 1 of Year 2 is the disposition date. Because A owns at least 10 percent of Target stock on September 1, the disposition date, and A's original 8 shares of Target stock owned on January 1 of Year 1 were not disposed of in the qualified stock disposition, A's original 8 shares of Target stock are nonrecently disposed stock. Although B's original 4 shares and C's original 3 shares were not disposed of in the qualified stock disposition, because neither B nor C owns, with the application of section 318(a), other than section 318(a)(4), at least 10 percent of the total voting power or value of Target stock on the disposition date, their original shares are not nonrecently disposed stock. The grossed-up basis of recently disposed Target stock is \$1,011, determined as follows: The purchasers' (A, B, and C) aggregate basis in the recently disposed target stock, determined without regard to acquisition costs, is \$840 ($(70 \times \$10) + (5 \times \$14) + (5 \times \$14)$). This amount is multiplied by a fraction, the numerator of which is 100 minus 8, the percentage of Target stock that is nonrecently disposed stock, and the denominator of which is 80, the percentage of Target stock attributable to recently disposed stock ($\$840 \times 92/80 = \966). This amount is then increased by the \$45 of acquisition costs incurred by A, B, and C to arrive at the \$1,011 grossed-up basis of recently disposed Target stock ($\$966 + \$45 = \$1,011$). New Target's AGUB is \$1,051, the sum of \$1,011, the grossed-up basis of recently disposed Target stock and \$40 ($8 \times \5), A's basis in his nonrecently disposed Target stock.

Example 2. The facts are the same as in *Example 1* except that A makes a gain recognition election. Pursuant to the gain recogni-

tion election, A is treated as if he sold on September 1 of Year 2, the disposition date, his 8 shares of nonrecently disposed Target stock for the basis amount, and A's basis in nonrecently disposed target stock immediately after the deemed sale is the basis amount. A's basis amount equals his basis in his recently disposed Target stock without regard to acquisition costs, \$700 ($70 \times \10), multiplied by a fraction, the numerator of which is 100 minus 8, the percentage of Target stock, by value, determined on the disposition date, which is A's nonrecently disposed Target stock, and the denominator of which is 70, the percentage of Target stock, by value, determined on the disposition date, which is A's recently disposed stock, which is then multiplied by a fraction, the numerator of which is 8, the percentage of Target stock, by value, determined on the disposition date, attributable to A's nonrecently disposed Target stock and the denominator of which is 100 minus the numerator amount. Accordingly, A's basis amount is \$80 ($\$700 \times 92/70 \times 8/92$). A therefore recognizes gain of \$40 under the gain recognition election (\$80 basis amount minus A's \$40 basis in his nonrecently disposed stock prior to the gain recognition election). New Target's AGUB is \$1,091, the sum of \$1,011, the grossed-up basis of all recently disposed Target stock and \$80, A's basis in his nonrecently disposed Target stock pursuant to the gain recognition election.

Example 3. (i) The facts are the same as in *Example 3* of § 1.336-3(g), that is, Seller owns all 100 of the outstanding shares of the common stock of Target, the only class of Target stock outstanding. On January 1 of Year 1, Seller sells 10 shares of Target stock to A for \$6,000 (\$600 per share). On August 1 of Year 1, Seller distributes the remaining 90 shares of Target stock to its unrelated shareholders in a transaction described in section 355(d)(2) or (e)(2). The value of Target stock on August 1 is \$560 per share. Target has two assets, Asset 1, which is stock in trade of Target, a Class IV asset, with a basis of \$15,000 and a value of \$50,000, and Asset 2, which is stock in a publicly traded, unrelated corporation, a Class II asset, with a basis of \$38,000 and a value of \$16,000. Target has no liabilities other than any liabilities for Federal tax on account of the deemed asset disposition. Assume Target's Federal tax rate for any gain or income on the deemed asset disposition is 34 percent. Seller had no selling costs in connection with its sale of the 10 shares of Target stock. A section 336(e) election is made. In addition, A incurred \$100 of acquisition costs with respect to the purchase of the 10 shares of Target stock. Target's AGUB in the assets deemed acquired pursuant to § 1.336-2(b)(2)(ii)(B) is determined as follows (for purposes of this *Example 3*, GRD is the grossed-up basis of recently disposed stock, BND is the basis in nonrecently disposed

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stock, TotL is Target's total liabilities, including Target's tax liability, and X is the A's total acquisition costs):

$$\text{AGUB} = \text{GRD} + \text{BND} + \text{TotL}$$

$$\text{GRD} = (\$6,000 + (\$560 \times 90)) \times ((100 - 0)/100) + X$$

$$\text{GRD} = (\$6,000 + \$50,400) \times (100/100) + \$100$$

$$\text{GRD} = \$56,500$$

$$\text{BND} = \$0$$

$$\begin{aligned} \text{TotL} = & .34 \times (\$27,152 \text{ (Target's gain recognized} \\ & \text{on deemed disposition of Asset 1)} - \\ & \$22,000 \text{ (Target's loss recognized on} \\ & \text{deemed disposition of Asset 2)}) \text{ (see } \textit{Ex-} \\ & \textit{ample 3} \text{ of } \text{§ 1.336-3(g)} \text{ for determination of} \\ & \text{Target's gain and loss recognized on} \\ & \text{deemed disposition of Assets 1 and 2)} \end{aligned}$$

$$\text{TotL} = \$1,752$$

$$\text{AGUB} = \$56,500 + \$0 + \$1,752$$

$$\text{AGUB} = \$58,252$$

(ii) The AGUB allocated to Asset 2 is \$16,000, the value of Asset 2. Because the excess of the total AGUB, \$58,252, over the portion of the AGUB allocated to Asset 2, \$16,000, does not exceed the value of Asset 1, the AGUB allocated to Asset 1 is such excess, \$42,252.

[T.D. 9619, 78 FR 28474, May 15, 2013]

§ 1.336-5 Effective/applicability date.

The provisions of §§ 1.336-1 through 1.336-4 apply to any qualified stock disposition for which the disposition date is on or after May 15, 2013.

[T.D. 9619, 78 FR 28474, May 15, 2013]

EFFECTS ON CORPORATION

§ 1.337(d)-1 Transitional loss limitation rule.

(a) *Loss limitation rule for transitional subsidiary*—(1) *General rule.* No deduction is allowed for any loss recognized by a member of a consolidated group with respect to the disposition of stock of a transitional subsidiary. However, for transactions involving loss shares of subsidiary stock occurring on or after September 17, 2008, see § 1.1502-36. Further, this section does not apply to a transaction that is subject to § 1.1502-36.

(2) *Allowable loss*—(i) *In general.* Paragraph (a)(1) of this section does not apply to the extent the taxpayer establishes that the loss is not attributable to the recognition of built-in gain by any transitional subsidiary on the disposition of an asset (including stock and securities) after January 6, 1987.

(ii) *Statement of allowable loss.* Paragraph (a)(2)(i) of this section applies only if a separate statement entitled

“Allowable Loss Under § 1.337(d)-1(a)” is filed with the taxpayer's return for the year of the stock disposition. If the separate statement is required to be filed with a return the due date (including extensions) of which is before January 16, 1991, or with a return due (including extensions) after January 15, 1991 but filed before that date, the statement may be filed with an amended return for the year of the disposition or with the taxpayer's first subsequent return the due date (including extensions) of which is after January 15, 1991.

(iii) *Contents of statement.* The statement required under paragraph (a)(2)(ii) of this section must contain—

(A) The name and employer identification number (E.I.N.) of the transitional subsidiary.

(B) The basis of the stock of the transitional subsidiary immediately before the disposition.

(C) The amount realized on the disposition.

(D) The amount of the deduction not disallowed under paragraph (a)(1) of this section by reason of this paragraph (a)(2).

(E) The amount of loss disallowed under paragraph (a)(1) of this section.

(3) *Coordination with loss deferral and other disallowance rules.* (i) For purposes of this section, the rules of § 1.1502-20(a)(3) apply, with appropriate adjustments to reflect differences between the approach of this section and that of § 1.1502-20.

(ii) *Other loss deferral rules.* If paragraph (a)(1) of this section applies to a loss subject to deferral or disallowance under any other provision of the Code or the regulations, the other provision applies to the loss only to the extent it is not disallowed under paragraph (a)(1).

(4) *Definitions.* For purposes of this section—

(i) The definitions in § 1.1502-1 apply.

(ii) *Transitional subsidiary* means any corporation that became a subsidiary of the group (whether or not the group was a consolidated group) after January 6, 1987. Notwithstanding the preceding sentence, a subsidiary is not a transitional subsidiary if the subsidiary (and each predecessor) was a member of the group at all times after