Internal Revenue
bulletin

Bulletin No. 2013-24
June 10, 2013

HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 2013–12, page 1237.

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for June 2013.

T.D. 9619, page 1212.

Final regulations under section 336(e) of the Code provide for an election to treat the sale, exchange, or distribution of at least 80 percent of the stock of a domestic subsidiary corporation or a subchapter S corporation as a sale of the corporation's assets, rather than a sale of its stock.

REG–126633–12, page 1245.

These proposed regulations provide guidance on the interpretation and application of section 833(c)(5). They guide certain health care organizations in computing and applying the medical loss ratio added to the Code by the Patient Protection and Affordable Care Act. A public hearing is scheduled for September 17, 2013.

Notice 2013–35, page 1240.

The conclusive presumption regulations (sections 1.166–2(d)(1) and (3) of the Income Tax Regulations) reflect a policy that when there is sufficient similarity between the standards a tax administrator uses to permit a deduction for a bad debt and the standards a bank regulator uses to identify a loan that should be charged off, in whole or in part, the tax administrator should accept that determination for purposes of § 166. There have been changes to the standards used by bank regulators to determine bad debt. This notice therefore seeks public comment on whether changes in these bank regulatory standards make compliance with the conclusive presumption regulations problematic and whether application of the conclusive presumption regulations continues to be consistent with the principles of section 166.

EXEMPT ORGANIZATIONS

Announcement 2013–25, page 1249.

The IRS has revoked its determination that Life Extension Foundation, Inc. of Ft. Lauderdale, FL, Mustard Seed Housing, Inc. of Petaluma, CA, and Northwest Regional Emergency Medical Services and Trauma Care Council of Bremerton, WA, qualify as organizations described in sections 501(c)(3) and 170(c)(2) of the Code.

ADMINISTRATIVE

Notice 2013–36, page 1242.

This notice updates the appendix to Notice 2013–1, which lists the Indian tribes that have settled tribal trust cases against the United States. Notice 2012–60 originally was published in I.R.B. 2012–41 (October 9, 2012). Notice 2012–60 was superceded by Notice 2013–1 I.R.B. 2013–3, and the appendix to Notice 2013–1 was superceded by Notice 2013–16 (I.R.B. 2013–14). However, three additional tribes have settled cases against the United States since the publication of Notice 2013–16, so this notice modifies and supersedes the appendix to Notice 2013–16.

(Continued on the next page)

Announcement of Declaratory Judgment Proceedings Under Section 7428 begins on page 1249.
Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

Rev. Proc. 2013–27, page 1243.

This proposed revenue procedure provides issuers of qualified mortgage bonds, as defined in § 143(a) of the Code, and issuers of mortgage credit certificates, as defined in § 25(c), with the United States median gross income figure most recently computed by the Department of Housing and Urban Development (HUD). The proposed revenue procedure also provides these issuers with guidance concerning the area median gross incomes as computed by HUD. Issuers of qualified mortgage bonds (QMB) and mortgage credit certificates (MCC) must use these income figures in determining whether the income limitation placed on the beneficiaries of the mortgages and certificates may be increased because the residences to be financed are located in high housing cost areas. See §§ 25(c)(2)(A)(iii)(IV) and 143(f)(5). Rev. Proc. 2012–16 is obsoleted with exceptions.

The IRS Mission

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2013. See Rev. Rul. 2013-12, page 1237.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of June 2013. See Rev. Rul. 2013-12, page 1237.

Section 336.—Gain or Loss Recognized on Property Distributed in Complete Liquidation

T.D. 9619

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Regulations Enabling Elections for Certain Transactions Under Section 336(e)

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide guidance under section 336(e) of the Internal Revenue Code (Code), which authorizes the issuance of regulations under which an election may be made to treat the sale, exchange, or distribution of at least 80 percent of the voting power and value of the stock of a corporation (target) as a sale of all its underlying assets. These regulations provide the terms and conditions for making such an election and the consequences of the election. These regulations affect domestic corporate sellers (seller), S corporation shareholders, and domestic targets.

DATES: *Effective Date:* These regulations are effective on May 15, 2013.

Applicability Date: These regulations apply to any qualified stock disposition for which the disposition date is on or after May 15, 2013.

FOR FURTHER INFORMATION CONTACT: Mark J. Weiss, (202) 622–7930 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under OMB control number 1545–2125. The collection of information in these final regulations is in §§1.336–2(h) and 1.336–4(c). This information is required by the IRS to allow certain parties to make a section 336(e) election and for certain shareholders to make a gain recognition election.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by section 6103.

Background

Section 336(e) of the Code authorizes the issuance of regulations under which an election may be made to treat the sale, exchange, or distribution of at least 80 percent of the voting power and value of the stock of a corporation (target) as a sale of all its underlying assets. Section 336(e) was enacted as part of *General Utilities* repeal. Similar to an election under section 338(h)(10) available with respect to certain purchases of target stock, section 336(e) is meant to provide taxpayers relief from a potential multiple taxation of the same economic gain that can result when a transfer of appreciated corporate stock is taxed without providing a corresponding step-up in the basis of the assets of the corporation. See H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess., Vol. II, 198, 204 (1986), 1986–3 C.B., Vol. 4, 198-207.

On August 25, 2008, the IRS and Treasury Department published a notice of proposed rulemaking in the **Federal Register** (REG–143544–04, 2008–42 I.R.B. 947 [73 FR 49965–02]) (the proposed regulations) that, when finalized, would permit certain taxpayers to make an election to treat certain sales, exchanges, and distributions of another corporation's stock as taxable sales of that corporation's assets.

Summary of Proposed Regulations

A. *In General*

Under the proposed regulations, an election under section 336(e) is available for "qualified stock dispositions" of domestic target stock by domestic corporate sellers (seller). The proposed regulations generally adopt the structure and principles established under section 338(h)(10) and the underlying regulations. For example, the proposed regulations generally incorporate the rules of section 338 governing the allocation of consideration in the resulting deemed sale of the target's assets and the determination of target's basis in its underlying assets resulting from such deemed sale. The proposed regulations alter terms or concepts to reflect principles and factual circumstances relevant to section 336(e).

Unlike an election under section 338(h)(10), which is available only if target stock is acquired by a corporate purchaser, the proposed regulations do not require an acquirer of target stock to be a corporation, or even necessarily a purchaser. Also unlike section 338(h)(10), which generally requires that a single purchasing corporation acquire the stock of a target, the proposed regulations permit the aggregation of all stock of a target that is sold, exchanged, and distributed by a seller to different acquirers for purposes of determining whether there has been a qualified stock disposition of a target.

B. *Two Different Models for Deemed Transactions*

The proposed regulations provide two different models for the deemed transactions treated as occurring if a section 336(e) election is made. The first model generally follows the same structure used for the deemed transactions resulting from the making of a section 338(h)(10) election (basic model) and is applicable to all qualified stock dispositions (including those consisting of taxable distributions of target stock) other than distributions described in sections 355(d)(2) or 355(e)(2) (section 355(d)(2) and (e)(2) transactions). Under the basic model, target, while owned by the seller (old target), is treated as selling all of its assets to an unrelated person and new target is treated as acquiring all of its assets from an unrelated person at the close of the date on which the threshold amount of target stock is disposed (deemed asset disposition). Old target recognizes the Federal income tax consequences from the deemed asset disposition before the close of the date on which its stock was disposed. After recognizing the tax consequences of the deemed asset disposition, old target is generally treated as liquidating into the seller. In addition, to the extent that the qualified stock disposition consisted of one or more distributions (rather than sales or exchanges) of the stock of a target (other than in section 355(d)(2) and (e)(2) transactions), the seller is treated as acquiring directly from new target an amount of new target stock equal to the amount of target stock distributed. The tax consequences of the purchaser(s) generally are unaffected by the section 336(e) election.

The second model adopted by the proposed regulations for the deemed transactions resulting from a section 336(e) election applies to section 355(d)(2) and (e)(2) transactions (sale-to-self model). Under the sale-to-self model, old target (the controlled corporation) is deemed to remain in existence; old target is treated as if it sold its assets to an unrelated person and then repurchased those assets. Following the deemed asset disposition, old target (the controlled corporation) is not deemed to liquidate into seller (the distributing corporation). Instead, after old target's deemed repurchase of its own assets, seller is treated as distributing the stock of old target to its shareholders, with seller recognizing no gain or loss. Because no liquidation of old target into seller is deemed to occur, old target will generally retain the tax attributes it would have had if the section 336(e) election had not been made, adjusted for the creation or absorption of attributes resulting from the election.

C. *The Disallowed Loss Rule*

The proposed regulations contain a rule that disallows the recognition of losses resulting from the deemed asset disposition to the extent the qualified stock disposition consisted of one or more distributions of target stock (disallowed loss rule). The preamble to the proposed regulations explains that the allowance of losses pursuant to a deemed asset disposition may be inconsistent with sections 311(a) and 355(c) because had the target stock been distributed, any loss in the target stock would not have been recognized pursuant to these provisions.

D. *Time and Manner of Making a Section 336(e) Election*

The time and manner of making a section 336(e) election provided in the proposed regulations also differed from those for making an election under section 338(h)(10). Noting that a joint election may be burdensome in cases with multiple purchasers, the proposed regulations provide that a section 336(e) election is unilaterally made by a seller attaching a statement to its timely filed Federal income tax return for the taxable year that includes the disposition date.

Summary of Comments and Explanation of Provisions

Written comments were received in response to the proposed regulations. A public hearing was not requested and none was held. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision. In general, the final regulations follow the approach of the proposed regulations with some modifications. The more significant comments and modifications are discussed in this section.

A. *The Disallowed Loss Rule*

The IRS and Treasury Department received several comments that the disallowed loss rule of the proposed regulations was too harsh and frustrated the intent of mitigating multiple levels of tax as envisioned by section 336(e). According to the comments, the result of the disallowed loss rule was that the making of a section 336(e) election in connection with a stock distribution would be largely impractical. One commenter also noted that the rationale for the disallowed loss rule, namely, that asset losses should not be allowed because a loss in target stock would not be recognized under sections 311(a) or 355(c), did not extend to a seller's distribution of target stock under section 336(a). This is because the seller generally would recognize the loss with respect to the target stock in such a case. The comments suggested several alternatives, including that realized losses in the deemed asset disposition should be netted against the amount of realized gains and that to the extent realized losses exceed realized gains, the net loss should be deferred by attaching the net loss to the basis of the assets in target's hands after the deemed asset disposition.

After consideration of the comments, the IRS and Treasury Department have determined that the disallowed loss rule as set forth in the proposed regulations is broader in scope than necessary to serve the purposes of section 336(e). Accordingly, the final regulations modify the rule of the proposed regulations to generally permit target's realized losses in the deemed asset disposition to offset the amount of target's realized gains. Thus, the proposed regulations disallow a net loss of target (that is, losses realized in excess of target's realized gains) recognized on a deemed asset disposition, but only in proportion to the portion of target stock that was disposed of by seller in one or more distributions.

The loss disallowance rule in the proposed regulations only applied to distributions that were taken into account as part of the qualified stock disposition on or before the disposition date. Thus, stock distributions that occurred after 80 percent of target was disposed of were not subject to the loss disallowance rule. The final regulations modify the disallowed loss rule of the proposed regulations to take into account (1) target stock distributed at any

time within the 12-month disposition period, not just on or before the disposition date, and (2) target stock distributed within the 12-month disposition period that is not part of the qualified stock disposition, such as stock distributed to a related person. The IRS and Treasury Department believe that limiting disallowed losses to stock distributed on or before the disposition date could lead to manipulation because sellers who would otherwise distribute target stock on the disposition date may delay the distribution for the sole purpose of decreasing the disallowed net loss recognized by target. Further, if stock distributions that are not part of the qualified stock disposition, such as distributions to a related person, were not taken into account by the disallowed loss rule, target would be able to recognize a greater portion of its net loss by distributing stock to a related person than it would recognize if it distributed the stock to an unrelated person, a result that the IRS and Treasury Department believe would be improper. Accordingly, under the disallowed loss rule of the final regulations, if a section 336(e) election is made and any stock of target is distributed during the 12-month disposition period, whether or not as part of the qualified stock disposition, any net loss attributable to such stock distribution is disallowed.

The final regulations do not follow the recommendation of some commenters that any disallowed losses be applied to increase the basis of target's assets after the deemed asset disposition for two reasons. First, as discussed elsewhere in this preamble, Congressional intent in providing for a section 336(e) election was to prevent multiple taxation of gain. Congress was not concerned with the preservation of loss. Second, allowing the losses to be deferred by adding the basis to target's assets would create administrative difficulties far outweighing the benefits, and disallowing losses rather than deferring losses is consistent with many other provisions within subchapter C. Accordingly, to the extent the disallowed loss rule of the final regulations applies, losses are allowed up to the amount of gains and any excess losses are permanently disallowed.

B. *Issues Relating to the Adopted Models*

1. *Basic model for non-section 355(d)(2) or (e)(2) transactions*

In general, the final regulations retain the rules of the proposed regulations with respect to the deemed transactions under the basic model. One commenter expressed concern that in the case of a distribution of stock as part of a qualified stock disposition that does not consist of section 355(d)(2) or (e)(2) transactions, the step in the basic model in which seller is deemed to purchase from new target the new target stock actually distributed might be combined with old target's deemed sale of its assets to new target resulting in a section 351 transaction with boot, which could lead to unintended consequences. The commenter also questioned what new target is deemed to do with the consideration it is deemed to receive from seller in the deemed stock acquisition. The commenter suggested resolving these issues by having seller be deemed to purchase new target stock from unrelated new target shareholders with cash equal to the fair market value of the distributed stock.

The IRS and Treasury Department agree with the concerns of the commenter. Accordingly, the final regulations modify the proposed regulations by providing that in a distribution of target stock (and also with respect to stock in target that seller retains after the distribution date) seller is deemed to purchase the new target stock that is distributed or retained not from new target but from an unrelated person in a taxable transaction. Seller will not recognize any gain or loss on the deemed distribution of new target stock and purchaser will have a fair market value basis in new target stock received without any possible application of section 351.

2. *Sale-to-self model for transactions described in section 355(d)(2) or (e)(2)*

We received several comments suggesting the removal of the sale-to-self model and the extension of the provisions of §1.336–2(b)(1), with any necessary adjustments, to section 355(d)(2) or (e)(2) transactions. Commenters stated that the sale-to-self model added unnecessary complexity and that existing law under section 312(h) and §1.312–10 adequately addresses the concern of having sufficient earnings and profits to allocate to the controlled corporation. One commenter also suggested that to the extent that the sale-to-self model is driven by a desire to have the controlled corporation retain its attributes, a special section 381 rule could be created to reach this result.

Although the IRS and Treasury Department agree with the commenters who pointed out that even if target was treated as a new corporation after the deemed sale of its assets, the rules of section 312(h) and §1.312–10 would typically result in target having some level of earnings and profits after the distribution of its stock, the IRS and Treasury Department still believe that the sale-to-self model should be retained. While the deemed transactions resulting from the making of section 336(e) elections with respect to taxable sales, exchanges, or distributions of target stock could actually be undertaken in a transaction involving the sale, exchange, or distribution of the assets of target, a transaction that included an actual sale or distribution of all the assets of target could not qualify under section 355. Because a deemed sale of assets to a new target cannot actually be undertaken in section 355(d)(2) or (e)(2) transactions, and the IRS and Treasury Department believe that the predominant feature of the section 336(e) election with respect to a section 355(d)(2) or (e)(2) transaction is the section 355 transaction, the regulations adopt the sale-to-self model and treat the transaction as the distribution of old target stock.

Additionally, the IRS and Treasury Department do not believe that the sale-to-self model adds significant complexity to the regulation; in fact, it may reduce complexity. As the commenters pointed out, if the IRS and Treasury Department believe that adjustments to the basic model would have to be made to account for a section 355(d)(2) or (e)(2) transaction, those adjustments, such as satisfying the five-year active trade or business requirement and maintaining all section 381 attributes with target (not solely earnings and profits), would require that exceptions and special rules be added to the basic model. These exceptions and special rules would result in a regulation that we believe would be more complex than the sale-to-self model. Furthermore,

because it is likely that only an insubstantial number of section 336(e) elections will be the result of transactions actually described in section 355(d)(2) or (e)(2) (although a substantial number of protective elections may be made), we believe that putting the exceptions and special rules into the provisions of §1.336–2(b)(1) for this limited number of cases would create complexity or confusion for the majority of taxpayers engaging in transactions that are not described in section 355(d)(2) or (e)(2). By separating the regulation into two separate models, taxpayers whose transaction does not involve a section 355(d)(2) or (e)(2) transaction may apply the regulation's provisions without having to concern themselves with provisions that do not apply to their transaction.

Commenters have suggested that if the regulations retain the sale-to-self model, the regulations should address the wash sale rules of section 1091 and the anti-churning rules of section 197(f)(9). For example, old target's deemed disposition of stock or securities and subsequent repurchase of the same stock or securities could be treated as a wash sale, which could then be subject to loss disallowance under section 1091(a) as well as the disallowed loss rule of these regulations. Under the section 336(e) regulations, the basis of the stock or security deemed purchased by target should be its fair market value, while under section 1091(d), the basis would be the basis of the stock or security deemed transferred plus or minus any difference in the sale and acquisition price of the stock or security.

The IRS and Treasury Department do not believe that adoption of the sale-to-self model should cause sections 197(f)(9) or 1091 to apply to a section 336(e) election with respect to a section 355(d)(2) or (e)(2) transaction. Because the deemed transactions resulting from the making of a section 336(e) election could not actually be undertaken in the context of a section 355(d)(2) or (e)(2) transaction, we do not believe that the regulations should cause a section 336(e) election in the context of a section 355(d)(2) or (e)(2) transaction to result in the application of sections 197(f)(9) or 1091 to the extent that a section 336(e) election outside the context of a section 355(d)(2) or (e)(2) transaction would not result in the application of such sections. Accordingly, the final regulations provide that for purposes of section 197(f)(9), section 1091, and any other provision designated in the Internal Revenue Bulletin by the IRS, old target, in its capacity as seller of assets in the deemed asset disposition, is treated as a separate and distinct taxpayer from, and unrelated to, old target in its capacity as acquirer of assets in the subsequent deemed purchase and for subsequent periods. For example, if one of target's assets immediately before old target's deemed asset disposition was stock or securities within the meaning of section 1091, old target, as seller of the stock or securities in the deemed asset disposition, is not treated for purposes of section 1091 as the same taxpayer that acquires substantially identical stock or securities in the deemed purchase of assets or that actually acquires substantially identical stock or securities in periods after the deemed asset disposition. Therefore, section 1091 will not disallow any of old target's loss on the deemed sale of the stock or securities as a result of either old target's deemed purchase of the same stock or securities or an actual purchase of substantially identical stock or securities within the 30-day period after the disposition date.

C. *Time and Manner for Making the Election*

Commenters requested that the unilateral seller election of the proposed regulations be made into a joint election between seller and target (acting in a capacity for the purchasers). The commenters expressed concern that a unilateral election by seller could result in unwanted results or unfair surprise to target or purchaser. The proposed regulations were premised on the view that a unilateral election is supportable because in sales or exchanges, purchasers should be able to protect their interests in any purchase contract; in distributions, distributees' interests should generally be protected because of the distributing corporation's fiduciary responsibilities to its shareholders. However, in response to the comments, the final regulations modify the rule of the proposed regulations. Under the final regulations, in order to make a section 336(e) election, seller(s), or in the case of an S corporation target, all of the S corporation shareholders (see section E of this preamble concerning the availability of a section 336(e) election for an S corporation target), and target must enter into a written, binding agreement to make a section 336(e) election and a section 336(e) election statement must be attached to the relevant return. If seller(s) and target are members of a consolidated group, the election statement is filed on a timely filed consolidated return and 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. If target is an S corporation, the election statement is filed on the S corporation's timely filed return. If seller and target are members of an affiliated group but do not join in the filing of a consolidated return, the election statement is filed with both seller's and target's timely filed returns. By (1) requiring seller(s), or all the S corporation shareholders, and target to enter into a written, binding agreement, (2) in the case of a consolidated group, requiring the common parent of the consolidated group to provide a copy of the election statement to target, and (3) in the case in which seller and target are members of an affiliated group but do not join in the filing of a consolidated return, requiring both seller and target to file the election statement on their respective returns, the IRS and Treasury Department believe that the final regulations significantly reduce the potential for unwanted results or unfair surprise.

Several commenters also requested changing the due date of the election from the due date of the seller's return to the 15th day of the ninth month after the disposition date, the same time for making a section 338 election. The commenters were concerned that the due date in the proposed regulations could result in many instances in which target's tax return would be due before the due date for the election (because target's taxable year will close upon its deemed dissolution), and therefore target would be required to file its return without knowing whether a section 336(e) election was made. After consideration of these comments, the final regulations retain the rule that the election must be made by the due date of the relevant tax return. The IRS and Treasury Department believe that a due date of the 15th day of the ninth month

after the disposition date will add administrative burden to both taxpayers and the IRS. Such due date would generally require that the election be made prior to the filing of the tax return, rather than on a tax return. It is administratively beneficial for the IRS to have the election made with the filing of a return rather than in some manner outside of the return. Additionally, an accelerated due date would give taxpayers less time in which to decide whether an election is beneficial or detrimental. The experience of the IRS in administering section 338 has shown that some taxpayers miss the due date for making a section 338 election because they wrongly believe that the election is due with the income tax return of the taxpayer. Further, except with respect to the election statement filed by seller if seller and target are members of the same affiliated group but do not join in the filing of a consolidated return, the due date for filing the election statement now coincides with the due date of the return that includes the deemed disposition tax consequences. Accordingly, the final regulations do not adopt this suggestion.

Because the general requirements for who must file a section 336(e) election statement have been modified from the proposed regulations, these final regulations provide detailed requirements to assist taxpayers in making a section 336(e) election for an eligible subsidiary of target (target subsidiary). See §1.336–2(h)(4) and (5). Some of these requirements are different than those for making a section 336(e) election for target subsidiaries under the proposed regulations, which treated the seller of the directly disposed of target (ultimate seller) as the seller of the target subsidiary for purposes of the additional election statement to be attached to the ultimate seller's return. Some of these requirements also differ from those for making a section 338 election for target subsidiaries on Form 8023, which treats the purchasing corporation(s) of the directly purchased target as the purchasing corporation(s) of any target subsidiary for purposes of completing and signing a Form 8023 for a target subsidiary that is filed outside of any return. For example, if seller and target are members of the seller consolidated group but target subsidiary is not, a section 336(e) election for target subsidiary now requires that target subsidiary be a party to either the agreement entered into by seller and target, or that target and target subsidiary enter into a separate agreement to make such election. Because target subsidiary is not a member of the same consolidated group as target, the section 336(e) election for target subsidiary requires that a section 336(e) election statement be attached to both seller's timely filed consolidated Federal income tax return and the timely filed Federal income tax return of the target subsidiary.

The IRS intends to modify Form 8883, which is currently entitled *Asset Allocation Statement Under Section 338*, or create a new form, to include an election under section 336(e). However, until Form 8883 is modified or a new form is created, old target and new target should file Form 8883 to report the results of the deemed asset disposition, making appropriate adjustments as necessary to account for a section 336(e) election. Examples of appropriate adjustments include treating a reference to Form 8023, a qualified stock purchase, the acquisition date, the 12-month acquisition period, or the aggregate deemed sales price on Form 8883 or the instructions thereto as a reference to the section 336(e) election statement, a qualified stock disposition, the disposition date, the 12-month disposition period, or the aggregate deemed asset disposition price, respectively. 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 assets in the deemed asset disposition and one in its capacity as the purchaser of assets in the deemed purchase of assets under the sale-to-self model.

D. *Intragroup Sales, Exchanges, or Distributions Prior to External Sales, Exchanges, or Distributions and Section 355(f)*

The proposed regulations requested comments concerning an intragroup sale, exchange, or distribution (an "intragroup transaction") prior to an external sale, exchange, or distribution, and also concerning the application of section 355(f).

Generally, if the stock of a corporation is sold or distributed within an affiliated group and then is transferred outside the affiliated group, a section 336(e) election is not available for the intragroup transaction because the buyer and seller in the intragroup transaction are related persons after the disposition of target outside the affiliated group. While a section 336(e) election may be available for the external transfer, the election could result in the affiliated group immediately recognizing multiple levels of gain, both on target's stock from the intragroup transaction and on target's assets from the deemed asset disposition. Section 1.1502–13(f)(5)(ii)(C) provides an election (a "§1.1502–13(f)(5) election") in the case of section 338(h)(10) and comparable transactions. A §1.1502–13(f)(5) election allows taxpayers to treat the deemed liquidation as the result of a section 338(h)(10) election or an actual liquidation as a taxable liquidation in order to provide the consolidated group with a stock loss to offset some, if not all, of the intragroup seller's stock gain from the intragroup transaction. One commenter asked for either a clarification that a §1.1502–13(f)(5) election is available for section 336(e) elections or that a similar election be provided in these regulations. Another commenter believed that the problem of multiple levels of tax could be solved by permitting a section 336(e) election on the intragroup transaction. With respect to the latter comment, the IRS and Treasury Department do not believe that allowing a section 336(e) election on the intragroup transaction is practical or administrable. Allowing a section 336(e) election would require special rules for related persons (see discussion of related party issues in section H of this preamble); further, these transactions could involve a significant time lapse between the intragroup transaction and external disposition. However, the IRS and Treasury Department agree with the first commenter that a taxpayer should be able to make a §1.1502–13(f)(5) election to treat the deemed liquidation of target into seller as a result of a section 336(e) election as a taxable liquidation. Although we believe that under the general rule of §1.336–1(a) of the proposed regulations, a §1.1502–13(f)(5) election would be available for a section 336(e) transaction without any modification in the final regulations, to remove any doubt the final regulations modify §1.1502–13(f)(5)(ii)(C) to clearly provide that the election is available for a section 336(e) election.

The IRS and Treasury Department also acknowledge that an external distribution under section 355(d)(2) or (e)(2) that is preceded by an intragroup transaction raises the same concerns as those described in the preceding paragraph, but a §1.1502–13(f)(5) election would not provide relief because in a section 355(d)(2) or (e)(2) transaction there is no deemed liquidation of target. The IRS and Treasury Department believe that the rationale behind §1.1502–13(f)(5) to prevent multiple levels of taxation exists just as much with a section 336(e) election as a result of a section 355(d)(2) or (e)(2) transaction as with a non-section 355(d)(2) or (e)(2) transaction. Therefore, the final regulations provide that in the case of a section 355(d)(2) or (e)(2) transaction that is preceded by an intragroup transaction, for the limited purpose of a §1.1502–13(f)(5) election, immediately after the deemed asset disposition of target's assets, target is deemed to liquidate into seller, thus providing seller with a stock loss that can offset some or all of the group's intercompany gain with respect to the intragroup transfer of target stock.

E. *Elections for S Corporations*

The proposed regulations do not provide for a section 336(e) election with respect to the sale of stock of an S corporation. Commenters asked that, just as a corporation that acquires stock of an S corporation in a qualified stock purchase may make a section 338(h)(10) election, the ability to make a section 336(e) election be extended to S corporation targets. Commenters noted that the IRS and Treasury extended the application of section 338(h)(10) to qualified stock purchases of S corporations and that Congress intended that "under regulations, principles similar to those of section 338(h)(10) may be applied to taxable sales or distributions of controlled corporation stock." See H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess., Vol. II, 198, 204 (1986) [1986–3 C.B., Vol. 4, 198, 204].

The IRS and Treasury Department agree with the commenters that the principles of the regulations implementing section 338(h)(10) should apply to the regulations implementing section 336(e) elections. Accordingly, these final regulations permit a section 336(e) election to be made for S corporation targets and provide additional and special rules to allow section 336(e) elections to be made with respect to S corporation targets.

If a section 338(h)(10) election is made with respect to an S corporation target, all of the S corporation shareholders, including those who do not sell their S corporation target stock, must consent to the election. With respect to a section 336(e) election, the final regulations provide the same requirement for purposes of making a section 336(e) election. While S corporation shareholders consent to a section 338(h)(10) election by signing Form 8023, to make a section 336(e) election, the S corporation shareholders do not file a section 336(e) election statement. Instead, consent to make a section 336(e) election is established by all the S corporation shareholders, including those who do not dispose of their stock in the transaction, and target entering into a written, binding agreement to make the election, on or before the due date (including extensions) of the S corporation target's income tax return. The section 336(e) election statement for an S corporation target is filed with the income tax return of the S corporation target.

If a section 336(e) election is made for 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) at which time old target's S election terminates, and old target ceases to exist. 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 for new target under section 1362(a) must be made.

F. *Determination of AGUB and ADADP*

A commenter requested that the provisions in the proposed regulations for determining the Aggregate Deemed Asset Disposition Price (ADADP) and Adjusted Grossed-Up Basis (AGUB) be modified by grossing up the selling costs among all stock of target in order to determine ADADP and by grossing up the acquisition costs among all stock of target in order to determine AGUB. The commenter also requested rules that would disregard preferred stock in determining the percentage of stock disposed of in the qualified stock disposition, and then add back the value of the preferred stock in determining the grossed-up amount realized.

With regard to grossing up the selling costs and acquisition costs over all target stock, this issue was specifically addressed in the preamble to the proposed section 338 regulations in 1999 ("Grossing-up the selling shareholders' selling costs or the purchasing corporation's acquisition costs would result in costs not actually incurred reducing old target's amount realized for the assets or increasing new target's cost basis in the assets.... [T]here is no evidence that the purchasing corporation's costs to acquire an amount of target stock sufficient for there to be a qualified stock purchase would increase proportionately if it acquired all of the target stock..."). See REG–107069–97, 1999–2 C.B. 346, 353. Accordingly, the final regulations retain the rule of the proposed regulations.

With regard to the preferred stock issue, the determination of grossed-up basis in section 338 is specifically provided for in the Code, and Congress included preferred stock in determining the percentage of stock attributable to recently purchased stock. The regulations under section 338 apply the same rule in determining grossed-up amount realized. The IRS and the Treasury Department believe that it is appropriate to use the same computation for purposes of a section 336(e) election. Accordingly, the final regulations retain the rule of the proposed regulations.

G. *Gain Recognition Elections*

Under the proposed regulations, a holder of nonrecently disposed stock may make a gain recognition election, similar to the gain recognition election under section 338, which treats nonrecently disposed stock as being sold as of the disposition date. The gain recognition election is mandatory if a purchaser owns (after the application of the rules of section 318(a), other than section 318(a)(4)), 80-percent or more of the voting power or value of target stock. Once made, a gain recognition election is irrevocable. The proposed regulations requested comments on whether the rules regarding gain recognition elections in the section 336(e) regulations are appropriate and whether the gain recognition election rules in reg-

ulations promulgated under section 338 should continue to apply.

Only one comment was received on this topic. The commenter was not sure why rules relating to gain recognition elections exist and believed they should be eliminated in both section 338(h)(10) and section 336(e). However, if this decision was not made, the election should be preserved for consistency in both sections. After consideration of this comment and further internal consideration, the IRS and Treasury Department have determined that the final regulations should retain the rule of the proposed regulations.

H. *Related Party Rule*

The proposed regulations provide that a transaction is not a disposition (and therefore is ineligible to count towards a qualified stock disposition) if target stock is sold, exchanged, or distributed to a related person. The proposed regulations, like the section 338 regulations, treat persons as related if stock in a corporation owned by one of the persons would be attributed to the other person under section 318(a), other than section 318(a)(4). Comments were requested regarding dispositions to related persons, including special rules needed to prevent the use of net operating losses to offset liquidation gains, manipulation of earnings and profits, and changes of accounting methods.

The IRS and Treasury Department received a wide range of comments, most of which believed some type of prohibition against section 336(e) elections in the case of related party transactions should be maintained. However, the commenters also stated that they believe that the definition of related person in the proposed regulations is too restrictive and should deviate from the section 338 definition. Commenters stated that unlike section 338, there is no statutory definition of the term purchase, and the decision to import the section 338 definition restricts the ability of a section 336(e) election to mitigate against multiple levels of tax. Commenters point to the fact that the legislative history does not prohibit related party transactions, but simply states that special rules may be needed to police certain situations (for example, rules prohibiting net operating loss refreshing, avoiding separate return limitation year rules, and triggering built-in gains to offset net operating losses otherwise limited by section 382). Suggestions made to modify the related party definition included (a) use of the existing section 338(h)(3)(A)(iii) definition, but limiting upstream and downstream partnership attribution to partners owning a specified percentage of the partnership and then only if the partnership bears some economic relationship to the transaction; (b) defining related persons by reference to whether the transaction that would be deemed to occur constitutes a nondivisive D reorganization or certain types of triangular C reorganizations using section 304(c) control; (c) defining related persons using section 267 principles; or (d) implementing some type of anti-abuse rule.

The IRS and Treasury Department reviewed the comments received and continue to have concerns about the administrability and complexity of rules that would be needed to permit related party transactions. However, the IRS and Treasury Department do agree that the attribution rules with respect to partnerships are more inclusive than is necessary for the purpose of these regulations. Because the attribution rules in section 318(a) with respect to partnerships do not have a minimum ownership threshold, a situation in which one partner holds a very small ownership in two different partnerships that own purchaser and seller, respectively, could, under the proposed regulations, prevent the making of a section 336(e) election on the sale of the stock of target to purchaser. Although some of the same concerns exist with respect to a section 338(h)(10) election, in such case, the statute clearly prohibits a section 338(h)(10) election. With respect to a section 336(e) election, there is no statutory prohibition, and the IRS and Treasury Department agree with the comments received that deemed asset disposition treatment should not be prohibited if cross ownership is minimal. While each of the suggested approaches for modifying the attribution rules have merit, the IRS and Treasury Department believe that the best manner for addressing the commenters' concerns is to modify the definition of related persons as pertaining to partnerships by providing that, solely for purposes of determining whether purchaser and seller are related for purposes of section 336(e), the attribution rules of sections 318(a)(2)(A) and 318(a)(3)(A) will not 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, less than five percent of the value of the partnership. A five-percent threshold is within the range suggested by comments for limiting upstream and downstream attribution under section 318(a) between partners and partnerships, and is consistent with the five-percent threshold of constructive ownership rules under sections 267(e)(3) and 1563(e)(2) relevant to partners and partnerships. The IRS and Treasury Department will continue to study whether related party transactions should qualify for a section 336(e) election.

I. *Scope of Regulations*

The proposed regulations look to and build upon section 338(h)(10) principles and guidelines that address taxable sales and exchanges of target stock. The proposed regulations expanded the section 338(h)(10) model to include fully taxable distributions and section 355(d)(2) and (e)(2) distributions. All of these transactions involve a basic taxable event relating to target's stock that is disregarded and in its place a sale of target's assets takes place.

Commenters asked the IRS and Treasury Department to extend a section 336(e) election to transactions in which the corporate level of tax is duplicated by other transactions, for example section 351 exchanges or certain tax-free reorganizations, so that the section 336(e) election can be used to turn two potential levels of tax into one. Commenters cited language from the legislative history to section 336(e), which discusses a section 336(e) election in both the context of *General Utilities* repeal and the desire to avoid multiple levels of corporate tax. "This provision offers taxpayers relief from a potential multiple taxation at the corporate level of the same economic gain, which may result when a transfer of appreciated corporate stock is taxed without providing a corresponding step-up in basis of the assets of the corporation." H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess., Vol. II, 198, 204 (1986) [1986–3 C.B., Vol. 4, 198, 204].

The IRS and Treasury Department believe that the commenters have raised some valid concerns and have considered whether the scope of the regulations should be broadened to include certain non-taxable transactions and if so, how the regulations would address those transactions. The issues involved are very complex. The IRS and Treasury Department believe that addressing these concerns in these final regulations would significantly delay the finalization of these regulations, thus preventing taxpayers whose transactions are within the scope of the proposed regulations from making a section 336(e) election until the rules and regulations, if any, for non-taxable transactions are also promulgated. Such delay would not be in the best interests of taxpayers as a whole. Accordingly, these final regulations do not permit an election to be made in non-taxable transfers of target stock. However, the IRS and Treasury Department will continue to study this issue and may address the issue in future guidance. We welcome any comments concerning this issue, including recommendations not just on the scope of the regulations, but on specific means and models for implementing such suggestions.

J. *International Provisions*

1. *Application to foreign targets*

The proposed regulations do not apply to transactions in which either seller or target is a foreign corporation. Comments were requested regarding how the proposed regulations should be modified to take into account the policies of international tax provisions if the proposed regulations were extended to apply to foreign sellers and/or foreign targets. The IRS and the Treasury Department received comments in response to this request. For reasons similar to those discussed concerning extending the scope of these regulations to non-taxable transactions, these final regulations retain the requirements in the proposed regulations that seller and target must be domestic corporations. However, the IRS and the Treasury Department will continue to study the application of section 336(e) to transactions in which either seller or target is a foreign corporation and may consider expanding the scope of the regulations to address these transactions in future guidance.

2. *Allocation of foreign taxes paid*

The proposed regulations provide that if a section 336(e) election is made and target's taxable year under foreign law (if any) does not close at the end of the disposition date, foreign income taxes paid by new target attributable to the foreign taxable income earned by target during such foreign taxable year are allocated to old target and new target under the principles of §1.1502–76(b). The proposed rule is consistent with a similar rule in §1.338–9(d) for allocating foreign tax paid by a target that is acquired in a transaction that is treated as an asset acquisition pursuant to an election under section 338 if the foreign taxable year of target does not close at the end of the acquisition date. In addition, regulations under section 901, which were published on February 14, 2012, provide foreign tax allocation rules, consistent with §1.338–9(d), for certain changes in ownership of a partnership or disregarded entity during the entity's foreign taxable year. See §1.901–2(f)(4). The final regulations at §1.336–2(g)(3)(ii) reflect modifications made to achieve consistency with §1.901–2(f)(4). The regulations also provide that if target holds an interest in a disregarded entity or partnership, the rules of §1.901–2(f)(4) apply with respect to foreign tax imposed at the entity level on the income of such entities. The IRS and Treasury Department intend to issue future guidance that will make similar modifications to §1.338–9(d).

Section 212 of the legislation commonly referred to as the Education Jobs and Medicaid Assistance Act of 2010, enacted on August 10, 2010 (Public Law 111–226), added section 901(m) to the Code. Section 901(m)(1) provides, in part, that in the case of a covered asset acquisition, the disqualified portion of any foreign income taxes determined with respect to the income or gain attributable to a relevant foreign asset shall not be taken into account in determining the foreign tax credit allowed under section 901(a). Section 901(m)(2)(B) defines a covered asset acquisition to include any transaction that is treated as an acquisition of assets for U.S. income tax purposes and as the acquisition of stock of a corporation (or is disregarded) for purposes of a foreign income tax. Because a section 336(e) election for target is treated as an acquisition of assets for U.S. income tax purposes, and is treated as the acquisition of stock of a corporation (or is disregarded in the case of tiered section 336(e) elections) for foreign tax purposes, a section 336(e) election for a target corporation is a covered asset acquisition. See Staff of the Joint Committee on Taxation, Technical Explanation of the Revenue Provisions of the Senate Amendment to the House Amendment to the Senate Amendment to H.R. 1586, Scheduled for Consideration by the House of Representatives on August 10, 2010, at 13, footnote 55 (August 10, 2010). Accordingly, the final regulations contain a cross-reference to the rules under section 901(m), which, for example, could apply if target has foreign branch operations.

K. *Retained Stock*

The proposed regulations provide that if seller retains any stock in target after the 12-month disposition period, seller is treated as purchasing the stock so retained on the day after the disposition date. The proposed regulations provide the holding period and purchase price (and thus the basis) of the retained stock. The regulations under §1.338(h)(10)–1 provide a similar rule concerning retained stock, with the exception that the §1.338(h)(10)–1 rule only requires that the stock be retained after the acquisition date. Under the proposed regulations, if seller sells, exchanges, or distributes less than all of its stock prior to the disposition date, but sells, exchanges, or distributes additional stock after the disposition date but before the end of the 12-month disposition period, the regulations are silent as to holding period and purchase price (and thus the basis) of such stock. If the later transaction is part of the qualified stock disposition, the basis and holding period may not be relevant, because no gain or loss is recognized on that transaction. However, if the stock is transferred in a transaction not part of the qualified stock disposition, such as a sale to a related person, the basis and holding period will be relevant. After considering this matter, the IRS and Treasury Department have determined that the rule in the §1.338(h)(10)–1 regulations, provid-

ing that stock is retained if seller owns the stock after the acquisition date, should be adopted by the regulations under section 336(e). Accordingly, the final regulations modify the rule of the proposed regulations, so that stock is retained if owned by seller after the disposition date.

L. *Consistency Rules*

The proposed regulations generally follow the structure and policies of section 338(h)(10), including the application of the consistency rules of §1.338–8. In general, §1.338–8 provides that if (1) a purchasing corporation (or an affiliate) acquires an asset meeting certain requirements from target (or a subsidiary of target) in a sale during the target consistency period, (2) gain from the sale is reflected in the basis of target stock as of the target acquisition date, and (3) the purchasing corporation acquires stock of target in a qualified stock purchase (but does not make a section 338 election), then the purchasing corporation is required to take a carryover basis in the acquired asset.

Commenters have asked how the consistency rules apply to qualified stock dispositions. Commenters expressed concern that although §1.338–8(b)(1)(iii) requires that the same corporate purchaser (or an affiliate) acquire both stock of target and an asset of target (or a subsidiary of target), because, unlike section 338, section 336(e) does not require a single corporate purchaser of 80 percent of the stock of target, the consistency rules could apply to any purchase of an asset of target (or a subsidiary of target) if there was also a qualified stock disposition of target, regardless of whether the purchaser of the asset was also the purchaser of target stock. That is, the regulations would be unnecessarily broad. Alternatively, the regulations could be viewed as too narrow because the consistency rules of §1.338–8, by their terms, only apply to corporate purchasers.

The IRS and Treasury Department agree with the commenters' concerns about the potential breadth of the consistency rules as applied to section 336(e). We do not believe that the purposes of the consistency rules mandate a carryover basis for an asset unless the same person (or a related person) acquires both the asset of the target (or subsidiary of target) and more than a minimal amount of the stock of target. In addition, it would be inappropriate to limit the consistency rules for purposes of section 336(e) to corporate purchasers. Accordingly, the final regulations provide that the consistency rules apply to an asset only if the asset is owned, immediately after its acquisition and on the disposition date, by a person (or by a related person to such a person) that acquires five percent or more, by value, of the stock of target in a qualified stock disposition.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. Further, it is hereby certified that these final regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations do not have a substantial economic impact because they merely provide for an election in the context of certain sales, exchanges, and distributions of stock of corporations. The collections of information may affect small businesses if the stock of a corporation that is a small entity is disposed of in a qualified stock disposition. The regulations permit an election to be filed in order to treat a stock sale as an asset sale, and impose the same type of requirements on small businesses as section 338(h)(10). The professional skills that would be necessary to make the election would be the same as those required to prepare a return for the small business. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, these final regulations, as well as the proposed regulations preceding these final regulations, were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business, and no comments were received.

Drafting Information

The principal author of these regulations is Mark J. Weiss of the Office of Associate Chief Counsel (Corporate). Other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1 — INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.336–1 is also issued under 26 U.S.C. 336. * * *

Section 1.336–2 is also issued under 26 U.S.C. 336. * * *

Section 1.336–3 is also issued under 26 U.S.C. 336. * * *

Section 1.336–4 is also issued under 26 U.S.C. 336. * * *

Section 1.336–5 is also issued under 26 U.S.C. 336. * * *

Par. 2. Sections 1.336–0 through 1.336–5 are added to read as follows:

§1.336–0 Table of contents.

This section lists captions contained in §§1.336–1, 1.336–2, 1.336–3, 1.336–4, and 1.336–5.

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

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(b) Definitions.

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(5) Disposed of; disposition.

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(A) In general.
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(11) Section 336(e) election.
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(14) Deemed asset disposition.
(15) Deemed disposition tax consequences.
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§1.336–2 Availability, mechanics, and consequences of section 336(e) election.

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(A) In general.
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(*1*) Gains.
(*2*) Losses.
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(*iii*) Amount and allocation of disallowed loss.
(*iv*) Tiered targets.
(*3*) Examples.
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(*i*) In general.
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(*iv*) Tiered targets.
(*3*) Examples.
(C) Tiered targets.
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(B) Tiered targets.
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(iii) Seller—distribution of target stock.
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(v) Qualification under section 355.
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(f) Treatment of target under other provisions of the Internal Revenue Code.
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(1) Target as two corporations.
(2) Treatment of members of a consolidated group.
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(i) Source and foreign tax credit.
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(A) General rule.
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(iii) Disallowance of foreign tax credits under section 901(m).
(h) Making the section 336(e) election.
(1) Consolidated group.
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(3) S corporation target.
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§1.336–3 Aggregate deemed asset disposition price; various aspects of taxation of the deemed asset disposition.

(a) Scope.
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(3) Section 338 election; section 338(h)(10) election; section 336(e) election.
(4) New target; old target.
(5) Recently purchased stock; recently disposed stock.
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(c) Gain recognition election.
(1) In general.
(2) 80-percent purchaser.
(3) Non–80-percent purchaser.
(4) Gain recognition election statement.
(d) Examples.

§1.336–5 Effective/applicability date.

§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, referred 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.

§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 x $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 x $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-tier 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 shareholders (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 tar-*

get—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) (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)(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 distributed 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, $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 x $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 x $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-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), 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 nonrecently 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, 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 1.338–6 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. 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 stock 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 ($8,000 ((50 shares x $88) + (30 shares x $120)) / .80 ($9,600 (80 shares x $120) / $12,000 (100 shares x $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 ($8,000 ((50 shares x $88) + (30 shares x $120)) x 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 an 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 im-

mediately 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.

§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 principles 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 x $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 x $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 common stock x $60, the value of a share of Target common stock on the disposition date) + (100, the total number of shares of Target preferred stock x $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 x ($2,750/($2,750 + $3,850))) and $3,500 is allocated to Asset 3 ($6,000 x ($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 dis-

posed in the qualified stock disposition x $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 x $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 x ($1,000/($1,000 + $2,025))) and $1,841 is allocated to Asset 5 ($2,750 x ($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 x 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, B1 is the adjusted basis of Asset 1, and B2 is the adjusted basis of Asset 2):

TotADADP = G + L + (T_R x (TotADADP - B1 - B2))
A1ADADP = TotADADP - A2ADADP
A2ADADP = $16,000
A1ADADP = TotADADP - $16,000
G = ($6,000 + ($560 x 90))/ 1
G = $56,400
TotADADP = $56,400 + 0 + (.34 x (TotADADP - $15,000 - $38,000))
TotADADP = $56,400 + .34TotADADP - $18,020
.66TotADADP = $38,380
TotADADP = $58,152
A1ADADP = $42,152

(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).

§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; nonrecently 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 applying §§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 nonrecently 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, her, 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, her, 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 x $10) + (5 x $14) + (5 x $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 x 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 x $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 recognition 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 x $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 x 92/70 x 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 stock, TotL is Target's total liabilities, including Target's tax liability, and X is A's total acquisition costs):

AGUB = GRD + BND + TotL
GRD = ($6,000 + ($560 x 90)) x ((100 - 0) / 100) + X
GRD = ($6,000 + $50,400) x (100/100) + $100
GRD = $56,500
BND = $0
TotL = .34 x ($27,152 (Target's gain recognized on deemed disposition of Asset 1) - $22,000 (Target's loss recognized on deemed disposition of Asset 2)) (see *Example 3* of §1.336–3(g) for determination of Target's gain and loss recognized on deemed disposition of Assets 1 and 2)
TotL = $1,752
AGUB = $56,500 + $0 + $1,752
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.

§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.

Par. 3. Section 1.338–0 is amended by adding entries for §§1.338–1(e) and 1.338–5(h) to read as follows:

§1.338–0 Outline of topics.

* * * * *

§1.338–1 General principles; status of old target and new target.

* * * * *

(e) *Effective/applicability date.*

* * * * *

§1.338–5 Adjusted grossed-up basis.

* * * * *

(h) *Effective/applicability date.*

* * * * *

Par. 4. Section 1.338–1 is amended by adding three new sentences after the parenthetical that follows the third sentence of paragraph (a)(1), by revising the first sentence in paragraph (c)(1), and adding a new paragraph (e) to read as follows:

§1.338–1 General principles; status of old target and new target.

(a) * * *

(1) * * * However, if, as a result of the deemed purchase of old target's assets pursuant to a section 336(e) election, there would be both a qualified stock purchase and a qualified stock disposition (as defined in §1.336–1(b)(6)) of the stock of a subsidiary of target, neither a section 338(g) election nor a section 338(h)(10) election may be made with respect to the qualified stock purchase of the subsidiary. Instead, a section 336(e) election may be made with respect to such purchase. See §1.336–1(b)(6)(ii). * * *

* * * * *

(c) * * *

(1) *In general.* The rules of this paragraph (c) apply for purposes of applying the regulations under sections 336(e), 338, and 1060. * * *

* * * * *

(e) *Effective/applicability date.* Paragraphs (a)(1) and (c)(1) of this section are applicable to any qualified stock disposition for which the disposition date (as defined in §1.336–1(b)(8)) is on or after May 15, 2013.

Par. 5. Section 1.338–5 is amended by revising the first sentence in paragraph (d)(3)(ii) and by adding a new paragraph (h) to read as follows:

§1.338–5 Adjusted grossed-up basis.

* * * * *

(d) * * *

(3) * * *

(ii) *Basis amount.* The basis amount is equal to the amount in paragraphs (c)(1) and (2) of this section (the purchasing corporation's grossed-up basis in recently purchased target stock at the beginning of the day after the acquisition date determined without regard to the acquisition costs taken into account in paragraph (c)(3) of this section) multiplied by a fraction the numerator of which is the percentage of target stock (by value, determined on the acquisition date) attributable to the purchasing corporation's nonrecently purchased target stock and the denominator of which is 100 percent minus the numerator amount. * * *

* * * * *

(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.

Par. 6. Section 1.901–2 is amended by redesignating paragraph (f)(5) as paragraph (f)(6), adding a new paragraph (f)(5), and revising the first sentence in paragraph (h)(4) to read as follows:

§1.901–2 Income, war profits, or excess profits tax paid or accrued.

* * * * *

(f) * * *

(5) *Allocation of foreign taxes in connection with elections under section 336(e) or 338.* For rules relating to the allocation of foreign taxes in connection with elections made pursuant to section 336(e), see §1.336–2(g)(3)(ii). For rules relating to the allocation of foreign taxes in connection with elections made pursuant to section 338, see §1.338–9(d).

* * * * *

(h) * * *

(4) Paragraphs (f)(3), (f)(4), and (f)(6) of this section apply to foreign taxes paid or accrued in taxable years beginning after February 14, 2012. * * *

Par. 7. Section 1.1502–13 is amended by:

1. Revising the heading of paragraph (f)(5)(ii)(C).

2. Revising the first sentence in paragraph (f)(5)(ii)(C)(*1*).

3. Adding a new sentence at the end of paragraph (m).

The revisions and addition read as follows:

§1.1502–13 Intercompany transactions.

* * * * *

(f) * * *

(5) * * *

(ii) * * *

(C) *Section 338(h)(10) and section 336(e)—(1) In general.* This paragraph (f)(5)(ii)(C) applies to a deemed liquidation of T under section 332 as the result of an election under section 338(h)(10) or section 336(e). * * *

* * * * *

(m) *Effective/applicability date.* * * * Paragraph (f)(5)(ii)(C) of this section is applicable to any qualified stock disposition (as defined in §1.336–1(b)(6)) for which the disposition date (as defined in §1.336–1(b)(8)) is on or after May 15, 2013.

* * * * *

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

Approved May 9, 2013

Mark J. Mazur,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on May 10, 2013, 4:15 p.m., and published in the issue of the Federal Register for May 15, 2013, 78 FR 28467)

Section 338.—Certain Stock Purchases Treated as Asset Acquisitions

Final regulations under section 336(e) of the Code provide for an election to treat the sale, exchange, or distribution of at least 80 percent of the stock of a domestic subsidiary corporation or a subchapter S corporation as a sale of the corporation's assets, rather than a sale of its stock. See T.D. 9619, page 1212.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of June 2013. See Rev. Rul. 2013-12, page 1237.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2013. See Rev. Rul. 2013-12, page 1237.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2013. See Rev. Rul. 2013-12, page 1237.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2013. See Rev. Rul. 2013-12, page 1237.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of June 2013. See Rev. Rul. 2013-12, page 1237.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2013. See Rev. Rul. 2013-12, page 1237.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of June 2013. See Rev. Rul. 2013-12, page 1237.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2013. See Rev. Rul. 2013-12, page 1237.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2013. See Rev. Rul. 2013-12, page 1237.

Section 901.—Taxes of Foreign Countries and of Possessions of United States

Final regulations under section 336(e) of the Code provide for an election to treat the sale, exchange, or distribution of at least 80 percent of the stock of a domestic subsidiary corporation or a subchapter S corporation as a sale of the corporation's assets, rather than a sale of its stock. See T.D. 9619, page 1212.

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also Sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for June 2013.

Rev. Rul. 2013–12

This revenue ruling provides various prescribed rates for federal income tax purposes for June 2013 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the

low-income housing credit described in section 42(b)(1) for buildings placed in service during the current month. However, under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, with respect to housing credit dollar amount allocations made before January 1, 2014, shall not be less than 9%. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2013–12 TABLE 1

Applicable Federal Rates (AFR) for June 2013

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term				
AFR	.18%	.18%	.18%	.18%
110% AFR	.20%	.20%	.20%	.20%
120% AFR	.22%	.22%	.22%	.22%
130% AFR	.23%	.23%	.23%	.23%
Mid-term				
AFR	.95%	.95%	.95%	.95%
110% AFR	1.05%	1.05%	1.05%	1.05%
120% AFR	1.14%	1.14%	1.14%	1.14%
130% AFR	1.24%	1.24%	1.24%	1.24%
150% AFR	1.44%	1.43%	1.43%	1.43%
175% AFR	1.67%	1.66%	1.66%	1.65%
Long-term				
AFR	2.47%	2.45%	2.44%	2.44%
110% AFR	2.72%	2.70%	2.69%	2.68%
120% AFR	2.96%	2.94%	2.93%	2.92%
130% AFR	3.22%	3.19%	3.18%	3.17%

REV. RUL. 2013–12 TABLE 2

Adjusted AFR for June 2013

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	.18%	.18%	.18%	.18%
Mid-term adjusted AFR	.95%	.95%	.95%	.95%
Long-term adjusted AFR	2.47%	2.45%	2.44%	2.44%

REV. RUL. 2013–12 TABLE 3

Rates Under Section 382 for June 2013

Adjusted federal long-term rate for the current month	2.47%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	2.70%

REV. RUL. 2013–12 TABLE 4

Appropriate Percentages Under Section 42(b)(1) for June 2013

Note: Under Section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, with respect to housing credit dollar amount allocations made before January 1, 2014, shall not be less than 9%.

Appropriate percentage for the 70% present value low-income housing credit	7.39%
Appropriate percentage for the 30% present value low-income housing credit	3.17%

REV. RUL. 2013–12 TABLE 5

Rate Under Section 7520 for June 2013

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	1.2%

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2013. See Rev. Rul. 2013-12, page 1237.

Section 1502.—Regulations

Final regulations under section 336(e) of the Code provide for an election to treat the sale, exchange, or distribution of at least 80 percent of the stock of a domestic subsidiary corporation or a subchapter S corporation as a sale of the corporation's assets, rather than a sale of its stock. See T.D. 9619, page 1212.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2013. See Rev. Rul. 2013-12, page 1237.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2013. See Rev. Rul. 2013-12, page 1237.

Part III. Administrative, Procedural, and Miscellaneous

Conclusive Presumption of Worthlessness of Debts

Notice 2013–35

SECTION 1. PURPOSE

This notice requests public comments on Treas. Reg. § 1.166–2(d)(1) and (3) (the "Conclusive Presumption Regulations"). In particular, comments are sought on whether 1) changes that have occurred in bank regulatory standards and processes since adoption of the Conclusive Presumption Regulations require amendment of those regulations, and 2) application of the Conclusive Presumption Regulations continues to be consistent with the principles of section 166. Comments are also sought on the types of entities that are permitted, or should be permitted, to apply a conclusive presumption of worthlessness.

SECTION 2. LAW

Section 166(a)(1) permits a deduction for any debt that becomes worthless in the taxable year. Section 166(a)(2) authorizes the Secretary to issue guidance on deducting debt that becomes partially worthless within the taxable year, with the deduction not to exceed the amount charged off.

Generally, whether a debt has become worthless within the taxable year is determined by examining all pertinent evidence, including objective circumstances such as the value of the collateral and the financial condition of the debtor. Section 1.166–2(a). Additionally, worthlessness is generally associated with identifiable events demonstrating the worthlessness of the debt and justifying the abandonment of hope of recovery. *Cole v. Commissioner*, 871 F.2d 64, 67 (7th Cir. 1989).

Section 1.166–2 includes two alternative rules that, if met, provide banks and other regulated corporations with a conclusive presumption that a debt is worthless. Section 1.166–2(d)(1) provides that

> [i]f a bank or other corporation which is subject to supervision by Federal authorities, or by State authorities maintaining substantially equivalent standards, charges off a debt in whole or part, either—
>
> (i) In obedience to the specific order of such authorities, or
>
> (ii) In accordance with established policies of such authorities, and, upon their first audit of the bank or other corporation subsequent to the charge-off, such authorities confirm in writing that the charge-off would have been subject to such specific orders if the audit had been made on the date of the charge-off,
>
> then the debt shall, to the extent charged off during the taxable year, be conclusively presumed to have become worthless, or worthless only in part, as the case may be, during such taxable year.

The conclusive presumption rule set forth in section 1.166–2(d)(1) is referred to herein as the "Specific Order Method."

Section 1.166–2(d)(3) provides an alternative method of accounting for banks that make a conformity election (the "Book Conformity Method"). If a bank regulator issues an express determination letter stating that a bank electing to use the Book Conformity Method maintains and applies loan loss classification standards that are consistent with the regulatory loan loss classification standards of the bank regulator, then loans classified by the bank as loss assets and charged off are conclusively presumed to have become worthless in whole or in part. The regulations define a loss asset as one that is classified as such under the standards set forth in

> the "Uniform Agreement on the Classification of Assets and Securities Held by Banks" (See Attachment to Comptroller of the Currency Banking Circular No. 127, Rev. 4–26–91...) or similar guidance issued by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve, or the Farm Credit Administration; or for institutions under the supervision of the Office of Thrift Supervision, 12 CFR 563.160(b)(3).
>
> Section 1.166–2(d)(3)(ii)(C).

SECTION 3. DISCUSSION

A. Bank Regulatory Standards and Debt Asset Review Process

The Conclusive Presumption Regulations reflect a policy that when there is sufficient similarity between the standards a tax administrator uses to permit a deduction for a bad debt and the standards a regulator uses to identify a loan that should be charged off, in whole or in part, the tax administrator should accept the determination of the regulator for purposes of section 166. This policy provides administrative convenience in that a debt asset is treated consistently for regulatory and tax purposes and only one agency needs to analyze the debt assets in a regulated entity's loan portfolio. In view of the "large volume of loans charged off annually for regulatory purposes," administrative convenience alone is not a sufficient reason for the Conclusive Presumption Regulations. *See* Treasury Department, Report to the Congress on the Tax Treatment of Bad Debts by Financial Institutions 19 (September 1991)("Treasury Report"). Rather, the standards and processes applied by a regulator must result in loan classifications that are "similar enough to the criteria for worthlessness under section 166 to make regulatory criteria and examination by regulatory authorities an acceptable surrogate for independent investigation by the Internal Revenue Service." Treasury Report, 19–22. Although the Treasury Department and the Internal Revenue Service believed that this similarity existed at the time of the adoption of the Conclusive Presumption Regulations, subsequent changes in the standards or processes that bank regulators use to determine worthlessness of a debt may have undermined the assumptions underlying the Conclusive Presumption Regulations.

Since adoption of the Conclusive Presumption Regulations, there have been a number of significant changes to the regulatory standards for loan charge-offs. For example, bank regulators rarely order banks to charge off particular loans or provide written confirmation that a bank took an appropriate charge-off on a loan as required by the Specific Order Method. Bank regulators also have changed the

standards that are used for charge-offs, and they no longer classify a loss asset using the April 26, 1991, version of the Uniform Agreement on the Classification of Assets and Appraisal of Securities Held by Banks that is referenced in the Conclusive Presumption Regulations.

In 2004, the bank regulators adopted the 2004 Uniform Agreement on the Classification of Assets and Appraisal of Securities Held by Banks and Thrifts (the "2004 Classification and Appraisal Agreement"), rescinding the prior 1991 agreement. The 2004 Classification and Appraisal Agreement classified applicable debt securities by relying on Financial Accounting Standards Board ("FASB") pronouncements. Under the 2004 Classification and Appraisal Agreement, a debt security is considered impaired if its fair value is less than its amortized cost, and the standards mandate recognizing a loss equal to the full difference between the debt's fair value and its amortized cost if the reduction in value (impairment) is other than temporary.

Additional changes to bank regulatory standards were made in 2009, when FASB issued additional guidance. *See* O.C.C. Bulletin 2009–11, Other-Than-Temporary Impairment Accounting (April 17, 2009). That guidance changed how the impairment should be reported on financial statements for held-to-maturity debt securities. For a held-to-maturity debt security, the portion of loss related to credit loss is to be recognized in earnings (on the income statement), while the portion of loss related to all other factors is to be reported directly on the balance sheet as other comprehensive income (thereby bypassing the income statement). Financial Accounting Standards Board Staff Positions, FSP FAS 115–2 and 124–2, Recognition and Presentation of Other-Than-Temporary Impairments (later codified as part of Accounting Standards Codification 320). Thus, beginning in 2009, the portion of the loss on held-to-maturity debt securities associated with credit impairment, as defined in regulatory standards, could be separately identified. These standards continue to be subject to future change, and they are currently under active review by FASB with a view, in part, to creating a uniform impairment model. *See* Exposure Draft, *Financial Instruments—Credit Losses (Subtopic 825–15)* (December 20, 2012).

In light of these changes to the regulatory standards relevant to loan charge-offs, the Treasury Department and the Internal Revenue Service are evaluating the Conclusive Presumption Regulations.

B. Entities Subject to the Conclusive Presumption Regulations

The Book Conformity Method under the Conclusive Presumption Regulations is expressly available only to banks. The Specific Order Method, in contrast, applies to a bank "...or other corporation which is subject to supervision by Federal authorities, or by State authorities maintaining substantially equivalent standards." The Treasury Department and the Internal Revenue Service have received questions about which taxpayers may qualify as "other corporations" for this purpose, particularly with respect to insurance companies and government-sponsored enterprises.

SECTION 4. REQUEST FOR COMMENTS

The Treasury Department and Internal Revenue Service request public comments on the matters described in Section 3 of this Notice. While comments on any aspect of these matters are welcome, we request comments on the following questions in particular:

1. Which corporations are regulated by a Federal or State entity that reviews and makes determinations about worthlessness of debt assets in a manner consistent with the tax standards for worthlessness under section 166, and which of these entities should be covered by revised conclusive presumption rules?
2. Should the Conclusive Presumption Regulations be modified to reflect the changes in bank regulatory standards and processes since adoption of the regulations, and if so, how?
3. Are the current bank regulatory standards incorporating generally accepted accounting principles ("GAAP") sufficiently similar to the standard of worthlessness under section 166 that they may appropriately be used in formulating revised conclusive presumption rules?
4. Should § 1.166–2(d)(1) and (3) be replaced with a single rule or should the regulations retain more than one conclusive presumption of worthlessness?
5. What process should be required by any new conclusive presumption regulations to verify that the regulated entity applied appropriate regulatory standards in taking a charge-off?
6. Are there limits that should be placed on the extent to which the timing of a deduction under section 166 may vary from the time when the regulatory standards mandate a charge-off?
7. Are there impediments to the uniform application of a loss standard across different GAAP debt classifications?

Comments must be submitted by October 8, 2013. All materials submitted will be available for public inspection and copying. Comments may be submitted to Internal Revenue Service, CC:PA:LPD:PR (Notice 2013–35), Room 5203, PO Box 7604, Ben Franklin Station, Washington, D.C. 20044. Submissions may also be hand-delivered Monday through Friday between the hours of 8:00 a.m. and 4:00 p.m. to the Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224, Attn: CC:PA:LPD:PR (Notice 2013–35), Room 5203. Submissions may also be sent electronically via the internet to the following email address: *Notice.Comments@irscounsel.treas.gov*. Include the notice number (Notice 2013–35) in the subject line.

SECTION 5. DRAFTING INFORMATION

The principal authors of this notice are Matthew P. Howard and John W. Rogers III of the Office of the Associate Chief Counsel (Financial Institutions & Products). For further information regarding this notice, contact Mr. Howard or Mr. Rogers at (202) 622–4695 (not a toll-free call).

Per Capita Payments from Proceeds of Settlements of Indian Tribal Trust Cases

Notice 2013–36

BACKGROUND

Notice 2013–1, 2013–3 I.R.B. 281, provides guidance on the federal tax treatment of per capita payments that members of Indian tribes receive from proceeds of certain settlements of tribal trust cases between the United States and those Indian tribes. Additional tribes have settled tribal trust cases against the United States since publication of Notice 2013–1. This notice provides an updated Appendix that reflects the additional settlement agreements.

EFFECT ON OTHER DOCUMENTS

Notice 2013–1 Appendix is modified and superseded.

FURTHER INFORMATION

For further information regarding this notice, please contact Telly Meier at phone number (202) 283–8877 (not a toll-free call).

Appendix
Tribes That Have Entered into Settlement Agreements of Tribal Trust Cases

1. Assiniboine and Sioux Tribes of the Fort Peck Reservation
2. Bad River Band of Lake Superior Chippewa Indians
3. Blackfeet Tribe of the Blackfeet Indian Reservation
4. Bois Forte Band of Chippewa
5. Cachil Dehe Band of Wintun Indians of the Colusa Rancheria
6. Chippewa Cree Tribe of the Rocky Boy's Reservation
7. Coeur d'Alene Tribe
8. Confederated Salish and Kootenai Tribes
9. Confederated Tribes of Siletz Indians
10. Confederated Tribes of the Colville Reservation
11. Confederated Tribes of the Goshute Reservation
12. Crow Creek Sioux Tribe
13. Eastern Shawnee Tribe of Oklahoma
14. Hualapai Indian Tribe
15. Iowa Tribe of Kansas and Nebraska
16. Kaibab Band of Paiute Indians of Arizona
17. Kickapoo Tribe of Kansas
18. Lac Courte Oreilles Band of Lake Superior Chippewa Indians
19. Lac du Flambeau Band of Lake Superior Chippewa Indians
20. Leech Lake Band of Ojibwe
21. Lower Brule Sioux Tribe
22. Makah Indian Tribe of the Makah Reservation
23. Mescalero Apache Tribe
24. Minnesota Chippewa Tribe
25. Nez Perce Tribe
26. Nooksack Indian Tribe
27. Northern Cheyenne Tribe of Indians
28. Omaha Tribe of Nebraska
29. Passamaquoddy Tribe of Maine
30. Pawnee Nation
31. Prairie Band of Potawatomi Nation
32. Pueblo of Zia
33. Quechan Tribe of the Fort Yuma Reservation
34. Red Cliff Band of Lake Superior Chippewa Indians
35. Rincon Luiseño Band of Indians
36. Rosebud Sioux Tribe
37. Round Valley Indian Tribes
38. Salt River Pima-Maricopa Indian Community
39. Santee Sioux Tribe of Nebraska
40. Sault Ste. Marie Tribe
41. Shoshone-Bannock Tribes of the Fort Hall Reservation
42. Soboba Band of Luiseño Indians
43. Spirit Lake Dakotah Nation
44. Spokane Tribe of Indians
45. Standing Rock Sioux Tribe
46. Stillaguamish Tribe of Indians
47. Summit Lake Paiute Tribe
48. Swinomish Indian Tribal Community

Appendix
Tribes That Have Entered into Settlement Agreements of Tribal Trust Cases

49. Te-Moak Tribe of Western Shoshone Indians
50. Tohono O'odham Nation
51. Tulalip Tribes
52. Tule River Indian Tribe
53. Ute Indian Tribe of the Uintah and Ouray Reservation
54. Ute Mountain Ute Tribe
55. Winnebago Tribe of Nebraska
56. Qawalangin Tribe of Unalaska
57. Tlingit & Haida Tribes of Alaska
58. Northwestern Band of Shoshone Indians
59. Hoopa Valley Tribe
60. Ak-Chin Indian Community
61. Oglala Sioux Tribe
62. Yoruk Tribe
63. Cheyenne River Sioux Tribe
64. Paiute-Shoshone Indians of the Bishop Community of the Bishop Colony
65. Seminole Nation of Oklahoma
66. Otoe-Missouria Tribe of Oklahoma

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26 CFR 601.601: Rules and Regulations.
(Also Part I, §§ 25, 103, 143; 1.25–4T, 1.103–1, 6a.103A–2.)

Rev. Proc. 2013–27

SECTION 1. PURPOSE

This revenue procedure provides guidance with respect to the United States and area median gross income figures that are to be used by issuers of qualified mortgage bonds, as defined in § 143(a) of the Internal Revenue Code, and issuers of mortgage credit certificates, as defined in § 25(c), in computing the income requirements described in § 143(f).

SECTION 2. BACKGROUND

.01 Section 103(a) provides that, except as provided in § 103(b), gross income does not include interest on any state or local bond. Section 103(b)(1) provides that § 103(a) shall not apply to any private activity bond that is not a qualified bond (within the meaning of § 141). Section 141(e) provides that the term "qualified bond" includes any private activity bond that (1) is a qualified mortgage bond, (2) meets the applicable volume cap requirements under § 146, and (3) meets the applicable requirements under § 147.

.02 Section 143(a)(1) provides that the term "qualified mortgage bond" means a bond that is issued as part of a "qualified mortgage issue". Section 143(a)(2)(A) provides that the term "qualified mortgage issue" means an issue of one or more bonds by a state or political subdivision thereof, but only if (i) all proceeds of the issue (exclusive of issuance costs and a reasonably required reserve) are to be used to finance owner-occupied residences; (ii) the issue meets the requirements of subsections (c), (d), (e), (f), (g), (h), (i), and (m)(7) of § 143; (iii) the issue does not meet the private business tests of paragraphs (1) and (2) of § 141(b); and (iv) with respect to amounts received more than 10 years after the date of issuance, repayments of $250,000 or more of principal on financing provided by the issue are used not later than the close of the first semi-annual period beginning after the date the prepayment (or complete repayment) is received to redeem bonds that are part of the issue.

.03 Section 143(f) imposes eligibility requirements concerning the maximum income of mortgagors for whom financing may be provided by qualified mortgage bonds. Section 25(c)(2)(A)(iii)(IV) provides that recipients of mortgage credit certificates must meet the income requirements of § 143(f). Generally, under §§ 143(f)(1) and 25(c)(2)(A)(iii)(IV), these income requirements are met only if all owner-financing under a qualified mortgage bond and all certified indebtedness amounts under a mortgage credit certificate program are provided to mortgagors whose family income is 115 percent or less of the applicable median family income. Under § 143(f)(6), the income limitation is reduced to 100 percent of the applicable median family income if there are fewer than three individuals in the family of the mortgagor.

.04 Section 143(f)(4) provides that the term "applicable median family income" means the greater of (A) the area median gross income for the area in which the residence is located, or (B) the statewide median gross income for the state in which the residence is located.

.05 Section 143(f)(5) provides for an upward adjustment of the income limitations in certain high housing cost areas. Under § 143(f)(5)(C), a high housing cost area is a statistical area for which the housing cost/income ratio is greater than 1.2. The housing cost/income ratio is determined under § 143(f)(5)(D) by dividing (a) the applicable housing price ratio by (b) the ratio that the area median gross income bears to the median gross income for the United States. The applicable housing price ratio is the new housing price ratio (new housing average purchase price for the area divided by the new housing average purchase price for the United States) or the existing housing price ratio (existing housing average area purchase price divided by the existing housing average purchase price for the United States), whichever results in the housing cost/income ratio being closer to 1. This income adjustment applies only to bonds issued, and nonissued bond amounts elected, after

December 31, 1988. See § 4005(h) of the Technical and Miscellaneous Revenue Act of 1988, 1988–3 C.B. 1, 311 (1988).

.06 The Department of Housing and Urban Development (HUD) has computed the median gross income for the United States, the states, and statistical areas within the states. The income information was released to the HUD regional offices on December 11, 2012, and may be obtained by calling the HUD reference service at 1–800–245–2691. The income information is also available at HUD's World Wide Web site, *http://www.huduser.org/portal/datasets/il.html*, which provides a menu from which you may select the year and type of data of interest.

.07 The most recent nationwide average purchase prices and average area purchase price safe harbor limitations were published on May 14, 2012, in Rev. Proc. 2012–25, 2012–20 I.R.B. 914.

SECTION 3. APPLICATION

.01 When computing the income requirements of § 143(f), issuers of qualified mortgage bonds and mortgage credit certificates must use either (1) the median gross income for the United States, the states, and statistical areas within the states, as released to the HUD regional offices on December 01, 2011, or (2) the median gross income for the United States, the states, and statistical areas within the states, as released to the HUD regional offices on December 11, 2012.

.02 If an issuer uses the median gross income for the United States, the states, and statistical areas within the states, as released to the HUD regional offices on December 01, 2011, to compute the housing cost/income ratio under § 143(f)(5), the issuer must use the median gross income for the United States, the states, and statistical areas within the states, as released to the HUD regional offices on December 01, 2011, for all purposes under § 143(f). Likewise, if an issuer uses the median gross income for the United States, the states, and statistical areas within the states, as released to the HUD regional offices on December 11, 2012, to compute the housing cost/income ratio under § 143(f)(5), the issuer must use the median gross income for the United States, the states, and statistical areas within the states, as released to the HUD regional offices on December 11, 2012, for all purposes under § 143(f).

SECTION 4. EFFECT ON OTHER REVENUE PROCEDURES

.01 Rev. Proc. 2012–16, 2012–10 I.R.B. 452, is obsolete except as provided in §§ 3.01, 3.02, or 5.01 of this revenue procedure.

.02 This revenue procedure does not affect the effective date provisions of Rev. Rul. 86–124, 1986–2 C.B. 27. Those effective date provisions will remain operative at least until the Service publishes a new revenue ruling that conforms the approach to effective dates set forth in Rev. Rul. 86–124 to the general approach taken in this revenue procedure.

SECTION 5. EFFECTIVE DATES

.01 Issuers must use the United States and area median gross income figures specified in § 3.01 of this revenue procedure for commitments to provide financing that are made, or (if the purchase precedes the financing commitment) for residences that are purchased, in the period that begins on December 11, 2012, and ends on the date when these United States and area median gross income figures are rendered obsolete by a new revenue procedure.

DRAFTING INFORMATION

The principal authors of this revenue procedure are David White and James Polfer of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure contact Mr. White or Mr. Polfer at (202) 622–3980 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Computation of, and Rules Relating to, Medical Loss Ratio

REG–126633–12

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations that provide guidance to Blue Cross and Blue Shield organizations, and certain other health care organizations, on computing and applying the medical loss ratio added to the Internal Revenue Code by the Patient Protection and Affordable Care Act. This document also contains a request for comments and provides notice of a public hearing on these proposed regulations.

DATES: Comments must be received by August 12, 2013. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for Tuesday, September 17, 2013, at 10 a.m. must be received by August 12, 2013.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–126633–12), Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–126633–12), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC, or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–126633–12). The public hearing will be held in the IRS Auditorium of the Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Graham R. Green, (202) 622–3970; concerning the submission of comments, the public hearing, and/or to be placed on the business access list to attend the hearing, Oluwafunmilayo Taylor, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 833 of the Internal Revenue Code (Code) provides that Blue Cross and Blue Shield organizations, and certain other health care organizations, are entitled to: (1) treatment as stock insurance companies; (2) a special deduction; and (3) computation of unearned premium reserves based on 100 percent, and not 80 percent, of unearned premiums under section 832(b)(4). This document contains proposed amendments to 26 CFR part 1 (Income Tax Regulations) under section 833(c)(5). Section 833(c)(5) was added to the Code by section 9016 of the Patient Protection and Affordable Care Act (Affordable Care Act), Public Law 111–148 (124 Stat. 119 (2010)), effective for taxable years beginning after December 31, 2009. Section 833(c)(5) provides that section 833 does not apply to any organization unless the organization's percentage of total premium revenue expended on reimbursement for clinical services provided to enrollees under its policies during such taxable year (as reported under section 2718 of the Public Health Service Act), a ratio referred to for this purpose as the medical loss ratio (MLR), is not less than 85 percent.

Section 2718 of the Public Health Service Act (42 U.S.C. 300gg–18) (PHSA) was added by section 1001 and amended by section 10101 of the Affordable Care Act and was incorporated into the Code by section 9815(a)(1). Section 2718 of the PHSA is administered by the Department of Health and Human Services. Section 2718(a) of the PHSA requires a health insurance issuer to submit a report for each plan year to the Secretary of the Department of Health and Human Services concerning the percentage of total premium revenue, after accounting for collections or receipts for risk adjustment and risk corridors and payments of reinsurance, that the issuer expends: (1) on reimbursement for clinical services provided to enrollees under such coverage; (2) for activities that improve health care quality; and (3) on all other non-claims costs, excluding Federal and State taxes and licensing or regulatory fees.

Section 2718(b) of the PHSA requires that a health insurance issuer offering group or individual health insurance coverage, with respect to each plan year, provide an annual rebate to each enrollee under such coverage, on a *pro rata* basis, if the ratio of the amount of premium revenue the issuer expends on costs for reimbursement for clinical services provided to enrollees under such coverage and for activities that improve health care quality to the total amount of premium revenue (excluding Federal and State taxes and licensing or regulatory fees and after accounting for payments or receipts for risk adjustment, risk corridors, and reinsurance under sections 1341, 1342, and 1343 of the Affordable Care Act (42 U.S.C. 18061, 18062, and 18063)) for the plan year is less than a prescribed percentage. Section 2718(b)(1)(B)(ii) provides that beginning on January 1, 2014, the medical loss ratio computed under section 2718(b) of the PHSA shall be based on expenses and premium revenues for each of the previous three years of the plan.

The Department of Health and Human Services issued interim final regulations on December 1, 2010, effective January 1, 2011, and December 7, 2011, effective January 3, 2012, that were subject to technical corrections on December 30, 2010, and May 16, 2012, and final regulations on December 7, 2011, effective January 3, 2012, May 16, 2012, effective June 15, 2012, and March 11, 2013, effective April 30, 2013 under section 2718 of the PHSA that are codified at 45 CFR part 158 (HHS Regulations). Relevant portions of these HHS Regulations are described in this preamble.

Prior Guidance

On November 23, 2010, the Treasury Department and the IRS issued Notice 2010–79, 2010–49 I.R.B. 809, which provided interim guidance and transitional relief to organizations under section 833(c)(5). The interim guidance applied

to an organization's first taxable year beginning after December 31, 2009.

The interim guidance provided that for purposes of determining whether an organization's percentage of total premium revenue expended on reimbursement for clinical services provided to enrollees was at least 85 percent (and thus satisfied the requirement of section 833(c)(5)), organizations were required to use the definition of "reimbursement for clinical services provided to enrollees" set forth in the HHS Regulations. In addition, the interim guidance provided that for purposes of determining whether the 85-percent requirement of section 833(c)(5) was satisfied, the IRS would not challenge the inclusion of amounts expended for "activities that improve health care quality" as described in the HHS Regulations.

Notice 2010–79 also stated that the consequences for an organization with an MLR of less than 85 percent (an insufficient MLR) were as follows: (1) the organization would not be taxable as a stock insurance company by reason of section 833(a)(1) (but may have been taxable as an insurance company if it otherwise met the requirements of section 831(c)); (2) the organization would not be allowed the special deduction set forth in section 833(b); and (3) the organization would only take into account 80 percent, rather than 100 percent, of its unearned premiums for purposes of computing premiums earned on insurance contracts under section 832(b)(4). However, Notice 2010–79 provided that solely for the first taxable year beginning after December 31, 2009, the IRS would not treat an organization as losing its status as a stock insurance company by reason of section 833(c)(5) provided the following conditions were met: (1) the organization was described in section 833(c) in the immediately preceding taxable year; (2) the organization would have been taxed as a stock insurance company for the current taxable year but for the enactment of section 833(c)(5); and (3) the organization would have met the requirements of section 831(c) to be taxed as an insurance company for the current taxable year but for its activities in the administration, adjustment, or settlement of claims under cost-plus or administrative services-only contracts.

Notice 2010–79 further provided interim guidance on whether the application of section 833 in a taxable year followed by nonapplication of that provision in the subsequent taxable year (or vice versa) could result in one or more changes in accounting method.

Notice 2010–79 invited comments on: (1) what further guidance, if any, was needed under section 833(c)(5); (2) whether specific guidance was needed on accounting method issues that would arise if an organization lost its status as an insurance company; (3) whether guidance would be needed in the future on the appropriate Subchapter L treatment of rebates that are paid under section 2718 of the PHSA; and (4) how guidance could coordinate the medical loss ratio computation under section 2718 of the PHSA with the computation of MLR under section 833(c)(5).

In Notice 2011–4, 2011–2 I.R.B. 282, and Rev. Proc. 2011–14, 2011–4 I.R.B. 330, the Treasury Department and the IRS provided procedures for an organization to obtain automatic consent to change its method of accounting for unearned premiums by reason of the application of section 833(c)(5).

On June 12, 2011, the Treasury Department and the IRS issued Notice 2011–51, 2011–27 I.R.B. 36, extending the interim guidance and transitional relief provided in Notice 2010–79 to an organization's first taxable year beginning after December 31, 2010. On May 26, 2012, the Treasury Department and the IRS issued Notice 2012–37, 2012–24 I.R.B. 1014 extending the interim guidance and transitional relief provided in Notice 2010–79 and Notice 2011–51, as clarified by Notice 2011–4 and Rev. Proc. 2011–14, through an organization's first taxable year beginning after December 31, 2012. Notice 2012–37 indicated that proposed regulations would be issued and requested comments on all aspects of section 833(c)(5), including how the proposed regulations might account for the specific reporting required under section 2718 of the PHSA and coordinate the computations under section 2718 of the PHSA and section 833(c)(5).

The Treasury Department and the IRS received four comments in response to Notice 2010–79 and two comments in response to Notice 2012–37 and have considered all comments in drafting these proposed regulations. The comments are discussed in more detail in this preamble.

Explanation of Provisions

1. *Determining the MLR*

In describing the MLR computation under section 833(c)(5), the statute provides that the elements in the computation are to be "as reported under section 2718 of the Public Service Health Act." As more specifically discussed below, commenters argued that this cross reference indicates that the MLR computation under section 833(c)(5) should be the same as the medical loss ratio computation under section 2718(b) of the PHSA. The Treasury Department and IRS have concluded that this cross reference indicates that Congress intended that, to the extent consistent with the express language in section 833(c)(5), the meaning of terms and the methodology used in the MLR computation under section 833(c)(5) should be consistent with the definition of those same terms and the methodology under section 2718 of the PHSA.

a. *MLR numerator*

Commenters suggested that the term "reimbursement for clinical services provided to enrollees" in section 833(c)(5) has the same meaning as provided under section 2718 of the PHSA. Both section 833(c)(5) and section 2718 of the PHSA include "reimbursement for clinical services provided to enrollees" in the numerator. Through the phrase "as reported under section 2718 of the Public Health Service Act," section 833(c)(5) suggests that the meaning of "reimbursement for clinical services provided to enrollees" should be the same as the meaning of that phrase for section 2718 of the PHSA and the regulations issued under that section. Accordingly, the proposed regulations adopt this suggestion.

Commenters suggested that in addition to amounts expended for reimbursement for clinical services provided to enrollees, the MLR numerator include amounts expended for "activities that improve health care quality" as reported under section 2718 of the PHSA. The proposed regulations do not adopt this suggestion. Unlike the phrase "reimbursement for clinical services provided to enrollees" that appears in the description of the numerator in both section 833(c)(5) and section 2718 of the PHSA, "activities that improve health

care quality" appears only in the description of the numerator in section 2718 of the PHSA; it does not appear in section 833(c)(5). Accordingly, the Treasury Department and IRS have concluded that the MLR numerator in section 833(c)(5) does not include costs for "activities that improve health care quality."

b. *MLR denominator*

Commenters suggested that term total premium revenue in the MLR denominator under section 833(c)(5) should have the same exclusions as provided for under section 2718(b) of the PHSA. The proposed regulations adopt this suggestion. Section 833(c)(5) refers to total premium revenue in describing the denominator. Section 2718(b) of the PHSA, which sets forth the rules for computing medical loss ratio for that section, also refers to total premium revenue and lists specific exclusions that should be taken from total premium revenue, including taxes and regulatory fees. These proposed regulations provide that the same exclusions that are permitted from total premium revenue under section 2718(b) of the PHSA are permitted exclusions from total premium revenue under section 833(c)(5) because, while these exclusions are not expressly included in the references to total premium revenue in section 833(c)(5) or section 2718(a) of the PHSA, both section 833(c)(5) and section 2718(b) of the PHSA use the term "total premium revenue." Under the HHS Regulations, these exclusions include assessments and fees imposed by the Affordable Care Act (see 45 CFR 158.221(c) and 158.240(c)). However, an organization's operating costs or any administrative costs associated with taxes or fees are not part of a State or Federal assessment and therefore may not be deducted from total premium revenue for purposes of the MLR calculation.

Accordingly, the proposed regulations provide that the term "total premium revenue" for purposes of section 833(c)(5) means the total amount of premium revenue (excluding Federal and State taxes and licensing or regulatory fees and after accounting for payments or receipts for risk adjustment, risk corridors, and reinsurance under sections 1341, 1342, and 1343 of the Affordable Care Act (42 U.S.C. 18061, 18062, and 18063)) as those terms are used for purposes of section 2718(b) of the PHSA and the regulations issued under that section.

c. *Computation of MLR*

For purposes of section 2718(b) of the PHSA, section 2718(b)(1)(B)(ii) of the PHSA and the HHS Regulations use a three-year period to compute the medical loss ratio, allowing certain limited adjustments after the end of the year to determine expenses and premium revenue. (See 45 CFR 158.220(b) and 158.140.) Although section 2718(b) of the PHSA provides that the medical loss ratio is computed for each "plan year," the HHS Regulations interpret the term "plan year" as referring to the "MLR reporting year." The HHS regulations further define the MLR reporting year as the calendar year for medical loss ratio reporting and rebating purposes under section 2718(a) and (b) of the PHSA. (See 45 CFR 158.103.) Section 833(c)(5) refers to expenses and revenues for a taxable year, which is generally a calendar year for the organizations described in section 833(c). See section 843.

The Treasury Department and the IRS have concluded that, for administrative convenience and to be consistent with the medical loss ratio calculation under section 2718(b)(1)(B)(ii) of the PHSA, it is appropriate to compute the MLR for a taxable year under section 833(c)(5) using the same three-year period used under section 2718(b) of the PHSA. Therefore, beginning with the effective date of these regulations, amounts used for purposes of section 833(c)(5) (that is, total premium revenue and total premium revenue expended on reimbursement for clinical services provided to enrollees) for each taxable year should be determined based on amounts reported under section 2718(a) of the PHSA for that taxable year and the two preceding taxable years, subject to the same adjustments that apply for purposes of section 2718 of the PHSA. Comments are requested as to whether organizations should, instead of using the three-year period used for purposes of section 2718(b)(1)(B)(ii) of the PHSA, compute their expenses and total premium revenue only for the taxable year for which the computation is being made under section 833(c)(5), and whether adoption of the proposed approach would create difficulties with respect to the computation of the MLR for the 2014 taxable year.

2. *Nonapplication of Section 833 in Case of an Insufficient MLR*

Commenters requested that the consequences of having an insufficient MLR under section 833(c)(5) be limited to losing certain benefits of section 833. Specifically, commenters posited that an organization that fails the MLR requirement under section 833(c)(5) should not lose its status as an insurance company under section 833(a)(1). Rather, the commenters argued that the organization should only suffer the loss of eligibility for the special deduction in section 833(b) and the less favorable computation of unearned premium reserves based on 80 percent, and not 100 percent, of its unearned premiums under section 832(b)(4).

The proposed regulations do not adopt this recommendation. Section 833(c)(5) provides that "this section [833]" shall not apply to any organization unless the organization satisfies the MLR requirement in section 833(c)(5). This language does not contemplate disallowance of some, but not all, of the benefits associated with treatment under section 833. Accordingly, the proposed regulations provide that for an organization described in section 833(c) that fails to satisfy the MLR requirement under section 833(c)(5): (1) the organization is not taxable as a stock insurance company by reason of section 833(a)(1), but may be taxable as an insurance company if it otherwise meets the requirements of section 831(c); (2) the organization is not allowed the special deduction set forth in section 833(b); and (3) if the organization qualifies as an insurance company under section 831(c), it must take into account 80 percent, rather than 100 percent, of its unearned premiums under section 832(b)(4) as it applies to other non-life insurance companies.

The determination of whether an organization's MLR under section 833(c)(5) is at least 85 percent is made annually. Accordingly, an organization's MLR may be sufficient in one year, but not another. For this reason, the Treasury Department and the IRS have concluded that an organization described in section 833(c) that has an insufficient MLR under section 833(c)(5) will lose the benefits of section

833 only for the taxable year or years for which the organization's MLR is insufficient. If the same organization meets the MLR standard for a later taxable year, the organization would be entitled to claim the benefits of section 833 for that taxable year and subsequent taxable years for which its MLR is sufficient. Comments are requested on whether further guidance is needed for an organization that is described in section 833 for only some taxable years because of section 833(c)(5).

Commenters requested that the Treasury Department and the IRS establish a regime under which an organization that has failed to satisfy the MLR ratio by a *de minimis* amount would have an opportunity to pay an amount to the IRS to prevent loss of treatment under section 833. The proposed regulations do not adopt this suggestion. The Treasury Department and the IRS understand that the consequences under section 833(c)(5) may be severe if an organization's MLR is insufficient. However, the statutory framework does not contemplate a penalty or other payment to the IRS. The Treasury Department and the IRS request comments on whether there are other possible means consistent with the statute of mitigating these consequences.

3. *Other Comments*

Commenters requested that the Treasury Department and the IRS permit certain nondeductible fees and taxes imposed by the Affordable Care Act to be taken into account for purposes of calculating an organization's special deduction for items attributable to the health-related business of the organization under section 833(b). Commenters also submitted comments regarding the treatment of MLR rebates as return premiums under section 832(b)(4), and the income and employment tax consequences of MLR rebates. The proposed regulations do not address these issues because they are not within the scope of the proposed regulations.

Proposed Effective Date

These proposed regulations are proposed to apply to taxable years beginning after December 31, 2013.

Availability of IRS Documents

The IRS notices and revenue procedure cited in this preamble are published in the Internal Revenue Cumulative Bulletin and are available at *http://www.irs.gov*.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these proposed regulations and because the regulations do not impose an information collection on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comments on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the "Addresses" heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules. Comments are specifically requested on the relationship between section 833(c)(5) and section 2718 of the PHSA. All comments will be available at *www.regulations.gov* or upon request.

A public hearing has been scheduled for Tuesday, September 17, 2013, at 10 a.m., in the IRS Auditorium of the Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written (signed original and eight (8) copies) or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic by August 12, 2013. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Graham R. Green, Office of Associate Chief Counsel (Financial Institutions & Products). However, other personnel from the Treasury Department and the IRS participated in their development.

* * * * *

Proposed Amendment to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.833–1 is added to read as follows:

§1.833–1 Medical loss ratio under section 833(c)(5).

(a) *In general.* Section 833 does not apply to an organization unless the organization's medical loss ratio (*MLR*) for a taxable year is at least 85 percent. Paragraph (b) of this section provides definitions that apply for purposes of section 833(c)(5) and this §1.833–1. Paragraph (c) of this section provides rules for computing an organization's MLR under section 833(c)(5). Paragraph (d) of this section addresses the treatment under section 833 of an organization that has an MLR of less than 85 percent. Paragraph (e) of this section provides the effective/applicability date.

(b) *Definitions*. The following definitions apply for purposes of section 833(c)(5) and §1.833–1.

(1) *Reimbursement for clinical services provided to enrollees*. The term *reimbursement for clinical services provided to enrollees* has the same meaning as that term has in 42 U.S.C. 300gg–18 and the regulations issued under that section (see 45 CFR 158.140).

(2) *Total premium revenue*. The term *total premium revenue* means the total amount of premium revenue (excluding Federal and State taxes and licensing or regulatory fees and after accounting for payments or receipts for risk adjustment, risk corridors, and reinsurance under sections 1341, 1342, and 1343 of the Patient Protection and Affordable Care Act, Public Law 111–148 (124 Stat. 119 (2010)) (42 U.S.C. 18061, 18062, and 18063)) as those terms are used for purposes of 42 U.S.C. 300gg–18(b) and the regulations issued under that section (see 45 CFR Part 158).

(c) *Computation of MLR under section 833(c)(5)*—(1) *In general*. An organization's MLR with respect to a taxable year is the ratio, expressed as a percentage, of the MLR numerator, as described in paragraph (c)(2) of this section, to the MLR denominator, as described in paragraph (c)(3) of this section.

(2) *MLR numerator*. The numerator of an organization's MLR is the total premium revenue expended on reimbursement for clinical services provided to enrollees under its policies for the taxable year, computed in the same manner as those expenses are computed for the plan year for purposes of 42 U.S.C. 300gg–18(b) and regulations issued under that section (see 45 CFR Part 158).

(3) *MLR denominator*. The denominator of an organization's MLR is the organization's total premium revenue for the taxable year, computed in the same manner as the total premium revenue is computed for the plan year for purposes of 42 U.S.C. 300gg–18(b) and regulations issued under that section (see 45 CFR Part 158).

(d) *Failure to qualify under section 833(c)(5)*. If, for any taxable year, an organization's MLR is less than 85 percent, then beginning in that taxable year and for each subsequent taxable year for which the organization's MLR remains less than 85 percent, paragraphs (d)(1) through (d)(3) of this section apply.

(1) *Automatic stock insurance company status*. The organization is not taxable as a stock insurance company by reason of section 833(a)(1), but may be taxable as an insurance company if it otherwise meets the requirements of section 831(c);

(2) *Special deduction*. The organization is not allowed the special deduction set forth in section 833(b); and

(3) *Premiums earned*. The organization must take into account 80 percent, rather than 100 percent, of its unearned premiums under section 832(b)(4) as it applies to other non-life insurance companies, provided the organization qualifies as an insurance company by meeting the requirements of section 831(c).

(e) *Effective/applicability date*. This section applies to taxable years beginning after December 31, 2013.

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on May 10, 2013, 8:45 a.m., and published in the issue of the Federal Register for May 13, 2013, 78 FR 27873)

Notice of Dispositions of Declaratory Judgment Proceedings under Section 7428

Announcement 2013–24

This announcement serves notice to donors that on January 29, 2013, the United States Tax Court entered a stipulated decision. Effective December 22, 2000, the organization listed below is not qualified as an organization described in I.R.C. § 501(c)(3), as amended, is not exempt from taxation under I.R.C. § 501(a), and is not an organization described in I.R.C. § 170(c)(2).

The Hope and Dreams Foundation,
Palo Alto, CA

This announcement serves notice to donors that on February 27, 2013, the United States Tax Court entered a stipulated decision that, effective for the taxable year ending August 31, 2006 and all subsequent taxable years, the organization listed below is not qualified as an organization described in section 501(c)(3).

A Family Budget Counseling, Inc
Huntington Station, NY

Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2013–25

The Internal Revenue Service has revoked its determination that the organizations listed below qualify as organizations described in sections 501(c)(3) and 170(c)(2) of the Internal Revenue Code of 1986.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on June 10, 2013, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Life Extension Foundation Inc.
Ft. Lauderdale, FL

Mustard Seed Housing, Inc.
Petaluma, CA

Northwest Regional Emergency Medical Services and Trauma Care Council
Bremerton, WA

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D. —Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z —Corporation.

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2012–27 through 2012–52 is in Internal Revenue Bulletin 2012–52, dated December 27, 2012.

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[1] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2012–27 through 2012–52 is in Internal Revenue Bulletin 2012–52, dated December 27, 2012.

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Internal Revenue Service
Washington, DC 20224

INTERNAL REVENUE BULLETIN

The Introduction at the beginning of this issue describes the purpose and content of this publication. The weekly Internal Revenue Bulletins are available at *www.irs.gov/irb/*.

CUMULATIVE BULLETINS

The contents of the weekly Bulletins were consolidated semiannually into permanent, indexed, Cumulative Bulletins through the 2008–2 edition.

INTERNAL REVENUE BULLETINS ON CD-ROM

Internal Revenue Bulletins are available annually as part of Publication 1796 (Tax Products CD-ROM). The CD-ROM can be purchased from National Technical Information Service (NTIS) on the Internet at *www.irs.gov/cdorders* (discount for online orders) or by calling 1-877-233-6767. The first release is available in mid-December and the final release is available in late January.

WE WELCOME COMMENTS ABOUT THE INTERNAL REVENUE BULLETIN

If you have comments concerning the format or production of the Internal Revenue Bulletin or suggestions for improving it, we would be pleased to hear from you. You can email us your suggestions or comments through the IRS Internet Home Page (*www.irs.gov*) or write to the IRS Bulletin Unit, SE:W:CAR:MP:P:SPA, Washington, DC 20224.