State Law & State Taxation Corner

By John A. Biek

Code Sec. 338(h)(10) Elections Give Divergent State Income Tax Results

Introduction

Two recent cases offer a useful reminder of the inconsistent treatments that even neighboring states can give to elections under Code Sec. 338(h)(10) of the Internal Revenue Code of 1986, as amended (the “Code”). In Trawick Construction Co. v. Georgia Department of Revenue, the Georgia Supreme Court ruled this past March that a Code Sec. 338(h)(10) election involving the sale of the stock of an S corporation was not recognized under the Georgia income tax laws because the S corporation itself had not been a party to the Code Sec. 338(h)(10) election. Consequently, the transaction was treated for Georgia income tax purposes as a sale of the stock of the S corporation, with the result that none of the S corporation’s shareholders were taxable in Georgia on gain from the transaction because the shareholders were all nonresidents of Georgia. If the Georgia Supreme Court had followed the federal income tax treatment of the transaction, there would have been S corporation gain from the deemed sale of its assets for Georgia to apportion and tax.

On the other hand, a Code Sec. 338(h)(10) election was respected in Prince v. State Department of Revenue, a May 2010 decision of the Alabama Court of Civil Appeals that also involved the sale of the stock of an S corporation. The Alabama Department of Revenue successfully taxed Alabama’s apportioned share of the gain from the deemed sale of the S corporation’s assets. This holding was bad news for Mr. Prince, who had paid tax to his home state of Mississippi on all of his gain from the transaction.

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In the real world, of course, S corporations often do business in many states. If the S corporation is disposed of in a straightforward stock sale transaction, each shareholder of the S corporation will usually be taxable only by his or her state of residence on the gain from the sale of the shareholder's stock in the S corporation. The state tax puzzle can become more complicated, however, if a purchasing corporation and the shareholders of the target S corporation make a Code Sec. 338(h)(10) election because of the vagaries of state income tax treatments of this election. As discussed in this article, the various states where the S corporation does business might (1) follow the federal income tax treatment of the Code Sec. 338(h)(10) election and tax the shareholders of the S corporation on their distributive shares of the gain from the deemed sale of its assets, (2) disregard the Code Sec. 338 election entirely and tax the stock sale gain of shareholders residing in the state or (3) possibly disregard the Code Sec. 338(h)(10) election while respecting the underlying Code Sec. 338(g) election, thereby subjecting both the stock sale gain and the deemed asset sale gain to tax. This issue needs to be carefully considered in any Code Sec. 338(h)(10) transaction so that state income taxes on the transactions are paid by the correct persons, in the correct amounts.

Federal Tax Treatment of Code Sec. 338 Elections

As many readers probably are aware, Code Sec. 338 provides for two different elections that treat a “qualified stock purchase” of a target corporation as a deemed sale of the target corporation’s assets. If a purchasing corporation acquires 80 percent or more of the stock of a target corporation (measured by vote and value) over a 12-month period, the purchasing corporation can unilaterally make an election under Code Sec. 338(g) to have the transaction taxed, for the purchasing corporation’s purposes, as if (1) the target corporation (“old target”) sold all of its assets at the close of the acquisition date at fair market value in a single transaction, and (2) the target corporation, in the guise of a new corporation (“new target”), purchased all of those assets as of the beginning of the day after the acquisition date, potentially receiving a stepped-up adjusted tax basis in the assets.

A Code Sec. 338(g) election results in two levels of tax liabilities for the parties to the transaction. The shareholder(s) of old target pay federal (and state) income tax on their gain from the sale of the stock of old target, measured by the difference between the purchase consideration and the shareholder's adjusted tax basis in his shares of old target’s stock. In addition, new target is subject to federal (and state) income tax on the gain from the deemed sale of old target’s assets and, since new target is owned by the purchasing corporation, it ultimately bears that tax liability. Even though the purchasing corporation may be interested in obtaining a stepped-up basis in the target corporation’s assets, that tax benefit may well be outweighed by the cost to the purchasing corporation of having to pay tax with respect to the deemed sale of target’s assets. For this reason, Code Sec. 338(g) elections are often undesirable unless the target corporation had significant amounts of net operating losses to offset its gain from the deemed sale of its assets or the target corporation is a foreign corporation that will not be subject to federal income tax.

The tax consequences can be more attractive, however, when the Code Sec. 338(g) election is combined with a joint election under Code Sec. 338(h)(10). Under the applicable regulations, a Code Sec. 338(h)(10) election can be made with respect to a qualified stock purchase of a target corporation, by the purchasing corporation and the shareholders of the target corporation, if the target corporation is (1) a member of a selling consolidated return group, (2) a member of a selling affiliated group that files separate federal tax returns, or (3) an S corporation. A Code Sec. 338(h)(10) election shifts the tax liability from the deemed sale of the target corporation’s assets to the selling consolidated return group, the final separate tax return of the target corporation or the shareholders if the target corporation was an S corporation. In addition, if a Code Sec. 338(h)(10) election is made, the asset sale that is deemed to occur as a result of the Code Sec. 338(g) election is treated as being followed by a liquidation of the target corporation.

Thus, the Code Sec. 338(h)(10) election generally results in only one level of federal (and state) tax being paid: by the sellers of old target on the gain from the deemed sale of its assets. If the Code Sec. 338(h)(10) election for the target corporation is not validly made, the federal tax regulations provide that the deemed Code Sec. 338(g) election for the target corporation also is not valid, so as to avoid the unintended and unfortunate consequences of the purchasing corporation having to pay tax on the transaction.
The Trawick Construction Co. Case

Trawick Construction Company was a closely held Florida corporation engaged in the telecommunications business in Alabama, Arkansas, Florida, Georgia, Louisiana, Mississippi, North Carolina and South Carolina. All of Trawick’s shareholders, directors and officers were members of the Trawick family. None of them resided in Georgia.

For federal income tax purposes, Trawick was treated as an S corporation, so the Trawick shareholders paid federal tax on their distributive shares of Trawick’s net income. For Georgia income tax purposes, however, Trawick was taxed as a C corporation because of Georgia Code Section 48-7-21(b)(7), which provides that “[a]ll elections made by corporate taxpayers under the Internal Revenue Code ... shall also apply under OCGA § 48-7-20 et seq., except elections involving consolidated corporate returns and Subchapter ‘S’ elections ....” (Emphasis added.) Georgia Code Section 48-7-21(b)(7)(B) does recognize a federal S corporation election where “all stockholders are subject to tax in this state on their portion of the corporate income” of the S corporation and “all nonresident stockholders pay the Georgia income tax on their portion of the corporate income” of the S corporation. However, this exception did not apply to Trawick, with the result that the company was paying tax directly to Georgia on its Georgia-apportioned business income.

On October 1, 1999, Trawick’s shareholders sold their shares of stock in Trawick to Quanta Services, Inc. (“Quanta”) for $36,500,000 (viz., $29,492,000 of cash and shares of Quanta common stock worth $7,008,000). The stock purchase agreement gave Quanta the option of having a Code Sec. 338(h)(10) election be made to treat the stock sale transaction as a deemed sale of Trawick’s assets, most of which was intangible goodwill. Quanta exercised this option in the purchase agreement, and the Trawick shareholders and Quanta executed the necessary IRS Form 8023 to make the Code Sec. 338(h)(10) election.

As a result of this Code Sec. 338(h)(10) election, Trawick included the gain from the deemed sale of its assets in its federal S corporation return (Form 1120S) for the short tax year ending on the October 1, 1999 closing date of the stock sale transaction. Altogether, Trawick reported $35,961,518 of federal taxable income on that federal tax return. The corresponding Georgia C corporation return (Form 600) that Trawick filed for the 1999 tax year reported the $35,961,518 of federal taxable income, allocated $29,689,534 of that income to Florida as nonbusiness income (probably representing the gain from the deemed sale of Trawick’s intangible goodwill) and apportioned the remaining $6,271,984 of business income among Georgia and the other states where Trawick was doing business.

Trawick’s 1999 Georgia tax return reported $799,659 of Georgia business income, resulting in $47,980 of Georgia tax liability. The Georgia Department of Revenue did what comes reflexively to a state tax agency: it reclassified nearly all the $35,961,518 of Trawick’s 1999 federal taxable income as apportionable business income. Using Trawick’s Georgia apportionment factor of 12.7497 percent, the Department increased Trawick’s 1999 Georgia business income to $4,546,674 and assessed an additional $224,820 of Georgia income tax liability, plus interest, on the Georgia-apportioned share of the taxable gain from the deemed sale of Trawick’s assets resulting from the Code Sec. 338(h)(10) election. Again, this additional Georgia income tax liability was assessed against Trawick because Georgia did not recognize Trawick’s federal S election.

On appeal, Trawick raised two arguments against the Georgia tax assessment. First, Trawick contended that it had correctly treated the lion’s share of its $35.6 million of 1999 federal taxable income as nonbusiness income resulting from the deemed sale of Trawick’s assets and, to the extent that income related to intangible goodwill, the income was specifically allocable to Florida, the state of Trawick’s commercial domicile. The argument that ended up gaining more traction, however, was that Trawick’s federal Code Sec. 338(h)(10) election had no effect under the Georgia income tax laws, so Trawick did not have any gain from the deemed sale of its assets that Georgia could apportion and tax.
Georgia income tax purposes as a sale of Trawick’s stock, and, as nonresidents of Georgia, the Trawick shareholders were not taxable in Georgia on their gains from selling their Trawick stock.

This argument had a certain logic because the factual predicate of a Code Sec. 338(h)(10) election did not exist at the Georgia level in the Trawick stock sale transaction. As noted earlier, a Code Sec. 338(h)(10) election is only available if the target corporation is a member of a seller affiliated group (whether or not the target corporation is included in federal consolidated tax returns) or an S corporation. Trawick was not part of an affiliated group of corporations and, while it was an S corporation for federal income tax purposes, Georgia did not recognize that S election. Therefore, there was a good argument that the Code Sec. 338(h)(10) election in the Trawick stock sale transaction should be disregarded for Georgia income tax purposes.

However, the Georgia Court of Appeals and Georgia Supreme Court opinions in the Trawick Construction case turned, instead, on highly technical readings of Georgia Code Section 48-7-21(b)(7), which, as noted earlier, states that the Georgia income tax laws respect all federal income tax elections “made by corporate taxpayers ... except elections involving consolidated corporate returns and Subchapter ‘S’ elections ....” (Emphasis added.) The Trawick stock purchase agreement included a provision stating that, “at Quanta’s option, each of [Trawick and its sister company] and the Stockholders will join Quanta in making an election under Code Sec. 338(h)(10) of the Internal Revenue Code (and any corresponding election under state, local and foreign tax law) with respect to the purchase and sale of the stock of [those Companies] ....”[22] In addition, in connection with the transaction, each Trawick shareholder signed a consent form stating, “I consent to the election between Quanta and Trawick to treat the acquisition of Trawick as an asset purchase and its resulting tax affects [sic] pursuant to a Section 338 election.”[23] Finally, Trawick’s Vice President-Finance, Jenee Floyd, signed the Code Sec. 338(h)(10) election form (Form 8023) in her corporate capacity, even though the Form 8023 stated that it is for the use of the “common parent,” “selling affiliate” or “S corporation shareholders” of the target corporation with respect to which the Code Sec. 338(h)(10) election is being made.[24]

Pointing to this documentation, the Georgia Court of Appeals held that the Trawick Code Sec. 338(h)(10) election was recognized under Section 48-7-21(b)(7) because “the Commissioner’s finding, as a matter of fact, that Trawick joined in making the Section 338 election by signing the Form 8023 as Trawick’s Vice President-Finance is supported by some evidence.”[25] The Georgia Court of Appeals drew further justification for its decision to recognize the Code Sec. 338(h)(10) election for Georgia tax purposes by noting that Trawick, as a subsidiary of Quanta, would be receiving the tax benefit of a stepped-up basis in its assets going forward.[26]

The Georgia Supreme Court reversed, in a decision issued on March 1, 2010. Carefully examining the language of Georgia Code Section 48-7-21(b)(7), the Georgia Supreme Court concluded that “giving the words ‘by corporate taxpayers’ in OCGA § 48-7-21(b)(7) their ordinary meaning, Trawick would have to be the actual maker of the election or possess the authority to direct that the election be made” in order for the Code Sec. 338(h)(10) election to be recognized under Section 48-7-21(b)(7). Notwithstanding some of the language in the Trawick stock purchase agreement, the Code Sec. 338(h)(10) election had, in fact, been made not by Trawick, but, rather, for Trawick by Quanta and Trawick’s shareholders. Concluding that the “corporate taxpayer” mentioned in Georgia Code Section 48-7-21(b)(7) was Trawick and that “the Court of Appeals had relied on irrelevant evidence when it found that Trawick joined in making the election ... ,” the Supreme Georgia Court disregarded the Code Sec. 338(h)(10) election.[27] Prepositions can be significant.

Taking a step back from this technical statutory construction exercise, the Georgia Supreme Court offered the following common sense observation as support for affording stock sale treatment to the disposition of Trawick and its sister corporation:

The Department has failed to show ill effects not only generally from a rejection of elections made “for” the taxpayer, but also specifically from the
The rejection of § 338(h)(10) elections. The State of Georgia benefited for many years from treatment of Trawick as a Subchapter C corporation which consistently paid taxes on its entire Georgia business income directly to this state, rather than as a Subchapter S corporation whose taxes are proportionately paid to this state only by those non-resident shareholders who consent thereto. See Graham v. Hanna, supra. Thus, there is no obvious unfairness in now requiring Georgia to continue to treat Trawick as a Subchapter C corporation and not as a Subchapter S corporation. It is not unreasonable to require the State of Georgia to forego a § 338(h)(10) election made for a Subchapter S corporation, when the State has consistently refused to recognize that corporation's original federal Subchapter S election.

"Because the gain from the deemed sale of assets recognized by Trawick on its federal income tax returns did not constitute Georgia taxable income," the Georgia Supreme Court invalidated the Department of Revenue's assessment of Georgia income tax on the gain from the deemed sale of Trawick's assets. The Department agreed that if the Code Sec. 338(h)(10) election was not respected for Georgia income tax purposes, the Trawick shareholders would be treated as having sold their stock to Quanta, for gains that were taxable only by the shareholder's state of residence. See Graham v. Hanna, supra. Thus, there is no obvious unfairness in now requiring Georgia to continue to treat Trawick as a Subchapter C corporation and not as a Subchapter S corporation. It is not unreasonable to require the State of Georgia to forego a § 338(h)(10) election made for a Subchapter S corporation, when the State has consistently refused to recognize that corporation's original federal Subchapter S election.

The Prince Case

In May 2010, the Alabama Civil Court of Appeals addressed a similar state tax issue in Prince, but this time, the federal Code Sec. 338(h)(10) election was recognized for state income tax purposes. Zebra.Net, Inc. ("Zebra.Net") had been founded in 1996 as an Alabama corporation, and its two Alabama resident shareholders made a federal S corporation election for Zebra.Net. Prince, a Mississippi resident, was later brought in as a one-third shareholder of Zebra.Net, who acted as a passive investor. Significantly, Alabama treated Zebra.Net as an S corporation for state income tax purposes.

In 1999, Prince and the other two shareholders of Zebra.Net merged the company with another corporation for consideration of $6.6 million, less some Zebra.Net liabilities. The merger agreement conditioned the form and amount of the merger consideration on whether Zebra.Net's shareholders were willing to join the acquiring corporation in making a Code Sec. 338(h)(10) election to treat the merger transaction as a deemed sale of Zebra.Net's assets. If the Code Sec. 338(h)(10) election were made, the three Zebra.Net shareholders would receive cash for their shares of Zebra.Net stock. Otherwise, the shareholders would receive 80 percent of their merger consideration in the form of stock of the acquiring corporation, with the other 20 percent being paid in cash.

The three Zebra.Net shareholders and the acquiring corporation duly made the Code Sec. 338(h)(10) election, and Zebra.Net's 1999 Alabama S corporation return reported $5,133,333 of operating income and gain from the deemed sale of its assets to the acquiring corporation. Prince received a Form K-1 reporting a distributive share of $1,711,109 of Alabama income from Zebra.Net in 1999. Prince paid income tax on this $1,711,109 distributive share to Mississippi, his state of residence, but no income tax to Alabama.

The Alabama Department of Revenue took a different view, however, assessing Prince $141,246 of Alabama income tax, penalties and interest with respect to his 1999 distributive share of Zebra.Net income. In his appeal, Prince's primary argument was that the Department was illegally taxing him on gain from the sale of his stock in Zebra.Net, which, as income from the disposition of intangible personal property, was allocable to Mississippi. Prince acknowledged that if this gain were deemed to have arisen from property owned or business transacted in Alabama (i.e., from the deemed sale of Zebra.Net's assets in Alabama pursuant to the Code Sec. 338(h)(10) election), the gain would be subject to Alabama income tax.

The Department successfully argued that the Alabama income tax treatment of the Zebra.Net stock sale transaction followed its federal tax treatment. Unlike Georgia, the Alabama income tax laws expressly stated that “[i]f a valid election under 26 U.S.C. § 338 is made, the amount of gain recognized by the target corporation shall be determined in accordance with 26 U.S.C. § 338.” In addition, Alabama had been treating Zebra.Net as a passthrough entity as a result of its federal S corporation election. The trial court concluded that “[i]t would be illogical to allow [Prince] to treat the sale as an asset sale for federal
tax purposes, yet claim it was a stock sale on a state return in order to obtain tax benefits where they suit him in either system.” The Court of Appeals agreed. Accordingly, as a result of the Code Sec. 338(h)(10) election having been made, Prince was treated for both federal and Alabama income tax purposes as having received a distributive share of Zebra.Net's gain from the deemed sale of assets, and Alabama was entitled to tax that gain because the Zebra.Net assets were physically located in Alabama.

Prince tried to argue that the Code Sec. 338(h)(10) election was invalid because the parties had not filed the Form 8023 election document with the Internal Revenue Service, but Prince could not prove this claim. Moreover, the facts that the Zebra.Net shareholders had received nothing but cash for their Zebra.Net shares, as provided for in the Code Sec. 338(h)(10) option in the merger agreement, that all the parties had signed the Form 8023, and that Zebra.Net had reported gain from the deemed sale of its assets on its 1999 federal and state tax returns, all suggested that a valid Code Sec. 338(h)(10) election had been made.

Based on these facts, the Alabama Civil Court of Appeals held in Prince that:

Because Alabama recognizes an election under § 338 and treats the sale occurring under such an election as a sale of assets, and because the characterization of an S corporation's income occurs at the corporate level rather than at the shareholder level, the sale at issue was of Zebra. Net's assets, the income from which is attributable, for Alabama income-tax purposes, to the individual shareholders of Zebra.net; it was not, for Alabama income-tax purposes, a sale of the shareholders' stock in Zebra.net.

This holding meant that Prince had overpaid Mississippi income tax on his entire distributive share of Zebra.Net income. If Prince's 1999 Mississippi tax year is now closed, Prince might no longer be able to claim a credit from Mississippi for his payment of the Alabama tax assessment. Presumably, that is the reason why Prince fought so hard to win this tax issue.

Analysis of State Code Sec. 338(h)(10) Positions

The decision of the Georgia Supreme Court in Trawick Construction to disregard the Code Sec. 338(h)(10) election is not surprising in light of the state’s tax treatment of Trawick as a C corporation. Regardless of what the phrase “by corporate taxpayers” in Georgia Code Section 48-7-21(b)(7) meant, the fact is the Trawick stock sale transaction did not present the factual predicate of a Code Sec. 338(h)(10) election at the Georgia level. Trawick was owned by three individuals, so it was not a member of a selling affiliated group. Nor was Trawick being treated as an S corporation for Georgia income tax purposes. Therefore, it was not difficult for a court to determine that, at least under these facts, the Code Sec. 338(h)(10) election would not apply at the state level.

Would the Georgia Supreme Court have reached the same conclusion if Trawick had been a target C corporation in a selling affiliated group? Under this scenario, all of the persons making the Code Sec. 338(h)(10) election would have been corporations, possibly rendering that Code Sec. 338(h)(10) election one of the federal tax elections “made by corporate taxpayers” that is recognized under Georgia Code Section 48-7-21(b)(7). However, it would still be true that the Code Sec. 338(h)(10) election was not made by Trawick, the target corporation. Since the Georgia Supreme Court conditioned the state’s recognition of the Code Sec. 338(h)(10) election on Trawick being a party to that election, it appears likely that no Code Sec. 338(h)(10) election—or a Code Sec. 338(g) election, for that matter—would have passed muster under the language of Section 48-7-21(b)(7). We will never know the answer to this question, though, because the Georgia legislature has now amended the Georgia income tax laws to explicitly recognize all Code Sec. 338 elections.

What about other state treatments of Code Sec. 338(h)(10) elections? A number of states do not provide for consolidated or combined reporting, and not all states give S corporations passthrough entity tax treatment, so it is certainly not a given that states will respect a Code Sec. 338(h)(10) election. According to a 2010 BNA state survey of this issue, nearly all

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of the states except Louisiana and possibly Texas, conform to the federal deemed asset sale treatment of a Code Sec. 338(h)(10) election involving a target C corporation. There are some wrinkles in these state administrative positions. For example, California and Wisconsin provide for a state-level Code Sec. 338(h)(10) election, and California requires that both parties making the election be California taxpayers. New York State only recognizes the Code Sec. 338(h)(10) election if the target C corporation files a New York combined report with the selling parent corporation for the tax year in which the target corporation was sold.

It is interesting that the group of states that follow the federal tax treatment of Code Sec. 338(h)(10) elections for target C corporations includes a number of separate return states. At one time, some of these states did not conform to Code Sec. 338(h)(10) elections because the target corporation was not allowed to file consolidated returns in the state. The expansion of the federal Code Sec. 338(h)(10) regulations in 1994 to cover target C corporations in a seller affiliated group filing separate federal tax returns may have made it easier for separate return states to conform to the federal tax treatment of Code Sec. 338(h)(10) elections. From an administrative standpoint, of course, it is convenient for the state to be able to piggy back off of the target corporation’s federal taxable income, which would include the gain from the deemed sale of the target corporation’s assets.

Fewer states conform to the federal tax treatment of a Code Sec. 338(h)(10) election for a target S corporation. Louisiana, New Jersey, New York State and New York City, Pennsylvania, Tennessee, and possibly Texas are among the states that do not recognize a Code Sec. 338(h)(10) election under these circumstances. This administrative position may be due, in part, to the fact that some of these states impose entity-level income tax on an S corporation.

In states that do not recognize the Code Sec. 338(h)(10) election, thought should be given to whether the state would nevertheless recognize the underlying Code Sec. 338(g) election that the purchasing corporation was deemed under Reg. §1.338(h)(10)-1(c)(4) to have made in connection with the qualified stock purchase transaction. The federal tax regulations explicitly provide that “[i]f a section 338(h)(10) election for T is not valid, the section 338 election for T is also not valid.” This provision ensures that the purchasing corporation will not experience the nasty surprise of having to recognize the gain from the deemed sale of the target corporation’s assets as a result of some defect in how the Code Sec. 338(h)(10) election was made.

But does a state’s nonrecognition of a Code Sec. 338(h)(10) election because, for example, the state does not treat S corporations as passthrough entities, mean that if the Code Sec. 338(h)(10) election was “invalid” for state tax purposes? Arguably, the answer should be “yes” so as to avoid both the buyer and the seller having to pay tax to the state with respect to the qualified stock purchase transaction.

However, it is by no means clear that this would be the state tax result. Indeed, as noted earlier, New York State limits its recognition of Code Sec. 338(h)(10) elections to target corporations that are filing New York combined reports, and the New York Department of Taxation and Finance reportedly will treat a transaction involving a disregarded Code Sec. 338(h)(10) election as if a general election were made under Code Sec. 338(g), resulting in recognition of both a gain on the deemed sale of the assets of the target corporation and gain on the sale of the target corporation’s stock. As a result of New York State’s nonrecognition of the Code Sec. 338(h)(10) election, the seller has to recognize gain from its sale of the target corporation’s stock, but that gain generally is then excluded from New York taxable income under the state’s corporation franchise tax subsidiary capital rule.

Conclusion

The treatment of a Code Sec. 338(h)(10) election by the various states where a target corporation is doing business can be inconsistent, to say the least. Most states will conform to the federal tax treatment of the transaction as a deemed sale of the target corporation’s assets, taxable to the seller consolidated return group, the old target’s final separate tax return or the shareholders of a target S corporation. However, some states may disregard the Code Sec. 338(h)(10) election and the underlying Code Sec. 338(g) election and treat the transaction as a sale of the target corporation’s stock. Other states might disregard the Code Sec. 338(h)(10) election, but recognize the Code Sec. 338(g) election, resulting in harsh, state tax treatment of the purchasing corporation. Stating the obvious, it would be prudent for the parties to a corporate stock sale transaction to analyze these state tax issues carefully before making a Code Sec. 338(h)(10) election, so that they fully understand its tax consequences.
ENDNOTES

1 The author would like to thank his partner, Andrea M. Despotes, for sprinkling her considerable wisdom into this article.


4 Code Sec. 338(a).

5 When a Code Sec. 338(h)(10) election is made, a Code Sec. 338(g) election is deemed to be made for the target corporation by the purchasing corporation. Reg. §1.338(h)(10)-1(c)(3).

6 Reg. §1.338(h)(10)-1.

7 Reg. §1.338-1(a)(1); Reg. §1.338(h)(10)-1(c)(4).

8 Reg. §1.338(h)(10)-1(c)(5).


10 See note 3 supra.

11 Id., slip op. at 1.

12 Id.

13 Id.

14 Id.

15 Id.

16 Id., slip op. at 2.

17 Id., slip op. at 3.


19 Prince, slip op. at 4.

20 Id.

21 Prince, slip op. at 4 at 6.

22 Id., slip op at 7.

23 Miss. Admin. Code 35.III.12 (“Individual resident taxpayers of Mississippi who earn income in other states, and who are required to pay income tax to the other state or states on that income, are allowed a credit against Mississippi income tax due for the same year for which the tax is paid to the other state”) (emphasis added).


25 Id.

26 Id.

27 Id.

28 Id.

29 Id.

30 Id.

31 Id.

32 Id.

33 Id.

34 Id.

35 Id.

36 Id.

37 Id.

38 Id., slip op at 2.

39 Id.

40 Id., slip op at 3.

41 Ala. Code §4-18-8(j).

42 Prince, slip op at 4.

43 Id.

44 Id.

45 Id.


47 BNA Weekly State Tax Report, supra, n. 47.

48 See also Mandelbaum v. Director, Division of Taxation, 20 N.J. Tax 141 (May 17, 2002) (“[i]n the absence of valid regulations under the GIT Act [addressing Section 338(h)(10) elections for S corporations], the Director may not import or apply federal tax principles from I.R.C. § 338(h)(10) and assess gross income tax in accordance with those principles. He must tax a transaction as it actually occurred. Thus, the Director may not treat Mr. Mandelbaum’s sale of stock as a hypothetical sale of corporate assets followed by a corporate liquidation”); TENN. CODE § 67-4-2006(b)(1)(M) (there shall be added to a taxpayer’s net earnings or net losses “[i]n the case of a corporation that has elected S corporation status under 26 U.S.C. Section 1361–1363, any gain that is not included in net earnings or loss that is attributable to an election under 26 U.S.C. Section 338(h)(10)”).

49 Reg. §1.338(h)(10)-1(c)(5).


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