

otherwise is recognized on such conversion transaction. See, for example, sections 336, 351(b), 351(e), 356, 357(c), 367, 368(a)(2)(F), and 1001.

(2) *Re-election of RIC or REIT status*—

(i) *Generally*. Except as provided in paragraphs (d)(2)(ii) and (iii) of this section, paragraph (a)(1) of this section does not apply to any corporation that—

(A) Immediately prior to qualifying to be taxed as a RIC or REIT was subject to tax as a C corporation for a period not exceeding two taxable years; and

(B) Immediately prior to being subject to tax as a C corporation was subject to tax as a RIC or REIT for a period of at least one taxable year.

(ii) *Property acquired from another corporation while a C corporation*. The exception described in paragraph (d)(2)(i) of this section does not apply to property acquired by the corporation while it was subject to tax as a C corporation from any person in a transaction that results in the acquirer's basis in the property being determined by reference to a C corporation's basis in the property.

(iii) *RICs and REITs previously subject to section 1374 treatment*. If the RIC or REIT had property subject to paragraph (b) of this section before the RIC or REIT became subject to tax as a C corporation as described in paragraph (d)(2)(i) of this section, then paragraph (b) of this section applies to the RIC or REIT upon its requalification as a RIC or REIT, except that the 10-year recognition period with respect to such property is reduced by the portion of the 10-year recognition period that expired before the RIC or REIT became subject to tax as a C corporation and by the period of time that the corporation was subject to tax as a C corporation.

(e) *Special rule for partnerships*. The principles of this section apply to property transferred by a partnership to a RIC or REIT to the extent of any C corporation partner's distributive share of the gain or loss in the transferred property. If the partnership were to elect deemed sale treatment under paragraph (c) of this section in lieu of section 1374 treatment under paragraph (b) of this section with respect to such

transfer, then any net gain recognized by the partnership on the deemed sale must be allocated to the C corporation partner, but does not increase the capital account of any partner. Any adjustment to the partnership's basis in the RIC or REIT stock as a result of deemed sale treatment under paragraph (c) of this section shall constitute an adjustment to the basis of that stock with respect to the C corporation partner only. The principles of section 743 apply to such basis adjustment.

(f) *Effective date*. This section applies to conversion transactions that occur on or after January 2, 2002. For conversion transactions that occurred on or after June 10, 1987, and before January 2, 2002, see §§ 1.337(d)-5 and 1.337(d)-6.

[T.D. 9047, 68 FR 12822, Mar. 18, 2003]

§ 1.338-0 **Outline of topics.**

This section lists the captions contained in the regulations under section 338 as follows:

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

- (a) In general.
  - (1) Deemed transaction.
  - (2) Application of other rules of law.
  - (3) Overview.
- (b) Treatment of target under other provisions of the Internal Revenue Code.
  - (1) General rule for subtitle A.
  - (2) Exceptions for subtitle A.
  - (3) General rule for other provisions of the Internal Revenue Code.
- (c) Anti-abuse rule.
  - (1) In general.
  - (2) Examples.
- (d) Next day rule for post-closing transactions.

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

- (a) Scope.
- (b) Nomenclature.
- (c) Definitions.
  - (1) Acquisition date.
  - (2) Acquisition date assets.
  - (3) Affiliated group.
  - (4) Common parent.
  - (5) Consistency period.
  - (6) Deemed asset sale.
  - (7) Deemed sale tax consequences.
  - (8) Deemed sale return.
  - (9) Domestic corporation.
  - (10) Old target's final return.
  - (11) Purchasing corporation.
  - (12) Qualified stock purchase.

- (13) Related persons.
- (14) Section 338 election.
- (15) Section 338(h)(10) election.
- (16) Selling group.
- (17) Target; old target; new target.
- (18) Target affiliate.
- (19) 12-month acquisition period.
- (d) Time and manner of making election.
- (e) Special rules for foreign corporations or DISCs.
  - (1) Elections by certain foreign purchasing corporations.
    - (i) General rule.
    - (ii) Qualifying foreign purchasing corporation.
    - (iii) Qualifying foreign target.
    - (iv) Triggering event.
    - (v) Subject to United States tax.
  - (2) Acquisition period.
  - (3) Statement of section 338 may be filed by United States shareholders in certain cases.
  - (4) Notice requirement for U.S. persons holding stock in foreign target.
    - (i) General rule.
    - (ii) Limitation.
    - (iii) Form of notice.
    - (iv) Timing of notice.
    - (v) Consequence of failure to comply.
    - (vi) Good faith effort to comply.

*§ 1.338-3 Qualification for the section 338 election.*

- (a) Scope.
- (b) Rules relating to qualified stock purchases.
  - (1) Purchasing corporation requirement.
  - (2) Purchase.
  - (3) Acquisitions of stock from related corporations.
    - (i) In general.
    - (ii) Time for testing relationship.
    - (iii) Cases where section 338(h)(3)(C) applies—acquisitions treated as purchases.
    - (iv) Examples.
  - (4) Acquisition date for tiered targets.
    - (i) Stock sold in deemed asset sale.
    - (ii) Examples.
  - (5) Effect of redemptions.
    - (i) General rule.
    - (ii) Redemptions from persons unrelated to the purchasing corporation.
    - (iii) Redemptions from the purchasing corporation or related persons during 12-month acquisition period.
      - (A) General rule.
      - (B) Exception for certain redemptions from related corporations.
    - (iv) Examples.
  - (c) Effect of post-acquisition events on eligibility for section 338 election.
    - (1) Post-acquisition elimination of target.
    - (2) Post-acquisition elimination of the purchasing corporation.
    - (d) Consequences of post-acquisition elimination of target where section 338 election not made.
      - (1) Scope.

- (2) Continuity of interest.
- (3) Control requirement.
- (4) Solely for voting stock requirement.
- (5) Example.

*§ 1.338-4 Aggregate deemed sale price; various aspects of taxation of the deemed asset sale.*

- (a) Scope.
- (b) Determination of ADSP.
  - (1) General rule.
  - (2) Time and amount of ADSP.
    - (i) Original determination.
    - (ii) Redetermination of ADSP.
    - (iii) Example.
  - (c) Grossed-up amount realized on the sale to the purchasing corporation of the purchasing corporation's recently purchased target stock.
    - (1) Determination of amount.
    - (2) Example.
    - (d) Liabilities of old target.
      - (1) In general.
      - (2) Time and amount of liabilities.
    - (e) Deemed sale tax consequences.
    - (f) Other rules apply in determining ADSP.
    - (g) Examples.
    - (h) Deemed sale of target affiliate stock.
      - (1) Scope.
      - (2) In general.
      - (3) Deemed sale of foreign target affiliate by a domestic target.
      - (4) Deemed sale producing effectively connected income.
      - (5) Deemed sale of insurance company target affiliate electing under section 953(d).
      - (6) Deemed sale of DISC target affiliate.
      - (7) Anti-stuffing rule.
      - (8) Examples.

*§ 1.338-5 Adjusted grossed-up basis.*

- (a) Scope.
- (b) Determination of AGUB.
  - (1) General rule.
  - (2) Time and amount of AGUB.
    - (i) Original determination.
    - (ii) Redetermination of AGUB.
    - (iii) Examples.
  - (c) Grossed-up basis of recently purchased stock.
    - (d) Basis of nonrecently purchased stock; gain recognition election.
      - (1) No gain recognition election.
      - (2) Procedure for making gain recognition election.
      - (3) Effect of gain recognition election.
        - (i) In general.
        - (ii) Basis amount.
        - (iii) Losses not recognized.
        - (iv) Stock subject to election.
      - (e) Liabilities of new target.
        - (1) In general.
        - (2) Time and amount of liabilities.
        - (3) Interaction with deemed sale tax consequences.
      - (f) Adjustments by the Internal Revenue Service.

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(g) Examples.

### § 1.338-6 Allocation of ADSP and AGUB among target assets.

- (a) Scope.
  - (1) In general.
  - (2) Fair market value.
    - (i) In general.
    - (ii) Transaction costs.
    - (iii) Internal Revenue Service authority.
  - (b) General rule for allocating ADSP and AGUB.
    - (1) Reduction in the amount of consideration for Class I assets.
      - (2) Other assets.
        - (i) In general.
        - (ii) Class II assets.
        - (iii) Class III assets.
        - (iv) Class IV assets.
        - (v) Class V assets.
        - (vi) Class VI assets.
        - (vii) Class VII assets.
      - (3) Other items designated by the Internal Revenue Service.
    - (c) Certain limitations and other rules for allocation to an asset.
      - (1) Allocation not to exceed fair market value.
      - (2) Allocation subject to other rules.
      - (3) Special rule for allocating AGUB when purchasing corporation has nonrecently purchased stock.
        - (i) Scope.
        - (ii) Determination of hypothetical purchase price.
        - (iii) Allocation of AGUB.
      - (4) Liabilities taken into account in determining amount realized on subsequent disposition.
      - (5) Allocation to certain nuclear decommissioning funds.
    - (d) Examples.

### § 1.338-7 Allocation of redetermined ADSP and AGUB among target assets.

- (a) Scope.
- (b) Allocation of redetermined ADSP and AGUB.
- (c) Special rules for ADSP.
  - (1) Increases or decreases in deemed sale tax consequences taxable notwithstanding old target ceases to exist.
  - (2) Procedure for transactions in which section 338(h)(10) is not elected.
    - (i) Deemed sale tax consequences included in new target's return.
    - (ii) Carryovers and carrybacks.
      - (A) Loss carryovers to new target taxable years.
      - (B) Loss carrybacks to taxable years of old target.
      - (C) Credit carryovers and carrybacks.
  - (3) Procedure for transactions in which section 338(h)(10) is elected.
  - (d) Special rules for AGUB.
    - (1) Effect of disposition or depreciation of acquisition date assets.

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(2) Section 38 property.

(e) Examples.

### § 1.338-8 Asset and stock consistency.

- (a) Introduction.
  - (1) Overview.
  - (2) General application.
  - (3) Extension of the general rules.
  - (4) Application where certain dividends are paid.
    - (5) Application to foreign target affiliates.
    - (6) Stock consistency.
  - (b) Consistency for direct acquisitions.
    - (1) General rule.
    - (2) Section 338(h)(10) elections.
  - (c) Gain from disposition reflected in basis of target stock.
    - (1) General rule.
    - (2) Gain not reflected if section 338 election made for target.
    - (3) Gain reflected by reason of distributions.
    - (4) Controlled foreign corporations.
    - (5) Gain recognized outside the consolidated group.
  - (d) Basis of acquired assets.
    - (1) Carryover basis rule.
    - (2) Exceptions to carryover basis rule for certain assets.
    - (3) Exception to carryover basis rule for de minimis assets.
    - (4) Mitigation rule.
      - (i) General rule.
      - (ii) Time for transfer.
  - (e) Examples.
    - (1) In general.
    - (2) Direct acquisitions.
  - (f) Extension of consistency to indirect acquisitions.
    - (1) Introduction.
    - (2) General rule.
    - (3) Basis of acquired assets.
    - (4) Examples.
    - (g) Extension of consistency if dividends qualifying for 100 percent dividends received deduction are paid.
      - (1) General rule for direct acquisitions from target.
      - (2) Other direct acquisitions having same effect.
      - (3) Indirect acquisitions.
      - (4) Examples.
      - (h) Consistency for target affiliates that are controlled foreign corporations.
        - (1) In general.
        - (2) Income or gain resulting from asset dispositions.
          - (i) General rule.
          - (ii) Basis of controlled foreign corporation stock.
            - (iii) Operating rule.
            - (iv) Increase in asset or stock basis.
        - (3) Stock issued by target affiliate that is a controlled foreign corporation.
        - (4) Certain distributions.
          - (i) General rule.

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(ii) Basis of controlled foreign corporation stock.

(iii) Increase in asset or stock basis.

(5) Examples.

(i) [Reserved]

(j) Anti-avoidance rules.

(1) Extension of consistency period.

(2) Qualified stock purchase and 12-month acquisition period.

(3) Acquisitions by conduits.

(i) Asset ownership.

(A) General rule.

(B) Application of carryover basis rule.

(ii) Stock acquisitions.

(A) Purchase by conduit.

(B) Purchase of conduit by corporation.

(C) Purchase of conduit by conduit.

(4) Conduit.

(5) Existence of arrangement.

(6) Predecessor and successor.

(i) Persons.

(ii) Assets.

(7) Examples.

### *§ 1.338-9 International aspects of section 338.*

(a) Scope.

(b) Application of section 338 to foreign targets.

(1) In general.

(2) Ownership of FT stock on the acquisition date.

(3) Carryover FT stock.

(i) Definition.

(ii) Carryover of earnings and profits.

(iii) Cap on carryover of earnings and profits.

(iv) Post-acquisition date distribution of old FT earnings and profits.

(v) Old FT earnings and profits unaffected by post-acquisition date deficits.

(vi) Character of FT stock as carryover FT stock eliminated upon disposition.

(4) Passive foreign investment company stock.

(c) Dividend treatment under section 1248(e).

(d) Allocation of foreign taxes.

(e) Operation of section 338(h)(16). [Reserved]

(f) Examples.

### *§ 1.338-10 Filing of returns.*

(a) Returns including tax liability from deemed asset sale.

(1) In general.

(2) Old target's final taxable year otherwise included in consolidated return of selling group.

(i) General rule.

(ii) Separate taxable year.

(iii) Carryover and carryback of tax attributes.

(iv) Old target is a component member of purchasing corporation's controlled group.

(3) Old target is an S corporation.

(4) Combined deemed sale return.

(i) General rule.

(ii) Gain and loss offsets.

(iii) Procedure for filing a combined return.

(iv) Consequences of filing a combined return.

(5) Deemed sale excluded from purchasing corporation's consolidated return.

(6) Due date for old target's final return.

(i) General rule.

(ii) Application of § 1.1502-76(c).

(A) In general.

(B) Deemed extension.

(C) Erroneous filing of deemed sale return.

(D) Erroneous filing of return for regular tax year.

(E) Last date for payment of tax.

(7) Examples.

(b) Waiver.

(1) Certain additions to tax.

(2) Notification.

(3) Elections or other actions required to be specified on a timely filed return.

(i) In general.

(ii) New target in purchasing corporation's consolidated return.

(4) Examples.

(c) Effective/applicability date.

### *§ 1.338-11 Effect of section 338 election on insurance company targets.*

(a) In general.

(b) Computation of ADSP and AGUB.

(1) Reserves taken into account as a liability.

(2) Allocation of ADSP and AGUB to specific insurance contracts.

(c) Application of assumption reinsurance principles.

(1) In general.

(2) Reinsurance premium.

(3) Ceding commission.

(4) Examples.

(d) Reserve increases by new target after the deemed asset sale.

(1) In general.

(2) Exceptions.

(3) Amount of additional premium.

(i) In general.

(ii) Increases in unpaid loss reserves.

(iii) Increases in other reserves.

(4) Limitation on additional premium.

(5) Treatment of additional premium under section 848.

(6) Examples.

(7) Effective/applicability date.

(i) In general.

(ii) Application to pre-effective date increases to reserves.

(e) Effect of section 338 election on section 846(e) election.

(1) In general.

(2) Revocation of existing section 846(e) election.

(f) Effect of section 338 election on old target's capitalization amounts under section 848.

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- (1) Determination of net consideration for specified insurance contracts.
- (2) Determination of capitalization amount.
- (3) Section 381 transactions.
- (g) Effect of section 338 election on policyholders surplus account.
- (h) Effect of section 338 election on section 847 special estimated tax payments.

*§ 1.338-11T Effect of section 338 election on insurance company targets (temporary).*

- (a) through (c) [Reserved]
- (d) Reserve increases by new target after the deemed asset sale.
  - (1) In general.
  - (2) Exceptions.
  - (3) Amount of additional premium.
  - (i) In general.
  - (ii) Increases in unpaid loss reserves.
  - (iii) Increases in other reserves.
  - (4) Limitation on additional premium.
  - (5) Treatment of additional premium under section 848.
  - (6) Examples.
  - (7) Effective dates.
    - (i) In general.
    - (ii) Application to pre-effective date increases to reserves.
  - (e) Effect of section 338 election on section 846(e) election.
    - (1) In general.
    - (2) Revocation of existing section 846(e) election.
  - (f) through (h) [Reserved]

*§ 1.338(h)(10)-1 Deemed asset sale and liquidation.*

- (a) Scope.
- (b) Definitions.
- (1) Consolidated target.
- (2) Selling consolidated group.
- (3) Selling affiliate; affiliated target.
- (4) S corporation target.
- (5) S corporation shareholders.
- (6) Liquidation.
- (c) Section 338(h)(10) election.
  - (1) In general.
  - (2) Simultaneous joint election requirement.
  - (3) Irrevocability.
  - (4) Effect of invalid election.
  - (d) Certain consequences of section 338(h)(10) election.
    - (1) P.
    - (2) New T.
    - (3) Old T—deemed sale.
      - (i) In general.
      - (ii) Tiered targets.
    - (4) Old T and selling consolidated group, selling affiliate, or S corporation shareholders—deemed liquidation; tax characterization.
      - (i) In general.
      - (ii) Tiered targets.
    - (5) Selling consolidated group, selling affiliate, or S corporation shareholders.

- (i) In general.
- (ii) Basis and holding period of T stock not acquired.
- (iii) T stock sale.
- (6) Nonselling minority shareholders other than nonselling S corporation shareholders.
  - (i) In general.
  - (ii) T stock sale.
  - (iii) T stock not acquired.
- (7) Consolidated return of selling consolidated group.
- (8) Availability of the section 453 installment method.
  - (i) In deemed asset sale.
  - (ii) In deemed liquidation.
- (9) Treatment consistent with an actual asset sale.
  - (e) Examples.
  - (f) Inapplicability of provisions.
  - (g) Required information.

*§ 1.338(i)-1 ≤Effective dates.*

- (a) In general.
- (b) Section 338(h)(10) elections for S corporation targets.
- (c) Section 338 elections for insurance company targets.
  - (1) In general.
  - (2) New target election for retroactive election.
    - (i) Availability of election.
    - (ii) Time and manner of making the election for new target.
  - (3) Old target election for retroactive election.
    - (i) Availability of election.
    - (ii) Time and manner of making the election for old target.

[T.D. 8940, 66 FR 9929, Feb. 13, 2001, as amended by T.D. 9158, 70 FR 55741, Sept. 16, 2004; T.D. 9257, 71 FR 17999, Apr. 10, 2006; T.D. 9264, 71 FR 30595, May 30, 2006; T.D. 9358, 72 FR 51705, Sept. 11, 2007; T.D. 9377, 73 FR 3871, Jan. 23, 2008]

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

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