

Reg. Section 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-subsubsidiary 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-subsubsidiary.

(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-subsidary chains of corporations making section 336(e) elections, the deemed liquidation of a lower-tier subsidiary corporation is considered to precede the deemed liquidation of a higher-tier subsidiary.

(iv) Seller-distribution of target stock. In the case of a distribution of target stock in a qualified stock disposition, seller (the distributor) is deemed to purchase from an unrelated person, on the disposition date, immediately after the deemed liquidation of old target, the amount of stock distributed in the qualified stock disposition (new target stock) and to have distributed such new target stock to its shareholders. Seller recognizes no gain or loss on the distribution of such stock.

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

(2) Dispositions described in section 355(d)(2) or (e)(2).

(i) Old target-deemed asset disposition.

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

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

(2) Exception. If an election is made under §1.1502-13(f)(5)(ii)(E), then solely for purposes of §1.1502-13(f)(5)(ii)(C), immediately after the

deemed asset disposition of old target, old target is deemed to liquidate into seller.

(B) Gains and losses.

(1) Gains. Except as provided in § 1.338(h)(10)-1(d)(8) (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-subsidary chains of corporations making section 336(e) elections with respect to a qualified stock disposition described, in whole or in part, in section 355(d)(2) or (e)(2), the Federal income tax consequences of the section 336(e) election for a subsidiary of target shall be determined under paragraph (b)(1) of this section unless the stock of the subsidiary of target is actually disposed of in a qualified stock disposition described, in whole or in part, in section 355(d)(2) or (e)(2). The deemed liquidation of a lower-tier subsidiary pursuant to paragraph (b)(1)(iii) of this section is considered to precede the deemed liquidation of a higher-tier subsidiary. The deemed liquidation of the highest tier subsidiary of target is considered to precede the distribution of old target stock described in paragraph (b)(2)(iii)(A) of this section.

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

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

(vi) Earnings and profits. The earnings and profits of seller and target shall be determined pursuant to §1.312-10 and, if applicable, §1.1502-33(e). For this purpose, target will not

be treated as a newly created controlled corporation and any increase or decrease in target's earnings and profits pursuant to the deemed asset disposition will increase or decrease, as the case may be, target's earnings and profits immediately before the allocation described in §1.312-10.

(c)Purchaser. Generally, the making of a section 336(e) election will not affect the Federal income tax consequences to which purchaser would have been subject with respect to the acquisition of target stock if a section 336(e) election was not made. Thus, notwithstanding §§1.336-2(b)(1)(i)(A), 1.336-2(b)(1)(iv), and 1.336-2(b)(2)(iii)(A), purchaser will still be treated as having purchased, received in an exchange, or received in a distribution, the stock of target so acquired on the date actually acquired. However, see section 1223(1)(B) with respect to the holding period for stock acquired pursuant to a distribution qualifying under section 355 (or so much of section 356 that relates to section 355). The Federal income tax consequences of the deemed asset disposition and liquidation of target may affect purchaser's consequences. For example, if seller distributes the stock of target to its shareholders in a qualified stock disposition for which a section 336(e) election is made, any increase in seller's earnings and profits as a result of old target's deemed asset disposition and liquidation into seller may increase the amount of a distribution to the shareholders constituting a dividend under section 301(c)(1).

(d)Minority shareholders.

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

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

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

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

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

(g) Special rules.

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

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

(3) International provisions.

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

(ii) Allocation of foreign taxes.

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

(B) Taxes imposed on partnerships and disregarded entities. If a section 336(e) election is made for target and target holds an interest in a disregarded entity or partnership, the rules of §1.901-2(f)(4) apply to determine the person who is considered for U.S. Federal income tax purposes to pay foreign tax imposed at the entity level on the income of the disregarded entity or partnership.

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

(h) Making the section 336(e) election.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(iii) Making of election for Target Subsidiary. Because Target Subsidiary is neither a member of the same consolidated group as S Corporation Target nor is an S corporation, in order to make a section 336(e) election for the qualified stock disposition of Target Subsidiary, the requirements of paragraph (h)(2) of this

section must be satisfied. On or before the due date of S Corporation Target's Federal income tax return that includes Date 1, or Target Subsidiary's Federal income tax return that includes Date 1, whichever is earlier, either Target Subsidiary must join in the written agreement described in paragraph (ii) of this Example 2 to make a section 336(e) election with respect to the qualified stock disposition of Target Subsidiary or S Corporation Target and Target Subsidiary must enter into a separate written, binding agreement to make a section 336(e) election with respect to the qualified stock disposition of Target Subsidiary; S Corporation Target and Target Subsidiary each must retain a copy of the written agreement; and S Corporation Target and Target Subsidiary each must attach the section 336(e) election statement to its timely filed Federal income tax return for the taxable year that includes Date 1. In preparing the section 336(e) election statement, paragraph (i) of the statement should include the relevant information for S Corporation Target, paragraph (iii) of the statement should include the relevant information for Target Subsidiary, paragraphs (vii) through (xi) of the statement should provide information for both A's and B's actual sale and C's actual retention of S Corporation Target stock as well as information for S Corporation Target's deemed sale of Target Subsidiary stock, and paragraph (xiii) of the statement should include a statement that A, B, C, S Corporation Target, and Target Subsidiary, or S Corporation Target and Target Subsidiary, whichever is appropriate, have executed a written, binding agreement to make a section 336(e) election with respect to the qualified stock disposition of Target Subsidiary.

(i) [Reserved]

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

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

Example (1). Sale of 100 percent of Target stock.

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

(ii) Consequences. The sale of Target stock constitutes a qualified stock disposition. July 1 of Year 1 is the disposition date. Accordingly, pursuant to the section 336(e) election, for Federal income tax purposes, rather than treating Parent as selling the stock of Target to A, the following events are deemed to occur. Target is treated as if, on July 1, it sold all of its assets to an unrelated person in exchange for the ADADP of \$10,000, which is allocated \$7,000 to Parcel 1 and \$3,000 to Parcel 2 (see §§ 1.336-3 and 1.338-6 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 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 ($\$8,000 ((50 \text{ shares} \times \$88) + (30 \text{ shares} \times \$120)) / .80$ ($\$9,600 (80 \text{ shares} \times \$120) / \$12,000 (100 \text{ shares} \times \$120)$)), 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 ($\$8,000 ((50 \text{ shares} \times \$88) + (30 \text{ shares} \times \$120)) \times 1.25 ((100 - 0) / 80)$), which is allocated to Buildings 1 and 2 in proportion to their fair market values, \$6,500 to Building 1 and \$3,500 to Building 2 (see §§1.336-4, 1.338-5, and 1.338-6 for determination of amount and allocation of AGUB). Old Target is treated as liquidating into Parent immediately after the deemed asset disposition, distributing the \$10,000 deemed received in exchange for its assets in a transaction qualifying under section 332. Parent recognizes no gain or loss on the liquidation. Parent is then deemed to purchase 30 shares of New Target stock from an unrelated person on July 1, and to distribute those 30 New Target shares to its shareholders. Parent recognizes no gain or loss on the deemed distribution of the 30 shares under § 1.336-2(b)(1)(iv). Parent is then deemed to purchase (and retain) on July 2, the day after the disposition date, 20 shares of New Target stock at their fair market value as determined under §1.336-2(b)(1)(v), \$2,000 (\$100 per share (20 shares multiplied by \$100 fair market value per share (\$10,000 grossed-up amount realized on the sale and distribution of 80

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

Example (6). Sale of Target stock by consolidated group members.

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

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

Example (7). Sale of Target stock by non-consolidated group members.

(i) Facts. The facts are the same as in Example 6 except that Parent, Sub, and Target do not join in the filing of a consolidated Federal income tax return.

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

Example (8). Distribution of 80 percent of Target stock in complete redemption of a greater-than-50-percent shareholder.

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

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

Example (9). Pro-rata distribution of 80 percent of Target stock.

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

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