



**April 22, 2014**  
**Pennsylvania Corporate Taxes**  
**No. CRP-14-001**  
**Corporate Net Income Tax**

ISSUE

- (1) Will the Pennsylvania Corporate Net Income Tax consequences of the Corp. C Sale on Corp. C and Corp. A be the same as the federal income tax consequences of the Corp. C Sale on Corp. C and Corp. A?
- (2) Will the Pennsylvania Corporate Net Income Tax consequences of the Pre-Acquisition Distribution on Corp. C and Corp. A be the same as the federal income tax consequences of the Pre-Acquisition Distribution on Corp. C and Corp. A?

CONCLUSIONS

- (1) Yes, the Pennsylvania Corporate Net Income Tax consequences of the Corp. C Sale on Corp. C and Corp. A will be the same as the federal income tax consequences of the Corp. C Sale on Corp. C and Corp. A. As such, for Pennsylvania Corporate Net Income Tax purposes, Corp. A should not recognize gain on the Corp. C Sale and Corp. C should recognize any gain on the deemed sale which results from the Section 338(h)(10) election. Each of Corp. A and Corp. C should report these tax consequences on a separate company basis.
- (2) Yes, the Pennsylvania Corporate Net Income Tax consequences of the Pre-Acquisition Distribution on Corp. C and Corp. A will be the same as the federal income tax consequences of the Pre-Acquisition Distribution on Corp. C and Corp. A. As such, neither Corp. C nor Corp. A should recognize any income on the Pre-Acquisition Distribution for Pennsylvania Corporate Net Income Tax purposes.

FACTS

Corporation A, a Pennsylvania corporation ("Corp. A"), is a wholly-owned subsidiary of Corporation B. Corp. A owns all of the issued and outstanding stock of Corporation C, a New York corporation ("Corp. C"). Corp. C owns all of the issued and outstanding stock of Corporation D, a New Jersey corporation ("Corp. D"), and all of the membership interests of Limited Liability Company A, a Delaware limited liability company ("LLC A").

Corp. A is negotiating with an unrelated corporation ("Buyer") in an effort to sell its Corp. C stock for cash. Corp. A and Buyer will make a joint election under Section 338(h)(10) of the Internal Revenue Code of 1986, as amended (the "Code"), with respect to this transaction (the "Corp. C Sale"). Prior to the Corp. C Sale, Corp. C will distribute its Corp. D stock, its membership interest in LLC A and certain other retained assets and liabilities to Corp. A (the "Pre-Acquisition Distribution").

The following representations have been made by Corp. A with respect to the Corp. C Sale:

- (1) Corp. A and Buyer will satisfy all of the requirements in Section 338(h)(10) with respect to the Corp. C Sale. Accordingly, the 338(h)(10) election will be treated as a valid election under Section 338(h)(10) for federal income tax purposes;



- (2) The Pre-Acquisition Distribution, along with the deemed distribution of Corp. C's assets that will result from the 338(h)(10) election, will be made pursuant to a formal plan of liquidation that will be adopted before the Pre-Acquisition Distribution and Corp. C Sale;
- (3) Corp. A and Buyer will agree that Corp. A will sell the Corp. C stock to Buyer after the Pre-Acquisition Distribution; and
- (4) Buyer will covenant that it will not undertake any action or engage in, or cause to be engaged in, any transaction that would jeopardize the validity of the 338(h)(10) election.

## LAW

### Federal Law

Section 338(h)(10) of the Code provides for the treatment of a qualified stock purchase as an asset purchase. The seller and buyer may make a joint election for the target corporation under Section 338(h)(10). If this election is made, the target corporation is deemed to have sold all of its assets to a new corporation owned by the buyer and then distributed the proceeds in complete liquidation. The deemed sale is generally taxable to the target corporation while the deemed liquidating distribution generally is not.

When a Section 338(h)(10) election is made, the distribution of unwanted assets by the target corporation to its parent in connection with the sale by the parent of all of the target corporation's stock to the buyer is considered to be part of the complete liquidation of the subsidiary under Section 338(h)(10). Treas. Reg. 1.338(h)(10)-1(e), Ex. 2. This complete liquidation is treated as a tax-free liquidation of the subsidiary under Sections 332 if: (1) the actual and deemed distributions are made pursuant to a formal plan of liquidation that is adopted before the actual distribution and stock sale; (2) seller and buyer agree that seller will sell the target stock to buyer after the target corporation's actual distribution of the unwanted assets; and (3) seller and buyer agree to jointly make an election under Section 338(h)(10). Treas. Reg. Sections 1.338(h)(10)-1(e), Ex. 2; 1.338(h)(10)-1(d)(4).

### Pennsylvania Law

Taxable income, which is the starting point for computing Pennsylvania Corporate Net Income Tax, is defined in relevant part as "... taxable income for the calendar year or fiscal year as returned to and ascertained by the federal government, or in the case of a corporation participating in the filing of consolidated returns to the Federal Government, the taxable income which would have been returned to and ascertained by the Federal Government if separate returns had been made to the Federal Government...." 72 P.S. § 7401(3)1. For corporate net income tax purposes, "[t]axable income generated as a result of a section 338 election is subject to Pennsylvania Corporate Net Income Tax and treated as business income subject to apportionment...." 61 Pa. Code § 153.81(d)(1). The income tax consequences of the Section 338(h)(10) election are to be reflected on a separate company basis and not as part of a combined or consolidated report. *Id.* Target corporations are required to file Corporate Net Income Tax reports for period for which a federal return is required to be filed, including a federal 1-day deemed sale return. 61 Pa. Code § 153.81(b).

## DISCUSSION

Based upon the above facts, representations and statements of the law, it is our understanding that the Corp. C Sale constitutes a valid Section 338(h)(10) transaction for federal income tax purposes and, as such, for federal income tax purposes Corp. A should not recognize gain on the Corp. C Sale and Corp. C should recognize any gain on the deemed sale which results from the Section 338(h)(10) election. Assuming the foregoing, because Pennsylvania law recognizes Section 338(h)(10) elections and the starting point for computing Pennsylvania Corporate Net Income Tax is taxable income as is or as would



have been returned to and ascertained by the Federal Government, Corp. A should not recognize gain on the Corp. C Sale for Pennsylvania Corporate Net Income Tax purposes and Corp. C should recognize any gain on the Corp. C Sale for Pennsylvania Corporate Net Income Tax purposes. Each of Corp. A and Corp. C should report these tax consequences on a separate company basis.

Based upon the above facts, representations and statements of the law, it is our understanding that the Pre-Acquisition Distribution will be treated for federal income tax purposes as a tax-free liquidation pursuant to Sections 338(h)(10) and 332 and, as such, neither Corp. C nor Corp. A should recognize any income as a result of the Pre-Acquisition Distribution for federal income tax purposes. Assuming the foregoing, because Pennsylvania law recognizes Section 338(h)(10) elections and the starting point for computing Pennsylvania Corporate Net Income Tax is taxable income as would have been returned to and ascertained by the Federal Government, neither Corp. C nor Corp. A should recognize any income on the Pre-Acquisition Distribution for Pennsylvania Corporate Net Income Tax purposes.