



State of Alabama Department of Revenue

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ALABAMA DEPARTMENT OF REVENUE REVENUE RULING 94-005

This document may not be used or cited as precedent. Code of Alabama 1975, §40-2A-5(a).

TO: Company A

FROM: Commissioner of Revenue
Alabama Department of Revenue

DATE: June 14, 1994

RE: Alabama income tax treatment of a transaction in which a federal election under §338(h)(10) of the Internal Revenue Code has been made. Code of Alabama 1975, §40-18-8(k).

FACTS

Company A has entered into a Stock Purchase Agreement dated April 22, 1994, pursuant to which Company A has agreed to sell the stock of its wholly-owned subsidiary (Target) to Company B for cash. Target is an Alabama corporation which does business in this state and which allocates and apports a substantial amount of its income to Alabama. Company A is a Delaware corporation which has its commercial domicile in Alabama and which files Alabama income tax returns on an annual basis. The Stock Purchase Agreement provides for a closing date of June 22, 1994.

The Stock Purchase Agreement obligates Company A and Company B to make a joint election under Section 338(h)(10) of the Internal Revenue Code of 1986, as amended (the "Code"), and to make a similar election under any comparable provisions of state, local or foreign tax laws for which an election is permissible. For federal income tax purposes, a §338(h)(10) election has the following effects:

1. The Target is treated as though it sold its assets in a single transaction to a new corporation owned by Company B, for an amount equal to the sum of (i) the purchase price which Company B pays for Target's stock, (ii) the Target's liabilities immediately after the transaction, and (iii) other relevant items.

2. The Target is treated as having liquidated into Company A in a tax-free transaction under Section 332 of the Code.

3. In the hands of Company B, Target takes a basis in its assets for tax purposes in an amount equal to the sum of the items listed in paragraph 1. above. The aggregate amount of basis is allocated to the assets according to their relative fair market values.

4. Company A's sale of the Target stock is ignored, and Company A does not recognize any gain or loss upon the stock sale.

The taxable year of Company A and Target ends with the last day of February. Company B's taxable year ends on December 31.

ISSUE

Whether the state follows the federal treatment afforded to Target and to Company A as a result of the §338(h)(10) election?

LAW AND ANALYSIS

Code of Alabama 1975, 40-18-8(k) incorporates into state tax law the federal tax treatment afforded by §338 of the Code as follows:

Election under 26 U.S.C. §338. -- If an acquiring corporation makes an election under 26 U.S.C. §338, the amount of gain recognized by the target corporation shall be determined under said 26 U.S.C. §338.

Section 40-18-8(k) incorporates all of the provisions of 26 U.S.C. §338, including subsection (h)(10) thereof. Section 338(h)(10)(A) of the Code provides, in part, that one of the effects of an election under §338(h)(10) is that ". . . no gain or loss will be recognized on stock sold or exchanged in the transaction . . ."

The Alabama Department of Revenue Administrative Code section 810-3-8-.13 implements §40-18-8(k) by providing as follows:

Recognition of Gain by Target Corporations.

(1) If an acquiring corporation makes an election under 26 U.S.C. §338, the target corporation -

(a) shall be treated as having sold all of its assets at the close of the acquisition date at fair market value in a single transaction * * *, and

(b) shall be treated as a new corporation which purchased all of the assets referred to in subparagraph (a) above as of the beginning of the day after the acquisition date.

Alabama tax will be paid by Target on its gain from the deemed asset sale as provided in §40-18-8(k). Like its federal counterpart, §40-18-8(k) is designed to afford to a stock sale the same income tax treatment as would be produced by an asset sale followed by a complete liquidation of the Target, but without forcing the parties to actually go through the intricacies of transferring assets piecemeal.

Alabama law also adopts the federal tax treatment for the tax-free liquidation of subsidiaries which are at least 80%-owned by the parent corporation. Code of Alabama 1975, §§40-18-8(i) and 40-18-8(j) incorporate 26 U.S.C. §§332 and 337, which generally provide that the liquidation of corporate subsidiaries meeting certain requirements shall be tax-free with respect to both the liquidating corporation and its parent.

Section 810-3-13-.01(4) of the Department of Revenue Administrative Code -- governing the taxable year and return-filing requirements applicable to target corporations subject to a §338 election -- provides the following:

(a) Effect of Election under §40-18-8(1) [now (k)] (and 26 U.S.C. §338). The making of an election for a deemed liquidation of a target corporation as provided in §40-18-8(1) [now (k)] does not operate to terminate the tax year of the target corporation. If the target corporation must change its taxable year to conform to that of a new consolidated parent company for federal tax purposes, the rules in subparagraph (c) above for change in accounting period apply.

RULINGS

1. Alabama follows the federal income tax treatment of transactions governed by an election under Section 338(h)(10) of the Code. Gain or loss on the deemed asset sale is recognized by the target corporation.

2. A copy of the federal election on Form 8023 may be filed with the target corporation's Alabama income tax return for the tax year in which the transaction occurs; this filing will invoke the application of Code of Alabama 1975, §40-18-8(k).

3. The sale of Target stock by Company A to Company B will be ignored for income tax purposes, and Company A will not recognize gain or loss upon the sale of Target stock.

4. Pursuant to Rule 810-3-13-.01(4), the target corporation's taxable year will not close as a result of the §338(h)(10) transaction, but rather the target corporation will change its taxable year to conform with that of Company B. That is, Target will file an Alabama income tax return for the short (ten-month) period beginning March 1, 1994 and ending December 31, 1994, and thereafter will file in Alabama on the basis of the calendar taxable year of Company B.

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