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From: [REDACTED]
Sent: Wednesday, July 10, 2024 8:58:41 AM
To: [REDACTED]
Cc: [REDACTED]
Bcc:
Subject: POSTU-123139-22

[REDACTED],

You requested our advice on how § 338 applies to the facts described below. Specifically, you asked whether, for purposes of the gross receipts test of § 165(g)(3)(B), Taxpayer must provide (and take into account) the gross receipts history of Subsidiary from taxable years beginning on, or prior to, Date 1, the date on which Taxpayer acquired Subsidiary in a qualified stock purchase. As explained in greater detail below, Taxpayer should not be required to provide (or take into account) the gross receipts history of Subsidiary for taxable years beginning prior to Date 2.

In this case, Taxpayer, a domestic Subchapter C corporation, acquired all the stock of Subsidiary, a foreign entity treated as a corporation for U.S. tax purposes, in a qualified stock purchase on Date 1. Taxpayer made a § 338(g) election with respect to the acquisition. According to Taxpayer, the stock of Subsidiary subsequently became worthless in Year 3, and Taxpayer claimed a worthless stock deduction under § 165(g)(3) with respect to such stock in Year 3.

Under § 165(g), a loss resulting from stock becoming worthless is generally a capital loss if the stock itself is a capital asset. However, § 165(g)(3) provides for ordinary loss treatment of worthless stock in “a corporation affiliated with a taxpayer” if over 90% of the corporation’s gross receipts from “all taxable years” are, generally, not from royalties, rents, dividends, interest, annuities, and gains from sales or exchanges of stocks and securities. See section 165(g)(3)(B). Taxpayer argues that, as a result of the § 338(g) election on Date 1, Subsidiary is treated as a new corporation formed on Date 2 (the day after Date 1), and “all taxable years” in § 165(g)(3)(B) only include the taxable years beginning on or after Date 2. Taxpayer concludes that it should not be required to provide records relating to the gross receipts history of Subsidiary for taxable years prior to Date 1. The field has requested advice on whether this treatment is appropriate pursuant to § 338 and the regulations thereunder.

If the purchasing corporation in a qualified stock purchase makes an election under § 338, the target corporation is treated as selling all of its assets at the close of the acquisition date at fair market value. Section 338(a)(1). The target is treated as a new

corporation that purchased those assets as of the beginning of the day after the acquisition date. Section 338(a)(2); see also Treas. Reg. § 1.338-1(a)(1) (“Although target is a single corporation under corporate law, if a section 338 election is made, then two separate corporations, old target and new target, generally are considered to exist for purposes of subtitle A of the Internal Revenue Code.”). Unless a specific exception in the regulations applies, new target is treated as a new corporation that is unrelated to old target for all purposes of subtitle A. Treas. Reg. § 1.338-1(b)(1). The exceptions, which are enumerated in Treas. Reg. § 1.338-1(b)(2) and (3), do not include § 165, a provision in subtitle A. As a result, Subsidiary is treated as a new corporation as of Date 2, and “all taxable years” of Subsidiary, for purposes of § 165(g)(3)(B), include taxable years beginning on or after Date 2 and do not include taxable years beginning before Date 2. Thus, documentation from years prior to Date 2 is not required in this case.

Please contact CC:CORP if you encounter this issue in any future cases, as determining whether any particular entity satisfies the gross receipts test may involve a complex factual analysis. [REDACTED]

[REDACTED] We would be happy to assist with factual development and legal analysis in any other cases with section 165(g)(3) issues.

Please let us know if you have any questions.

Thank you,
[REDACTED]

Legend

Taxpayer =
Subsidiary =
Date 1 =
Date 2 =
Year 3 =

[REDACTED]