



STATE OF CALIFORNIA  
 FRANCHISE TAX BOARD  
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 Chair

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 Member

January 30, 2003

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Information letter  
 20020526

Re: \*\*\*\*\*

Dear \*\*\*\*\*:

As you know, your letter of \*\*\*\*\* , has been referred to me for response. We appreciate the fact that the taxpayer is concerned with whether the \*\*\*\*\* , sale of all of the stock of \*\*\*\*\* . \*\*\*\*\* is allowed or required to be treated as a deemed asset sale for California tax purposes pursuant to its Internal Revenue Code (IRC) section 338(h)(10) election for federal tax purposes.

My review of your letter indicates that you are requesting a Chief Counsel Ruling. FTB Notice 89-277 (copy attached for your convenience) identifies and discusses the guidelines for requesting a ruling from the Franchise Tax Board. It is the policy of the Franchise Tax Board, when appropriate and in the interest of sound tax administration, to respond to inquiries from taxpayers about their status for tax purposes and the tax effects of their planned acts or transactions. However, the Franchise Tax Board may decline to issue a ruling or opinion, whenever warranted by the facts and circumstances of a particular case. The question of whether the \*\*\*\*\* sale of all of the stock of \*\*\*\*\* is permitted or required to be treated as a deemed asset sale for California tax purposes pursuant to its IRC section 338(h)(10) election for federal tax purposes does not involve a planned act or transaction. Instead, the question involves the determination of the tax effects for a closed and completed transaction. The department generally does not respond to the requests for such determinations.

While we will not be issuing a Chief Counsel Ruling because of the after-the-fact nature of the inquiry, we can provide a brief discussion of the issues that arise regarding the California tax treatment of stock sales when the taxpayer has filed its federal tax return electing to treat the transaction as a deemed asset sale pursuant to IRC section 338(h)(10), where the target was a corporation for federal tax but not for state tax purposes. You should be aware that this information is being provided to you for informational purposes only and may not be construed as "written advice from the Board" within the meaning of Revenue and Taxation Code (R&TC) section 21012. You should also be aware that our response is subject to change, in the event of a change

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in relevant statutory authority, judicial or administrative case law, or a change in federal interpretation of federal law, where our opinion is based on such interpretations.

### The Facts Provided

In your letter of \*\*\*\*\*, and in subsequent telephone conversations, you provided a great deal of information, including the following:

1. \*\*\*\*\*, purchased all of the stock of \*\*\*\*\* from its individual shareholders;
2. \*\*\*\*\* was an S corporation for federal tax purposes, but was a C corporation for California tax purposes;
3. \*\*\*\*\* jointly made an IRC section 338(h)(10) election for federal tax purposes;
4. \*\*\*\*\* elected out of IRC section 338(h)(10) treatment for California tax purposes and therefore did not recognize gain on the deemed asset sale; and
5. To date \*\*\*\*\* has not filed its California tax return but wants to file its return claiming IRC section 338(h)(10) treatment.

### The Law

R&TC section 24451 conforms California law to all of Subchapter C of Chapter 1 of Subtitle A of the Internal Revenue Code, which includes Internal Revenue Code section 338. To qualify for IRC section 338(h)(10) treatment for California tax purposes the facts that exist for California tax purposes, i.e. \*\*\*\*\* was a C corporation, must meet the legal requirements of IRC section 338(h)(10). To qualify for IRC section 338(h)(10) treatment, before the stock purchase, \*\*\*\*\* must have been a member of a selling consolidated or affiliated group. In this case this legal requirement is not met because \*\*\*\*\* shareholders were presumably individuals since for federal tax purposes \*\*\*\*\* was an S corporation. Treas. Regs. section 1.338-2(c) states in pertinent part::

(16) *Selling group.* The *selling group* is the affiliated group (as defined in section 1504) eligible to file a consolidated return that includes target for the taxable period in which the acquisition date occurs. However, a selling group is not an affiliated group of which target is the common parent on the acquisition date.

See also Treas. Regs. section 1.338(h)(10)-1(c)(1) & (2).

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### Conclusion

\*\*\*\*\* was a C corporation for California tax purposes. In order for the transaction to qualify for an IRC section 338(h)(10) election, prior to the acquisition \*\*\*\*\* must have been but was not a part of a selling corporation's affiliated group. Accordingly, it does not appear that the September 24, 2001, stock sale qualifies for IRC section 338(h)(10) treatment for California tax purposes.

Very truly yours,

Cody C. Cinnamon  
Tax Counsel III

Attachment