

New U.S. Treasury 336(e) Election Adds Flexibility for Step-Ups in Acquisitions

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Recently issued U.S. Treasury regulations provide rules for making a "336(e) election," a new tax-planning tool that may be available when stock of a corporation is being acquired but asset purchase treatment is desired for income tax purposes. Purchasers now have additional flexibility to achieve a stepped-up tax basis in assets where neither an actual asset sale nor a 338(h)(10) election is possible. A 336(e) election generally has the same federal tax consequences as an election under Section 338(h)(10) of the Internal Revenue Code, but it is available in some situations in which a 338(h)(10) election would not be permitted.

To make a 336(e) election, at least 80 percent of the vote and value of a C corporation's or S corporation's stock must be disposed of within a 12-month period. If the target is a C corporation, the seller must itself be a corporation. If the election is made, then for federal tax purposes, the target generally is deemed to have sold its assets to a new corporation ("newco") in a taxable sale, and the target recognizes taxable gain or loss as a result. Under these deemed events, newco's tax basis in the assets is "stepped-up" to equal the total consideration treated as being paid by newco in the deemed asset sale.

The 80 percent vote-and-value requirement and deemed-sale consequences are similar to those of a 338(h)(10) election. Certain key differences between the two elections include the following:

- To qualify for a 338(h)(10) election, the requisite stock must be acquired by a corporation (or affiliated group). Conversely, a 336(e) election may be made even if the buyer is not a corporation (i.e., partnerships, limited liability companies, individuals or combinations thereof) and there are multiple buyers, even if not affiliated.
- A 336(e) election may be made if the disposition occurs in a sale, exchange or distribution, and not only in a taxable stock purchase. Thus, for example, a 336(e) election may be available if stock of a corporate subsidiary is distributed by a parent corporation to its shareholders.
- A 336(e) election generally is made by the selling shareholders and the target corporation, rather than by the selling shareholders and the buyer. Thus, if such an election is desired, the buyer should obtain the agreement of the selling shareholders and the target to make the

election.

The rules governing 338(h)(10) elections generally take precedence if a transaction qualifies for both types of elections. Special rules apply if the transaction is described in Section 355(d)(2) or Section 355(e)(2) of the Internal Revenue Code (relating to certain spin-off transactions).

A 336(e) election may be most appealing in circumstances in which the acquiring entity is an LLC or a partnership. For example, a private equity fund would not need to establish a corporate acquirer solely to facilitate a stepped-up tax basis in the assets of the target under the 336(e) election. Moreover, a consortium of funds purchasing a corporation could establish their holding vehicle as an LLC and retain eligibility to make a 336(e) election. In some contexts, however, forming a corporate acquirer and making a 338(h)(10) election may still be advisable.

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