

Item	Yes	No	Comments
<b>Validity of S status</b>			
<b>1.</b> Is the target an S corporation at the time of the QSP?			
<p>Only certain target corporations can participate in a Sec. 338(h)(10) election (i.e., members of a consolidated group, affiliated corporations and S corporations). This checklist focuses on S targets. If stock of a purported S corporation is purchased in a QSP, it is critical to ascertain that the target has a valid S election in effect at the time of acquisition if a Sec. 338(h)(10) election is intended.</p>			
<b>2.</b> Has the target maintained S status continuously since its most recent election?			
<b>3.</b> Determine continuous S status by examining the following documents:			
<input type="checkbox"/> Form 2553, Election by a Small Business Corporation. Make sure all shareholders at the time of the corporation's current S election have signed the form. Certain other shareholders' consents may be required; see Regs. Sec. 1.1362-6(b)(2). Have appropriate consents been reviewed?			
<input type="checkbox"/> Did both spouses sign the election form if they live in a community property state?			

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<input type="checkbox"/> Are both spouses qualified shareholders?			
<input type="checkbox"/> If a qualified subchapter S trust (QSST) was a shareholder on the date of the S election, did the current beneficiary (rather than the trustee(s)) sign the election form?			
<input type="checkbox"/> Did the current beneficiary make a valid QSST election?			
<input type="checkbox"/> Under Notice 97-12, 1997-1 CB 385, if an electing small business trust (ESBT) was a shareholder on the date of the S election, the trustee was required to consent to the S election. Did the trustee consent?			
<input type="checkbox"/> Did the trustee make a valid ESBT election?			
<input type="checkbox"/> Examine the corporation's "governing provisions" and ask the target to provide a distribution schedule for each of its shareholders on a year-by-year basis. Do the governing provisions state that each outstanding share of stock has identical rights to distribution and liquidation proceeds; were distributions made on a pro-rata basis? If not, could the non-pro-rata distributions result in a second class of stock? See Regs. Sec. 1.1361-1(l) to determine whether a potential second class of stock exists. Payment of varying amounts to S shareholders in a transaction for which a Sec. 338(h)(10) election has been made will not violate the one-class-of-stock requirement, if the varying amounts have been negotiated at arm's length with the purchaser. Have these things been done?			
<input type="checkbox"/> Review any shareholder, buy-sell or redemption agreement to determine whether these instruments have created a second class of stock.			
<input type="checkbox"/> Review the liabilities and equity sections of the balance sheet to make sure that no instruments, obligations or arrangements could result in a second class of stock; see Regs. Sec. 1.1361-1(l)(4).			
<input type="checkbox"/> Review any stock option plans to determine if call options are outstanding and whether a second class of stock exists.			
<input type="checkbox"/> Review all trust shareholder agreements to ensure the trusts are eligible S shareholders.			
<input type="checkbox"/> Review prior-year tax returns for possible disqualifying transactions (e.g., pre-1997 ownership of 80% or more of the stock of a domestic or foreign corporation).			
<b>4.</b> Has there been an inadvertent termination (or an invalid election) of S status? If so, request a letter ruling seeking a waiver of the invalid election or termination. (See Rev. Proc. 98-55, 1998-2 CB 645, for certain automatic waivers.) If applicable, has this been done?			
<b>Validity of QSub election</b>			
<b>5.</b> If the target S corporation has a purported QSub, has it been verified that the QSub election has been properly filed and that no event has terminated the election?			
<b>6.</b> Has making a protective Sec. 338(h)(10) election for a subsidiary whose QSub status is uncertain been considered?			
<b>QSPs</b>			
<b>7.</b> Will the QSP requirements be met for the anticipated acquisition? If the acquisition is not a QSP, a Sec. 338 election cannot be made, nor a cost basis in the target's assets obtained.			
<input type="checkbox"/> Has 80% or more (by vote and value) of the target's stock been acquired?			
<input type="checkbox"/> Is the acquirer a C or an S corporation?			
<input type="checkbox"/> Has the acquiring corporation "purchased" the stock of the target S corporation?			
Sec. 338(d)(3) requires, among other things, that a QSP be effected through a "purchase." In general, stock is "purchased" if the acquiring corporation			

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acquires the stock from an unrelated person and receives a cost basis in it; see Sec. 338(h)(3) and Regs. Sec. 1.338-3(b).			
8. Has the equity interest of a shareholder of the target S corporation been completely terminated during the S corporation's final taxable year (but prior to the QSP)?			
<input type="checkbox"/> If so, have the S corporation, the terminated shareholder and other affected shareholders agreed to a Sec. 1377(a)(2) closing-of-the-books for income-allocation purposes?			
<input type="checkbox"/> If so, is the new management of the S corporation (New T) contractually obligated to effectuate the Sec. 1377(a)(2) election by attaching an appropriate statement to Old T's timely filed original (or amended) final return?			
<input type="checkbox"/> If a Sec. 1377(a)(2) election has not been made for a previous termination of a shareholder's interest, has it been considered?			
<p>If an S shareholder's entire interest is terminated during a taxable year, the corporation may elect under Sec. 1377(a)(2) to "close its books" as to the affected shareholder(s) at the close of the day of such termination. All affected shareholders and the corporation must agree. Regs. Sec. 1.1377-1(b)(5) requires the election to be attached to a timely filed or amended return for the taxable year. If the S corporation is the target of a QSP for which a Sec. 338(h)(10) election is made, New T's management files the tax return for the target corporation's taxable year that ends on the date of the QSP. Thus, the "old" S shareholders may want to contractually require that New T attach the election to Form 1120S, U.S. Income Tax Return for an S Corporation. A similar issue arises in the case of a "qualifying disposition" under Regs. Sec. 1.1368-1(g).</p>			
9. Will all target shareholders sell their stock to the acquiring corporation?			
<input type="checkbox"/> If not, have the nonselling shareholders determined how they will pay tax on asset gains allocated to them, as well as on gain or loss on the deemed liquidation, when the Sec. 338(h)(10) election is made and the S corporation is deemed to have sold its assets and liquidated?			
<b>Filing requirements</b>			
10. Will New T file Old T's final S return?			
<input type="checkbox"/> New T is responsible for filing Old T's final Form 1120S. The Old T shareholders should negotiate the content of final Form 1120S with the purchaser before the QSP.			
<input type="checkbox"/> New T is liable for Old T's Federal income tax liabilities, including the tax liability for the deemed-sale tax consequences, notwithstanding the deemed liquidation of Old T; see Regs. Secs. 1.338(h)(10)-1(d)(2) and 1.338-1(b)(3)(i). Under Sec. 6011(a) and Regs. Sec. 1.6011-1(a), the person liable for the tax is responsible for the proper filing of returns.			
<input type="checkbox"/> Although New T and Old T generally are treated as two separate corporations for purposes of Code subtitle A, New T generally is treated as a continuation of Old T for purposes other than subtitle A; see Regs. Sec. 1.338-1(a)(1), (b)(1), (b)(3). "Procedure and administration" is in subtitle F; thus, New T is a continuation of Old T for this purpose.			
11. Will Old T's final Form 1120S be filed by the fifteenth day of the third month following the month of the QSP?			
12. Will the acquiring corporation and all target S shareholders (even those who do not sell their stock) jointly make a Sec. 338(h)(10) election on Form			

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8023, Elections Under Section 338 for Corporations Making Qualified Stock Purchases?			
<input type="checkbox"/> Will Form 8023 be filed by the fifteenth day of the ninth month following the month of the QSP?			
<p>Penalties for failure to file or pay tax are waived if Old T's final S return is filed and the tax paid by the Form 8023 due date. Interest on any underpayment runs from the original due date of the final return to the date of payment; see Regs. Sec. 1.338-10(b).</p>			
<b>13.</b> Will Form 8023 be ready for signature at the closing of the acquisition?			
<p>From the buyer's perspective, the target shareholders should not be allowed to leave the closing table with cash in hand without having signed Form 8023. If the parties have not yet decided to actually file the election form (due by the fifteenth day of the ninth month following the month of the QSP), the executed form can be held by either the buyer's or seller's attorney until such a decision is made. If the selling shareholders have already agreed to a Sec. 338(h)(10) election, as a matter of convenience it makes sense for all selling shareholders to sign the election at closing.</p>			
<p>The preamble to TD 8940 (2/13/01) (on deemed and actual asset acquisitions under Secs. 338 and 1060) states that Form 8594, Asset Acquisition Statement Under Section 1060, will be revised.</p>			
<p>For a transaction subject to a Sec. 338 election, the IRS will require that the form be filed with the Old T and New T income tax returns for the tax periods that include the deemed sale and purchase. The form will require information about the allocation of aggregate deemed sale price (ADSP) and adjusted grossed-up basis (AGUB).</p>			
<b>Installment sales</b>			
<b>14.</b> Did the consideration received for the S stock include nonmarketable installment obligations not payable on demand? If yes:			
<input type="checkbox"/> Did the target S corporation, in the deemed asset sale, recognize the full gain or loss on S assets not subject to installment-method treatment?			
<input type="checkbox"/> Did the target S corporation properly account for depreciation recapture under Sec. 453(i)?			
<input type="checkbox"/> Did the target S corporation properly take into account a deemed payment on the installment obligation under the liabilities-in-excess-of-basis rule of Temp. Regs. Sec. 15A.453-1(b)(3)(i)?			
<p>When some or all of the target stock is sold for an installment obligation and a Sec. 338(h)(10) election is made, Regs. Sec. 1.338(h)(10)-1(d)(8) makes the Sec. 453 installment-sale method of accounting available to Old T, provided the deemed asset sale would otherwise qualify for installment-sale reporting. Sec. 453 generally applies to gain (not loss) from a property sale when at least one of the payments will be received in a future year. Property disqualified from installment treatment includes inventories of personal property, real property held for sale to customers in the ordinary course of the corporation's trade or business and publicly traded stock or securities. If a sale or other disposition of the installment note occurs, gain or loss will generally be recognized.</p>			
<p>In general, the installment obligation may not be payable on demand or readily tradable for Sec. 453 to apply. If a liquidation occurs within a 12-month period and Sec. 331 applies, the receipt of certain installment obligations by a shareholder is not deemed a liquidation payment. Instead, under Sec. 453(h), payments made to the shareholder under the installment obligation are deemed payments for the shareholder's stock. All amounts distributed along with the installment obligation (e.g., cash and the fair market value of other property) are deemed received by the shareholder as the Sec. 453 selling price</p>			

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<p>for the stock in the liquidating corporation; see Regs. Sec. 1.453-11(a)(3) and (a)(5), <i>Example 2</i>.</p>			
<p>In addition, in such a 12-month liquidation, the liquidating S corporation does not recognize gain or loss on the distribution of the installment obligation, except for purposes of computing taxes under Secs. 1374 and 1375; see Sec. 453B(h).</p>			
<p><b>15.</b> If the target S corporation is subject to Sec. 1374 and the deemed sale is within the recognition period, did the target properly take into account the recognized built-in gain (or more infrequently, loss) on the deemed distribution of the installment note in complete liquidation of the target S corporation? See Sec. 453B(h). A similar rule applies if the target is subject to Sec. 1375.</p>			
<p>The gain or loss on the distribution of the installment obligation applies <i>only</i> for purposes of computing corporate-level tax.</p>			
<p><b>16.</b> Does the face amount of the installment obligation exceed \$5 million? If so, see Sec. 453A.</p>			
<p>For purposes of Sec. 453A (interest charged on taxes deferred under the installment method), a \$5 million threshold is applied and interest calculations are made at the shareholder level; see Notice 88-81, 1988-2 CB 397.</p>			
<p><b>17.</b> Is Old T subject to the Sec. 1374 BIG tax?</p>			
<p>The BIG tax is a liability of Old T. However, under Regs. Sec. 1.338(h)(10)-1(d)(2), New T remains liable for Old T's tax liabilities (including the tax liability stemming from the deemed sale, particularly the BIG tax); see Regs. Sec. 1.338-1(b)(3)(i). Because the BIG tax will be paid out of New T's assets, it should be included in AGUB; see Regs. Sec. 1.338-5(e)(1). Similarly, it is included in ADSP (see Regs. Sec. 1.338-4(d); see also Regs. Sec. 1.338-5(g), <i>Example 1</i>, and 1.338-4(g), <i>Example 1</i> (Old T's tax liability resulting from T's deemed asset sale included in AGUB and ADSP)). Under Sec. 1366(f)(2), the amount of the BIG tax flows through as a loss to Old T's shareholders.</p>			
<p><b>18.</b> Have contingent liabilities arisen from the QSP?</p>			
<p>Regs. Sec. 1.338-7(a) states that ADSP and AGUB are redetermined when an increase or decrease would be required under general principles of tax law for the elements of ADSP or AGUB; see Regs. Sec. 1.338-4(b)(2)(ii) and -5(b)(2)(ii). Under Regs. Sec. 1.338-7(c)(3), any changes in the deemed-sale tax consequences of a Sec. 338(h)(10) transaction caused by an increase or decrease in ADSP are accounted for in determining the taxable income of the S (i.e., Old T) shareholders for the taxable year in which it is taken into account. See Regs. Sec. 1.338-7(d) for the effect of a contingent payment on acquisition-date assets disposed of, depreciated, amortized or depleted by New T.</p>			
<p><b>19.</b> Have assumed liabilities been considered (including compensation liabilities)?</p>			
<p><b>20.</b> Has the proper treatment of transaction costs been considered?</p>			
<p>Transaction costs are not taken into account in allocating ADSP or AGUB to assets, except indirectly through their effect on the computation of ADSP and AGUB; see Regs. Sec. 1.338-6(a)(2)(ii).</p>			
<p>The proper treatment (as nondeductible capital items, deductible expenses or amortizable expenses) of the acquiring corporation's and target S corporation's expenditures to effect the Sec. 338(h)(10) election is unclear. The law is developing and authorities sometimes conflict.</p>			