FLORIDA
DEPARTMENT OF REVENUE

Executive
Director
Marshall Stranburg

QUESTIONS:
1. WHETHER THE FLORIDA CORPORATE INCOME TAX TREATMENT OF THE S. 338(h)(10), I.R.C. ELECTION CONFORM TO THE FEDERAL TREATMENT OF THE S. 338(h)(10), I.R.C. ELECTION?

2. WHETHER THE DISTRIBUTION WILL BE TREATED AS PART OF THE COMPLETE LIQUIDATION OF THE SUBSIDIARY PURSUANT TO S. 338(h)(10), I.R.C. AND S. 332, I.R.C. AND THEREFORE TAX-FREE FOR FLORIDA CORPORATE INCOME TAX PURPOSES?

ANSWER:
FLORIDA FOLLOWS THE FEDERAL TREATMENT OF S. 338(h)(10), I.R.C., TRANSACTIONS AND SUBSIDIARY IS REQUIRED TO REPORT THE GAIN FROM THE DEEMED SALE OF ITS ASSETS ON ITS FLORIDA CORPORATE INCOME TAX RETURN AS BUSINESS INCOME. ALSO, WHERE TREAS. REG. S. 1.338(h)(10)-1(e), EXAMPLE (2), APPLIES, AN ACTUAL DISTRIBUTION OF UNWANTED ASSETS BY SUBSIDIARY TO TAXPAYER WILL BE TREATED FOR FLORIDA CORPORATE INCOME TAX PURPOSES THE SAME AS IT IS TREATED FOR FEDERAL INCOME TAX PURPOSES.

June 18, 2014

Re: Technical Assistance Advisement 14C1-005
Corporate Income Tax – Adjusted Federal Income
Section 220.02(3), F.S.
XXXXXXX ("Taxpayer")
XXXXXXX ("Parent")
XXXXXXX ("Subsidiary")

Dear XXXXXXX:

This is in response to your request dated XXXXXXX, for a Technical Assistance Advisement (TAA) pursuant to s. 213.22, F.S., and Rule Chapter 12-11, F.A.C., regarding whether or not Florida follows the federal treatment under s. 332, I.R.C., where the tax free liquidation of a subsidiary into the parent is made, as part of the election under s. 338(h)(10), I.R.C. An examination of your letter has established that you have complied with the statutory and regulatory requirements for issuance of a TAA. Therefore, the Department is hereby granting your request for a TAA.

FACTS PROVIDED BY TAXPAYER

Taxpayer is a wholly-owned subsidiary of Parent. Taxpayer provides medicines for an array of health concerns in several therapeutic areas. Parent is the common parent of an affiliated group of corporations which file consolidated federal and consolidated Florida corporate income tax returns. Taxpayer is included in the federal and Florida consolidated filing of Parent. Taxpayer is negotiating with an unrelated corporation ("Buyer") to sell the stock of its wholly-owned subsidiary, Subsidiary, for cash. Taxpayer and Buyer will make a joint election pursuant to s. 338(h)(10), I.R.C., whereby the transaction will be treated for federal income tax purposes as if Subsidiary had sold its assets to Buyer and distributed the sale proceeds to Seller (the Taxpayer) in a complete liquidation under s. 332, I.R.C. Prior to the sale of Subsidiary stock, Subsidiary will distribute all of its XXXXXXX stock, its membership interest in XXXXXXX and certain other retained assets and liabilities (the "Distribution") to Taxpayer.

QUESTION

1. Whether the Florida corporate income tax treatment of the s. 338(h)(10), I.R.C. election conform to the federal treatment of the s. 338(h)(10), I.R.C. election?

2. Whether the Distribution will be treated as part of the complete liquidation of Subsidiary pursuant to s. 338(h)(10), I.R.C. and s. 332, I.R.C. and therefore tax-free for Florida corporate income tax purposes?

LAW

Section 220.02(3), F.S., states, in part:

> (3) It is the intent of the Legislature that the income tax imposed by this code utilize, to the greatest extent possible, concepts of law which have been developed in connection with the income tax laws of the United States, in order to:
> (a) Minimize the expenses of the Department of Revenue and difficulties in administering this code;
> (b) Minimize the costs and difficulties of taxpayer compliance; and
> (c) Maximize, for both revenue and statistical purposes, the sharing of information between the state and the Federal Government.
> . . .

Rule 12C-1.0511, F.A.C., states, in part:

> The Department of Revenue hereby incorporates by reference in this rule ….: …
> (d) s[ection] 338 [of the United States Internal Revenue Code of 1986, as amended, and in effect January 1, 1993].

Rule 12C-1.013(1)(c), F.A.C., states:

> Elections under s. 338(h)(10), I.R.C. For federal tax purposes, an election under s. 338(h)(10), I.R.C., can only be made if a consolidated return is being filed that includes both the target corporation and the selling consolidated group. **The federal tax treatment of s. 338(h)(10), I.R.C., which is incorporated by reference in Rule 12C-1.0511, F.A.C., will be piggybacked to the greatest extent possible even though the taxpayer is not filing a consolidated Florida return.** The target corporation should report the gain attributable to the deemed asset sale on its separate Florida return, if appropriate. The basis in the assets will then be stepped-up for Florida tax purposes to the same extent as for federal income tax purposes. (Emphasis Supplied)

DISCUSSION

Stock Sale

Sometimes, the parties to an acquisition may wish to structure the transaction as a stock sale rather than an asset sale for nontax reasons, but may wish to have the transaction treated as an asset sale for tax purposes. In order to achieve this goal, the parties may consider an election under s. 338(h)(10), I.R.C. Under I.R.C. s. 338(h)(10), the stock sale is treated as if the target had sold its assets in a taxable transaction and liquidated tax-free into its parent under s. 332, I.R.C. (or its subchapter S shareholders). The sale of the target's stock is disregarded for federal income tax purposes. Thus, the only tax that is imposed is on a deemed sale of assets by the target.

Florida explicitly conforms to the federal treatment of s. 338(h)(10), I.R.C. by incorporating by reference s. 338, I.R.C. in Rule 12C-1.0511, F.A.C. In addition, Florida conforms simply by calculating state taxable income based on federal taxable income.

Under the federal tax law, if a corporation purchases the stock of a target corporation, the acquiring corporation's basis in the stock is usually the amount paid for the stock. Generally, the basis of the target's assets is a carryover basis even if the target distributes them to the acquiring corporation (new parent) in a complete liquidation. However, if the acquiring corporation elects under I.R.C. s. 338 to treat the transaction as a purchase of the target's assets. I.R.C. s. 338 provides, in pertinent part:

> For purposes of this subtitle, if a purchasing corporation makes an election under this section . . . then, in the case of any qualified stock purchase, the target corporation—
>
> (1) 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
>
> (2) Shall be treated as a new corporation which purchased all of the assets . . . at the beginning of the day after the acquisition date. (Emphasis Supplied)

If an election is made under s. 338(h)(10), I.R.C., the target corporation recognizes the gain or loss on the deemed sale of assets, but the Seller (the Taxpayer) does not recognize any gain or loss with respect to the actual sale of the target's stock for federal income tax purposes. One effect of a s. 338(h)(10), I.R.C. election is to increase the basis of certain depreciable assets such as property, plant and equipment to reflect current fair market value at the close of the acquisition date of the assets. The increase in tax basis also affects the Buyer's federal taxable income in future years, in that depreciation deductions are increased and federal adjusted income is accordingly decreased.

Like many states, Florida uses federal taxable income as the starting point for determining the Florida corporate income tax. In other words, the computation of Florida net income starts with its federal taxable income as defined under the Internal Revenue Code, as in effect for the taxable year, with some exceptions not relevant to this protest. In this case, Taxpayer is proposing to sell its stock in Subsidiary to Buyer and the parties will make a joint s. 338 (h)(10), I.R.C. election. As a result of the s. 338(h)(10), I.RC. rules and for purposes of computing federal taxable income, Subsidiary (the target corporation) will be treated as if it had sold its assets for fair market value at the close of the acquisition. The resulting gain will then be included in Subsidiary's federal taxable income and correspondingly Subsidiary's Florida net income (tax base). In other words, Subsidiary will report the gain from the deemed sale of its assets on its Florida corporate income tax return as business income.

Distribution

The Florida Corporate Income Tax Code adopts the Internal Revenue Code. See s. 220.03, F.S. In addition, *s.* 220.02(3), F.S., provides that federal income tax concepts are adopted as a guide in interpreting and administering the Florida Income Tax Code. Thus, Treas. Reg. s. 1.338(h)(10)-1(e), Example (2), applies in determining (for Florida purposes) whether the Distribution will be treated as part of the complete liquidation of Subsidiary pursuant to s. 338(h)(10) and s. 332, I.R.C. In this case, in connection with the s. 338(h)(10), I.R.C. transaction (i.e., stock sale), Buyer and Taxpayer agreed that Subsidiary will distribute unwanted assets to Taxpayer. If the Distribution is treated as a non-taxable transaction for Federal income tax purposes, the Distribution will also be treated as a non-taxable transaction for Florida corporate income tax purposes.

CONCLUSION

Florida will follow the federal treatment of s. 338(h)(10), I.R.C. transaction and Subsidiary will report the gain from the deemed sale of its assets on its Florida corporate income tax return as business income. Also, where Treas. Reg. s. 1.338(h)(10)-1(e), Example (2), applies, an actual distribution of unwanted assets by Subsidiary to Taxpayer will be treated for Florida corporate income tax purposes the same as it is treated for federal income tax purposes.

This response constitutes a Technical Assistance Advisement under section 213.22, F.S., which is binding on the Department only under the facts and circumstances described in the request for this advice as specified in section 213.22, F.S. Our response is predicated on those facts and the

specific situation summarized above. You are advised that subsequent statutory or administrative rule changes, or judicial interpretations of the statutes or rules, upon which this advice is based, may subject similar future transactions to a different treatment than expressed in this response.

You are further advised that this response, your request and related documents are public records under Chapter 119, F.S., which are subject to disclosure to the public under the conditions of s. 213.22, F.S. Your name, address, and any other details, which might lead to identification of the taxpayer, must be deleted before disclosure. In an effort to protect the confidentiality of such information, we request you provide the undersigned with an edited copy of your request for Technical Assistance Advisement, backup material and response within fifteen days of the date of this advisement.

Sincerely,

Jermane L. Wright
Senior Attorney
Technical Assistance and
Dispute Resolution

JLW/
Control No.: 161468