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Income/Franchise:
California: Ruling on IRC § 338(h)(10) Transaction and Distribution of Appreciated Unwanted Assets

Chief Counsel Ruling 2021-01, Cal. FTB (7/14/21). In a chief counsel ruling (CCR 2021-01) involving the California franchise and income tax treatment of the transfer/distribution of unwanted appreciated property by an out-of-state insurance company (*i.e.*, the "target") to its parent corporation (*i.e.*, the "seller") prior to a transaction in which the parties (*i.e.*, the seller, buyer and target) made an election under Internal Revenue Code (IRC) section 338(h)(10) wherein the buyer purchased the seller's stock in the wholly-owned target, the California Franchise Tax Board (FTB) concluded that:
URL: https://www.ftb.ca.gov/tax-pros/law/chief-counsel-rulings/2021-01.pdf

1. The seller is treated as receiving a distribution of the target's earnings and profits, which is then treated as a dividend for purposes of the dividends received deduction allowed pursuant to California Revenue and Taxation Code (CRTC) section 24410;
2. IRC sections 332 and 337 apply to the deemed liquidation such that gain would not otherwise be recognized on the distribution of the unwanted assets; and
3. IRC section 334(b) applies to give the seller a carry-over basis in the unwanted assets, and because the distribution of the unwanted assets is treated as part of a plan of complete liquidation, it does not impact the target's earnings and profits.

In doing so, the FTB reasoned that pursuant to CRTC sections 24465(h)(2)(B) and 24465(h)(3), with respect to the applicability of IRC section 332 as it relates to the transaction, the seller is treated as receiving a distribution of all of the target's earnings and profits, which is then treated as a dividend for purposes of the dividends received deduction allowed pursuant to CRTC section 24410. Pursuant to Treasury Regulation section 1.338(h)(10)-1(d)(4), the FTB reasoned that the transfer of the unwanted assets is treated as part of an IRC section 332 liquidation of the target into the seller, and that other than the deemed dividend treatment to the extent of the earnings and profits described in Treasury Regulation § 1.367(b)-3(b)(3)(i), the transaction is treated as a liquidation under IRC section 332. As a result, the FTB explained that under IRC section 337(a), the target does not recognize income on the distribution of the unwanted assets, and under IRC section 334(b)(1), the seller takes a carry-over basis in the unwanted assets. Please contact us with any related questions.

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