

April 20, 2001

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RE: Corporate Income Tax - Corporate Liquidations
Opinion Number 20010428

Dear XXXXXXXXXXXX:

I have been asked to respond to your letter of April 2, 2001, to Mr. Dick Barclay, Director of the Arkansas Department of Finance and Administration. It is my understanding that the XXXXXXXXXXXX Department of Revenue Services is conducting a state-by-state survey on the taxability of gain realized from a deemed sale of corporate assets under *IRC* Section 338(h)(10). I will proceed to answer the Questions that you have posed.

Question 1: Does Arkansas conform to the federal treatment of an *IRC* Section 338(h)(10) election and follow the federal rules?

Response: Yes.

Question 2: Must a separate Arkansas election be made?

Response: If the taxpayer has elected to be treated as a C corporation for both federal and Arkansas purposes or an S corporation for both federal and Arkansas purposes and has already filed a 338 election with the IRS, the taxpayer would not be required to file a separate election with Arkansas. However, if the taxpayer has elected S corporation status for federal income tax purposes but not for Arkansas income tax purposes (therefore retaining its C corporation status with Arkansas), the taxpayer would be required to file a separate 338 election with Arkansas. Corporation Income Tax Regulation 2.26-51-413.

Question 3: Assuming Arkansas permits an *IRC* Section 338(h)(10) election, is the gain from the deemed sale of assets treated as apportionable business income?

Response: This would depend upon the nature of the sale. Generally speaking, if the sale furthers the seller's unitary business enterprise, the gain would be considered apportionable income. On the other hand, if the sale represents a divestiture of one of the seller's lines of business, the gain would most likely not be considered apportionable.

Question 4: Are the gross proceeds for the deemed sale included in the numerator and denominator of the target subsidiary's sales factor?

Response: The gross proceeds would have to be "business income" in order to be included in the sales factor. Assuming the gross proceeds are apportionable business income, the proceeds would be included in the sales factor. However, if the proceeds would cause the

sales factor to become materially distorted, the proceeds would not be included in the factor. *Corporate Income Tax Regulation 2.26-51-715(1)*.

Question 5: If the answer to Question 4 is "no", is the net gain from the deemed sale included in the sales factor instead?

Response: No.

Question 6: If the answers to both Questions 4 and 5 are "no", please briefly describe the legal basis for this exclusion from the sales factor.

Response: The exclusion of income from the sales factor due to material distortion is addressed in *Corporate Income Tax Regulation 2.26-51-715(1)*.

Question 7: Does Arkansas require the gain and short-period income to be apportioned based upon apportionment factors for the short-period?

Response: Yes.

Question 8: Does Arkansas require the gain and short-period income to be apportioned based upon the prior year's apportionment factors?

Response: No.

Question 9: Does Arkansas require the gain and short-period income to be apportioned based upon any other methods?

Response: No.

I have included a copy of the Department's *Corporation Income Tax Regulations* booklet (1998-1) for your reference.

This opinion is based on my understanding of the facts as set out in your inquiry as those facts are governed by current Arkansas laws, rules and regulations. Any change in the facts or law could result in a different opinion.

Sincerely,

Michael J. Wehrle, Attorney
Revenue Legal Counsel

Enclosure