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F Reorganization as an Alternative to a Section 338(h)(10) Election in the Taxable Acquisition of an S Corporation

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Generally, the parties to an acquisition involving an S corporation have different objectives. The shareholders of the acquired corporation want to maximize their long-term capital gains, minimize state income tax, and maintain the ability to deduct the transaction expenses. The investor wants to obtain a stepped-up basis in the assets and to maintain the S corporation status of the acquired corporation ("Target Corporation") after the transaction. While several alternatives exist, this article focuses on two: making a bilateral election under Section 338(h)(10) of the Internal Revenue Code (the "Code"); and the participation in a pre-closing reorganization under Section 368(a)(1)(F) of the Code.

Typically, in a taxable stock acquisition, the investor prefers that the parties agree to make an election under Internal Revenue Code §368(h)(10) ("§ 338(h)(10) Election"). A § 338(h)(10) Election is a bilateral election made by both the investor and the selling shareholders of the Target Corporation to treat the stock purchase as a deemed asset purchase and liquidation of the Target Corporation. When making a § 338(h)(10) Election, the purchase price of the shares is grossed-up to account for the additional taxes the selling shareholders will face as a result of this election.

The § 338(h)(10) Election results in the Target Corporation, an S corporation, being treated as if it transferred all of its assets to the investor in exchange for consideration (including the assumption of liabilities). Thereafter, the S corporation is considered to be liquidated by a deemed transfer of its remaining asset (i.e., proceeds from the transaction) to its shareholders. Although the shareholders may not recognize gain or loss on the sale of their transferred stock, they may recognize gain or loss with respect to the deemed liquidation of the S corporation. One of the main risks involved in making

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an election under Section 338(h)(10) is the inadvertent termination of the S corporation's status. Such inadvertent termination may occur if, during the due diligence process, the investor fails to recognize that the S corporation neglected to maintain its status as an S corporation throughout its existence. When this occurs, the investor will actually acquire the stock of a C corporation rather than an S corporation.

To mitigate the potential risk involved in making a § 338(h)(10) Election, the parties may want to consider having the Target Corporation participate in a tax-free reorganization under § 368(a)(1)(F) prior to the acquisition. This strategy under § 368(a)(1)(F) generally involves the following steps: (i) the Target Corporation's shareholders form a new corporation ("Target Holding") by contributing the shares of Target Corporation into Target Holding in exchange for all of Target Holding's stock; (ii) Target Corporation then elects to be a qualified subchapter S corporation ("QSub"); and, (iii) Target Corporation converts, under a state conversion statute, from a corporation to a limited liability company ("LLC"). Once the foregoing steps are completed, the investor can choose from multiple options to effect the acquisition, including the formation of a partnership through the distribution of interest in Target Corporation to one of the shareholders of Target Holding. After the partnership is created, Target Corporation would then make an election under Section 754, and the investor would acquire an interest in Target Corporation. If the assets of Target Corporation have appreciated, the basis of the assets of Target Corporation would be stepped-up under Section 743 and in connection with the Section 754 election.

The Internal Revenue Code provides the following requirements when participating in a pre-transaction reorganization under § 368(a)(1)(F): **1.**Immediately after the F Reorg., all of the stock of Target Holding, including any stock of the Target Holding issued before the reorganization, must have been distributed (or deemed distributed) in exchange for stock of Target Corporation in the F Reorg.; **2**.The same person or persons must own all of the stock of the Target Corporation, as determined immediately before the F Reorg., and of Target Holding, immediately after the F Reorg., in identical proportions; **3.** Target Holding may not hold any property or have any tax attributes immediately prior the reorganization; **4.** Target Corporation must completely liquidate, for federal income tax purposes, in the F Reorg.; **5.** Immediately after the F Reorg., no corporation other than the Target Holding may hold property that was held by Target Corporation immediately before the reorganization, if such other corporation would, as a result, succeed to and take into account the items of Target Corporation; and **6.** Immediately after the F Reorg., Target Holding may not hold property acquired from a corporation other than Target Corporation if the resulting corporation would, as a result, succeed to and take into account the items of such other corporation. As you can see both options discussed above provide certain benefits to both parties in an acquisition and with thoughtful research and planning the parties can make the decision that is best for them and their situation. Each option described above requires certain tax filings and documentation and it is advised to have your CPA and attorney work hand in hand on these types of transactions. See IRC § 368(h)(10) and the Regulations thereunder. Treas. Reg. § 1.338(h)(10)-1(d)(6).Treas. Reg. § 1.338(h)(10)-1(d)(6)(iii). Treas. Reg. § 1.368-2(m)(1)(i) through (vi).

"Your German is Under All Sow" - Why Automated Translation Should Not Replace Multilingual Attorneys

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In the United States, more people than ever before speak a language other than English at home. At close to 60 million in 2010, this number has almost doubled since 1990 and almost tripled since 1980, according to the U.S. Census Bureau. Furthermore, 8.3% of people older than five, about 25 million, speak English less than "very well," which means that "a substantial portion of people involved in the American legal system have limited English proficiency." According to the Denver Regional Council of Governments, this includes over 215,000 people in the Denver metro area alone.

Growing language diversity in the U.S. and a large number of cross-border business deals have increased demand for multilingual attorneys. However, hiring an attorney can be expensive, and in an attempt to reduce costs, some may be tempted to rely on automated translation processes instead. Computer-based translation services have also seen growth, both in the number of providers and revenue, estimated at $45 billion globally in 2020. Companies and individuals seeking to utilize translation services for legal documents are well-advised to hire an attorney instead.

Translation software has come a long way since its inception, but it has yet to reach the same quality as human interpreters. One example of this can be found in the title of this article. "Your German is under all sow" is the translation Google Translate produced of a German vernacular attesting to the recipient's poor knowledge of the German language. While technically correct, this translation will seem nonsensical to most English speakers. Of course, vernaculars are rarely found in formal legal documents, but this experiment (which readers may feel free to repeat at home) nonetheless demonstrates a key point: Language is irregular, nuanced, and highly dependent on context.

In the experience of multilingual attorneys, finding *the one* correct translation can be quite difficult. As stated by the Professional Issues Committee, "[t]-ranslation, like interpretation, is not [merely] the automatic conversion of words from English into the non-English language." Instead, workarounds may be needed to express the entire meaning of a word, phrase, or sentence.

A classic case of translation confusion is *Frigaliment Importing Company. v. B.N.S. International Sales Corporation*. The Court succinctly summarized this case as follows: "The issue is, what is chicken?" The plaintiff, a Swiss corporation, had ordered tens of thousands of pounds of chicken from a New York-based seller. While the parties had negotiated in German, the final contract used the English word "chicken." "Chicken" is the exact translation of the German word "Huhn." The plaintiff was unpleasantly surprised when, upon arrival of the shipment in Switzerland, "the . . . birds were not young chicken suitable for broiling and frying but stewing chicken or 'fowl.'" Litigation ensued, and the Court went to great lengths to interpret the ambiguous word "chicken" based on the contract, the parties' prior communications, general trade usage, and Department of Agriculture regulations. Finding that a "chicken" can be any one of a broiler or fryer, a roaster, a capon, a stag, a hen or stewing chicken or fowl, or an old rooster, the Court found against the plaintiff. It dismissed the complaint, and the plaintiff had to accept the delivery of larger chicken than it was prepared to process.

All of this illustrates the need for careful, precise translations performed by an attorney who can appreciate the nuances of a matter beyond a word's rigid replacement with its literal equivalent. While *Frigaliment* occurred before the age of translation software, a quick use of Google Translate reveals that "Huhn" is indeed translated as "chicken." If two companies were to strike a similar deal today, *Frigaliment* should serve as a lesson on the risks of using automated translation processes instead of a bilingual attorney. An attorney fluent in both English and German could have understood the intent during negotiations and more carefully crafted the written agreement to specify the exact type of chicken. An automated translation software would be drastically less able, if at all, to appreciate the nuances of what it is translating.

Of course, nothing in this article is meant to suggest that automated translation processes are not useful. In plenty of contexts, such software can help reduce the workloads of human translators. Perhaps attorneys will find it helpful as a supporting feature, which they might use to generate first drafts or partial translations. Nevertheless, it would be wise to maintain a human element in the form of a multilingual attorney supervising the process, correcting mistakes, and adding nuance which might save the day in the event of litigation.

In conclusion, companies and individuals seeking to translate legal documents or prepare them in another language should carefully review their options. Although the market for translation software has grown along with the diversification of languages spoken in the U.S., automated processes may not be suitable for every need, especially in the complex world of legal language. When faced with ambiguities, courts may decide against a plaintiff bringing a claim based on what they unilaterally understood to be the deal terms. Working with a multilingual attorney can help clients avoid such pitfalls and secure an enforceable contract from the start.

Madison E. Wahler, *A Word is Worth A Thousand Words: Legal Implications of Relying on Machine Translations*, 48 Stetson L. Rev. 109, 109 (2018) (citing *Detailed Languages Spoken at Home and Ability to Speak English for the Population 5 Years and Over for United States: 2009–2013*, tbl. 1, U.S. Census Bureau (2015), https://www.census.gov/data/tables/2013/demo/2009-2013-lang-tables.html. | Robert Half, *Foreign Language Skills See High Demand in Legal Market*, The Robert Half Blog (Nov. 6, 2013), https://www.roberthalf.com/blog/salaries-and-skills/foreign-language-skills-see-high-demand-in-legal-market. *See also*, Jennifer Borum Bechet, *The Language of the Law: The Demand for Bilingual Attorneys in Corporate Law Departments*, Minority Corporate Counsel Ass'n (originally published in Diverity & The Bar, May/June 2006), https://mcca.com/mcca-article/the-language-of-law-the-demand-for-bilingual-attorneys/. | VR Ferose, Barney Pell & Lorien Pratt, *From the Business of Language to the Language of Business: The Future of Translation Worldwide*, Digitalist Magazine (May 17, 2018), https://www.digitalistmag.com/future-of-work/2018/05/17/future-of-translation-worldwide-06168565. | Richard Acello, *Bilingual lawyers have a leg up in many niche practice groups*, ABA Journal (March 1, 2013), https://www.abajournal.com/magazine/article/bilingual_lawyers_have_a_leg_up_in_many_niche_practice_groups. | Professional Issues Committee, *Guide to Translation of Legal Materials*, Nat'l Center for State Courts (Consortium for Language Access in the Courts, ed. 2011), https://ncsc.contentdm.oclc.org/digital/collection/accessfair/id/232 | *Frigaliment Importing Co. v. B.N.S. Int'l Sales Corp.*, 190 F. Supp. 116 (S.D.N.Y. 1960).

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