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Asset Sale vs Stock Sale vs 338(h)(10): Structure Basics

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Why structure is negotiated at all

A business can change hands in three common ways: the owners sell their shares, the company sells its assets, or the owners sell shares and both sides elect under Section 338(h)(10) to treat the deal as an asset sale for tax purposes. The price can be identical while the tax consequences, the liabilities that travel and the paperwork differ. That is why structure is negotiated as its own line in a letter of intent.

This article describes statutes, regulations and IRS forms as they read on October 28, 2026. It is not tax or legal advice, and it does not estimate tax rates, step-up value or net proceeds for anyone.

Structure decides three things: the buyer's tax basis (Section 1060 allocates consideration "for purposes of determining both" the transferee's basis and the transferor's gain or loss (26 U.S.C. 1060)), who recognizes gain and at what level, and which liabilities come along. Buying shares means buying the legal entity, with its history; buying assets means buying what the contract lists.

Stock sale: what changes hands

In a stock sale the shareholders sell their shares. The company keeps operating as the same legal entity, with its contracts, permits, employees, tax history and liabilities, known and unknown. Protection against old liabilities comes from the purchase agreement, not from leaving anything behind.

For tax purposes, the deemed asset sale is a consequence of an election, not of the stock purchase itself. Section 338(a) applies only "if a purchasing corporation makes an election under this section (or is treated under subsection (e) as having made such an election)" (26 U.S.C. 338). Without an election, the statute does not treat the target as having sold its assets, and the target's tax attributes are not reset by Section 338.

Stock sales still carry reporting. Section 1060(e) provides that if a person holding 10 percent or more (by value) of an entity transfers an interest and, in connection with the transfer, enters into "an employment contract, covenant not to compete, royalty or lease agreement, or other agreement with the transferee," the owner and the transferee must furnish information as the Secretary may require (26 U.S.C. 1060).

Asset sale: allocation under Section 1060 and Form 8594

In an asset sale the company sells some or all of its assets, and the buyer assumes only the liabilities the contract says it assumes. Contracts, leases and permits generally have to be assigned or reissued, which may need consents.

Section 1060 governs the tax allocation. An "applicable asset acquisition" is a transfer "of assets which constitute a trade or business" where "the transferee's basis in such assets is determined wholly by reference to the consideration paid for such assets." In such an acquisition, consideration is allocated among the assets "in the same manner as amounts are allocated to assets under section 338(b)(5)." The statute then adds the sentence that makes allocation a negotiated term: if the parties "agree in writing as to the allocation of any consideration, or as to the fair market value of any of the assets, such agreement shall be binding on both the transferee and transferor unless the Secretary determines that such allocation (or fair market value) is not appropriate" (26 U.S.C. 1060).

The IRS form is Form 8594, Asset Acquisition Statement Under Section 1060. According to the IRS, "Both the seller and purchaser of a group of assets that makes up a trade or business must use Form 8594" if "goodwill or going concern value attaches, or could attach, to such assets" and "the purchaser's basis in the assets is determined only by the amount paid for the assets" (IRS, About Form 8594). The current form is Rev. November 2021, and the About page listed no recent developments on 2026-10-28.

The form shows what the parties have to agree on:

- Part II allocates the total sales price across asset classes: Class I, II, III, IV, V, and VI and VII combined.
- Line 5 asks whether the purchaser and seller provided for an allocation "in the sales contract or in another written document signed by both parties," and whether the values reported are the agreed amounts.
- Line 6 asks whether the purchaser also bought a license or a covenant not to compete, or entered into a lease, employment contract, management contract "or similar arrangement with the seller (or managers, directors, owners, or employees of the seller)," and if so requires an attached statement of the maximum consideration.

(Form 8594)

The instructions (Rev. November 2021) say that "both the purchaser and seller must file Form 8594 and attach it to their income tax returns," generally for the year in which the sale date occurred, and that if the amount allocated to any asset later increases or decreases, whoever is affected files a supplemental form for the year the change is taken into account (Instructions for Form 8594). Because each party files its own form, an allocation schedule in the purchase agreement keeps the two filings consistent.

Section 338(a) and the qualified stock purchase

Section 338 lets a stock purchase be taxed as an asset purchase. Its definitions:

- **Purchasing corporation:** "any corporation which makes a qualified stock purchase of stock of another corporation."
- **Qualified stock purchase (QSP):** "any transaction or series of transactions in which stock (meeting the requirements of section 1504(a)(2)) of 1 corporation is acquired by another corporation by purchase during the 12-month acquisition period."
- **Purchase:** excludes stock whose basis carries over from the transferor, stock acquired in exchanges under sections 351, 354, 355 or 356, and stock acquired from a person whose ownership would be attributed to the buyer under section 318(a).

(26 U.S.C. 338)

Section 1504(a)(2) supplies the threshold: stock that "possesses at least 80 percent of the total voting power" and "has a value equal to at least 80 percent of the total value of the stock" (26 U.S.C. 1504).

If the election is made, Section 338(a) says the target "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 "shall be treated as a new corporation which purchased all of the assets" as of the beginning of the next day. Section 338(b) sets the

deemed purchase price from the purchaser's stock basis, "adjusted under regulations prescribed by the Secretary for liabilities of the target corporation and other relevant items." Under Section 338(g), the election is due "not later than the 15th day of the 9th month beginning after the month in which the acquisition date occurs," except as regulations provide, and "once made, shall be irrevocable" (26 U.S.C. 338).

The form is Form 8023. The IRS says: "Purchasing corporations use this form to make elections under section 338 for the target corporation if they made a qualified stock purchase (QSP) of the target corporation" (IRS, About Form 8023). The current form and instructions are Rev. October 2023, with no recent developments listed on 2026-10-28. The instructions say to "File Form 8023 by the 15th day of the 9th month after the acquisition date," by electronic fax or by mail to the IRS in Ogden, Utah (Instructions for Form 8023).

The 338(h)(10) election for S corporation targets

Section 338(h)(10) is the joint version. Treasury Regulation 1.338(h)(10)-1 sets the conditions:

- **Availability.** The election "may be made for T if P acquires stock meeting the requirements of section 1504(a)(2) from a selling consolidated group, a selling affiliate, or the S corporation shareholders in a qualified stock purchase."
- **S corporation target.** "An S corporation target is a target that is an S corporation immediately before the acquisition date."
- **Joint election.** The election "is made jointly by P and the selling consolidated group (or the selling affiliate or the S corporation shareholders) on Form 8023 in accordance with the instructions to the form. S corporation shareholders who do not sell their stock must also consent to the election."
- **Deadline.** The same 15th-day-of-the-9th-month rule as Section 338(g).
- **Irrevocability and linkage.** The election is irrevocable; if it is made, "a section 338 election is deemed made for T"; and "If a section 338(h)(10) election for T is not valid, the section 338 election for T is also not valid."
- **Consequences.** Old T is treated as transferring all its assets "to an unrelated person in exchange for consideration that includes the discharge of its liabilities in a single transaction at the close of the acquisition date," and then as transferring all of its assets to the S corporation shareholders and ceasing to exist. For an S corporation target, "T's S election continues in effect through the close of the acquisition date." New T "remains liable for the tax liabilities of old T."

(26 CFR 1.338(h)(10)-1)

Form 8023 reflects this: page 2 has an "S Corporation Shareholder(s) Signature(s) (Section 338(h)(10) Election)" block, with a schedule for additional signatures (Form 8023). The instructions add that for an S corporation target the election "must be made by all of the shareholders of the target, including shareholders who do not sell target stock in the QSP" (Instructions for Form 8023).

The election is not the only filing. Form 8883, Asset Allocation Statement Under Section 338, reports the deemed sale: for section 338(g) and 338(h)(10) elections "both the old target and the new target must file Form 8883." For an S corporation target, old target attaches it to Form 1120-S; new target attaches it to its first return (Instructions for Form 8883).

The election depends on the target really being an S corporation. The IRS requirements: the company must "Be a domestic corporation," "Have only allowable shareholders" (individuals, certain trusts and estates; not partnerships, corporations or non-resident alien shareholders), "Have no more than 100 shareholders," "Have only one class of stock," and not be an ineligible corporation. To become an S corporation, a company submits Form 2553 "signed by all the shareholders" (IRS, S corporations). A target that was not an S corporation immediately before the acquisition date is not an "S corporation target," and an invalid 338(h)(10) election also invalidates the section 338 election (c)(5). Hence diligence on S status history, not only the current return.

Side-by-side comparison

Cells are limited to what the sources above say; "ask counsel" marks what a statute summary cannot settle.

	Stock sale, no election	Asset sale	Stock purchase with 338(h)(10)
What legally transfers	Shares; entity continues	Listed assets and assumed liabilities	Shares; entity continues
Tax treatment in the text	No deemed asset sale under 338(a) without an election	Consideration allocated among assets under 1060(a)	Old T treated as selling all assets, then liquidating
Basis language	338 does not apply	Allocation determines transferee's basis and transferor's gain or loss	New T's basis (AGUB) determined under 1.338-5
Who must agree	Buyer and selling shareholders (contract)	Buyer and selling company (contract); written allocation binds both	Purchaser jointly with S shareholders; non-selling S shareholders consent
Buyer eligibility	Any buyer	Any buyer	Must be a corporation making a QSP (80% vote and value, 12-month period)
Target eligibility	Any	Assets must constitute a trade or business for 1060	S corporation immediately before acquisition date (or consolidated/affiliate seller)
IRS forms named in sources	1060(e) information if a 10% owner signs related agreements	Form 8594, both parties	Form 8023; Form 8883 (old and new target)
Deadline in the text	None stated	Attach 8594 to income tax return	15th day of 9th month after acquisition-date month
Pre-closing liabilities	Remain in the entity	Stay with seller unless assumed	Remain in the entity; new T liable for old T's taxes
Third-party consents	Ask counsel (change-of-control clauses)	Ask counsel (assignment of each contract)	Ask counsel (change-of-control clauses)
State tax effects	Ask counsel	Ask counsel	Ask counsel

Sources: 26 U.S.C. 338, 1060, 1504; 26 CFR 1.338(h)(10)-1; Forms 8594 and 8023; instructions for Forms 8023, 8594 and 8883.

Illustrative example (fictional)

Cedar Point Fabrication, Inc. is an invented S corporation. Two founders each own 45% of the shares; a third shareholder owns 10% and wants to keep them as rollover equity. A buyer offers $20,000,000. The buyer is a newly formed corporation owned by a private equity fund. It shows questions, not tax figures.

Structure 1: stock sale, no election. The founders sell 90% ($9,000,000 each at the headline price, before any adjustments). Questions: Since liabilities stay in the company, which ones need indemnity or escrow? Do customer or lender contracts have change-of-control clauses? If a founder signs an employment or non-compete agreement, what information does Section 1060(e) require?

Structure 2: asset sale. Cedar Point sells its operating assets to the buyer for $20,000,000. Questions: How is the $20,000,000 allocated across Classes I through VII, and is that allocation written into the agreement so both Forms 8594 match? Which liabilities does the buyer assume? Which contracts, leases and permits need consent to assign? What happens to the proceeds inside the company, and then for each shareholder?

Structure 3: stock purchase with a 338(h)(10) election. The buyer acquires 90%; confirm with the adviser that this meets the 80% vote-and-value test. Questions: Has Cedar Point been a valid S corporation throughout, with one class of stock, only allowable shareholders and a Form 2553 signed by all shareholders? Will the 10% holder, who is not selling, consent on Form 8023? Who files it? If the acquisition date is March 10, 2027, the 15th day of the 9th month beginning after March is December 15, 2027.

Worksheet: questions to bring to a tax adviser

Question	Why it matters (source)	Answer / owner
Is the buyer, or its acquisition vehicle, a corporation?	Only a "purchasing corporation" makes a QSP (26 U.S.C. 338(d))	
Will the buyer acquire at least 80% by vote and by value within 12 months?	QSP threshold (26 U.S.C. 338(d)(3), 1504(a)(2))	
Was the target an S corporation immediately before the acquisition date?	Defines "S corporation target" (26 CFR 1.338(h)(10)-1(b)(4))	
Any history of a second class of stock, ineligible shareholder or more than 100 shareholders?	S eligibility (IRS S corporations page)	
Do all non-selling shareholders agree to consent?	Required for 338(h)(10) (1.338(h)(10)-1(c)(3))	
Who files Form 8023, and what is the deadline date?	15th day of 9th month (338(g)(1); 1.338(h)(10)-1(c)(3))	
Is the asset allocation agreed in writing, by class?	Binding on both parties under 1060(a); Form 8594 line 5	
Are there employment, consulting, non-compete or lease agreements with sellers?	Form 8594 line 6; 1060(e) for 10% owners	
Who bears the cost if the structure or election fails?	Contract question for counsel	

Question	Why it matters (source)	Answer / owner
What do state and local rules add?	Not covered by these federal sources	

What origination teams should log

Some structure evidence is available before the LOI:

- **Entity type and status from the state registry.** Corporation or LLC, formation date, and whether the entity is active or in good standing. See business entity status triage and, for LLC targets, who owns an LLC: state evidence matrix.
- **S status is not a registry field.** A state registry shows legal form, not federal tax classification; Form 2553 goes to the IRS, not a public registry. Log S status as an open question unless the owner or a document in the data room states it, and record the source when it does.
- **Ownership count and holders.** Evidence of many owners or a corporate or non-US parent prompts the S-eligibility questions above.
- **Named related agreements.** Public statements that a founder will stay on, or that real estate is owned by a related entity, point to the Form 8594 line 6 and Section 1060(e) questions.

Docket's Triage, Scout and Audit agents record items like entity type and registry status as sourced, typed answers and leave S status visibly open when no retained page states it; Docket does not give tax or legal advice.

Source links

Links cited in this article, in order of first appearance. Full addresses are provided for readers using extracted text.

1. https://www.law.cornell.edu/uscode/text/26/1060
2. https://www.law.cornell.edu/uscode/text/26/338
3. https://www.irs.gov/forms-pubs/about-form-8594
4. https://www.irs.gov/pub/irs-pdf/f8594.pdf
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