14 T.C. 74 (1950)

When a taxpayer's primary intention in purchasing stock is to acquire the underlying assets, the transaction is treated as a direct asset purchase for tax purposes, and the taxpayer's basis in the assets is their cost.

Summary

Kimbell-Diamond Milling Co. (Kimbell-Diamond) sought to acquire a replacement mill after its original one was destroyed by fire. Using insurance proceeds, Kimbell-Diamond purchased all the stock of Whaley Mill & Elevator Co. (Whaley) with the express intention of liquidating Whaley and acquiring its assets. The Tax Court held that the series of transactions should be viewed as a single integrated transaction – the purchase of assets. Therefore, Kimbell-Diamond's basis in the acquired assets was its cost (the purchase price of the Whaley stock), not Whaley's historical basis in those assets. This is a foundational case establishing that a purchase of stock, followed by a quick liquidation, can be re-characterized as an asset purchase for tax purposes.

Facts

- Kimbell-Diamond's milling plant in Wolfe City, Texas, was destroyed by fire in August 1942.
- Kimbell-Diamond collected $124,551.10 in insurance proceeds in November 1942.
- On December 26, 1942, Kimbell-Diamond acquired 100% of the stock of Whaley Mill & Elevator Co. for $210,000, using the insurance proceeds and other funds.
- Kimbell-Diamond's sole intention in purchasing Whaley's stock was to acquire Whaley's assets and liquidate Whaley as soon as practicable.
- On December 29, 1942, Whaley's stockholders approved dissolution and distribution of assets.
- On December 31, 1942, Whaley was dissolved, and its assets were distributed to Kimbell-Diamond.

Procedural History

- The Commissioner of Internal Revenue determined deficiencies in Kimbell-Diamond's income, declared value excess profits, and excess profits taxes for the fiscal years ended May 31, 1945 and 1946.
- The deficiencies resulted from the Commissioner's reduction of Kimbell-Diamond's basis in the assets acquired from Whaley.
- Kimbell-Diamond petitioned the Tax Court, contesting the adjustments.

Issue(s)

1. Whether a prior Tax Court decision regarding involuntary conversion acts as

collateral estoppel on the issue of Kimbell-Diamond's basis in Whaley's assets.
2. Whether the acquisition of Whaley's stock and subsequent liquidation should be treated as a tax-free reorganization under Section 112(b)(6) of the Internal Revenue Code.
3. What is Kimbell-Diamond's basis in the assets acquired from Whaley for purposes of depreciation and calculating excess profits tax credit?

Holding

1. No, because the prior decision did not actually determine the issue of Kimbell-Diamond's basis in Whaley's assets. The court had expressly declined to rule on that issue in the prior proceeding.
2. No, because the purchase of Whaley's stock and its subsequent liquidation must be considered as one transaction: the purchase of Whaley's assets.
3. Kimbell-Diamond's basis in the assets is its cost: $110,721.74 (the basis of its destroyed assets plus the amount expended over the insurance proceeds), because the transaction was effectively a purchase of assets.

Court's Reasoning

- The court rejected Kimbell-Diamond's collateral estoppel argument, citing *Sunnen v. Commissioner, 333 U.S. 591*, which stated that collateral estoppel applies only to matters actually presented and determined in the first suit. The court emphasized that it had explicitly left the basis question open in the prior proceeding.
- The court emphasized that the incidence of taxation depends on the substance of a transaction, citing *Commissioner v. Court Holding Co., 324 U.S. 331*. The court considered Kimbell-Diamond's minutes and the liquidation agreement, concluding that the sole intention was to acquire Whaley's assets.
- The court applied the principles of *Commissioner v. Ashland Oil & Refining Co., 99 F.2d 588*, which held that when the essential nature of a transaction is the acquisition of property, courts will view it as a whole, and closely related steps will not be separated.
- The court stated: "We hold that the purchase of Whaley's stock and its subsequent liquidation must be considered as one transaction, namely, the purchase of Whaley's assets which was petitioner's sole intention. This was not a reorganization within section 112 (b) (6), and petitioner's basis in these assets, both depreciable and nondepreciable, is, therefore, its cost…"

Practical Implications

- The Kimbell-Diamond doctrine dictates that a taxpayer's intent is crucial in determining whether a stock purchase followed by liquidation should be treated as an asset purchase for tax purposes.
- This case highlights the importance of documenting the intent behind corporate acquisitions, especially when liquidation is contemplated.

- The ruling has significant implications for calculating depreciation, taxable gain/loss upon subsequent sale, and other tax attributes tied to asset basis.
- The Kimbell-Diamond doctrine has been partially codified and significantly impacted by subsequent legislation, especially regarding Section 338 of the Internal Revenue Code, which provides elective treatment of stock purchases as asset acquisitions under certain circumstances. Despite the enactment of Section 338, the Kimbell-Diamond doctrine may still apply in limited circumstances where Section 338 is not applicable or elected.

