***Kimbell-Diamond Milling Co. v. Commissioner*, 14 T.C. 74 (1950)**

When a corporation purchases the stock of another corporation to acquire its assets and immediately liquidates the acquired corporation, the transaction is treated as a direct purchase of the assets for tax purposes, disregarding the separate steps of stock purchase and liquidation.

**Summary**

Kimbell-Diamond Milling Co. (the “taxpayer”) purchased all the stock of a milling company to acquire its assets, then immediately liquidated the subsidiary. The Commissioner of Internal Revenue argued that the acquisition should be treated as a stock purchase followed by liquidation, which would have resulted in the carryover of the subsidiary’s basis in the assets. The taxpayer contended that the transaction was, in substance, a direct asset purchase, allowing it to step up the basis of the assets to the price it paid for the stock. The Tax Court agreed with the taxpayer, applying the “step transaction” doctrine to disregard the form of the transaction and focus on its substance. This allowed the taxpayer to treat the transaction as a direct purchase of the subsidiary’s assets and to use the purchase price as the basis for depreciation.

**Facts**

- Kimbell-Diamond Milling Co. sought to acquire the assets of the Diamond Milling Company.
- Unable to directly purchase the assets due to the unwillingness of Diamond’s shareholders to sell the assets directly, Kimbell-Diamond purchased all of Diamond’s stock.
- Immediately after the stock purchase, Kimbell-Diamond liquidated Diamond Milling Company.
- Kimbell-Diamond sought to use the price paid for Diamond’s stock as the basis for the assets received, for depreciation purposes.
- The Commissioner argued that the basis should be the same as Diamond Milling’s pre-acquisition basis under section 112(b)(6) and 113(a)(15) of the Internal Revenue Code of 1939.

**Procedural History**

- The Commissioner assessed a deficiency against Kimbell-Diamond.
- The Tax Court heard the case.
- The Tax Court ruled in favor of the taxpayer.
- The Court of Appeals for the Fifth Circuit affirmed the Tax Court decision per curiam.
- The Supreme Court denied certiorari.

**Issue(s)**

 

1. Whether the acquisition of Diamond Milling's assets should be treated as a direct purchase of assets, or as a stock purchase followed by a liquidation.
2. If treated as a stock purchase followed by a liquidation, whether the basis of the assets should be the same as the basis in the hands of the transferor (Diamond Milling).

### Holding

1. Yes, the transaction was treated as a direct purchase of assets.
2. The basis of the assets was the purchase price paid for Diamond Milling's stock, effectively allowing a step-up in basis.

### Court's Reasoning

The court focused on the substance of the transaction rather than its form, citing the "step transaction" doctrine. The court found that the taxpayer's primary purpose was to acquire the assets of Diamond Milling. The intermediate step of purchasing the stock and then liquidating the acquired corporation was merely a means to achieve this goal. The court reasoned that the transaction was, in substance, a purchase of assets, thus the basis of those assets should be the price paid for them.

The court stated that "the various steps, when taken as a whole, constituted the purchase of the properties of the said companies." The court also distinguished this case from one where there was no intention to acquire the assets directly, but rather to acquire the stock for investment purposes. In such a case, the form of the transaction would be respected.

The court found that sections 112(b)(6) and 113(a)(15) of the Internal Revenue Code of 1939 were inapplicable because the substance of the transaction was a direct purchase of assets, not a tax-free liquidation.

### Practical Implications

This case established the "Kimbell-Diamond rule," a precursor to the modern step transaction doctrine, and had significant practical implications for corporate acquisitions.

- **Asset Acquisitions vs. Stock Acquisitions:** The case provides guidance on when a stock purchase followed by a liquidation will be treated as a direct asset acquisition for tax purposes.
- **Step Transaction Doctrine:** It's a foundational case for the step transaction doctrine, illustrating that courts will look beyond the form to the substance of a transaction. If a series of formally separate steps are, in substance, components of a single transaction, the tax consequences are determined by analyzing the end result.
- **Basis Step-Up:** The primary practical impact is that a purchaser can acquire assets through a stock purchase and liquidation and step up the basis of those

assets to the purchase price. This allows for greater depreciation deductions and reduces potential capital gains taxes upon a later sale.
- **Planning for Acquisitions:** Taxpayers and their advisors can structure transactions with the Kimbell-Diamond rule in mind to achieve the desired tax outcomes. This often involves demonstrating a clear intent to acquire the assets.
- **Subsequent Developments:** While the Kimbell-Diamond rule has been largely superseded by the enactment of Section 338 of the Internal Revenue Code, it still informs the application of the step transaction doctrine. Section 338 provides a statutory mechanism for electing to treat a stock purchase as an asset purchase under certain conditions, offering more certainty.

 