33 T.C. 677 (1960)

When a corporation purchases the stock of another company with the intent to acquire its assets, and then liquidates the acquired company, the transaction is treated as a direct asset purchase for tax purposes, allowing the acquiring corporation to use its cost of acquisition as the basis for the assets.

Summary

North American Service Co., Inc. (NASCO) acquired the stock of North American Service Company (NASCO) for $965,000 and immediately liquidated it. The IRS argued the liquidation was a tax-free event, meaning NASCO took over NASCO's existing tax basis for the assets. NASCO contended the purchase and liquidation should be treated as a direct asset purchase under the *Kimbell-Diamond* rule, enabling it to use its purchase price as the basis. The Tax Court sided with NASCO, finding that the substance of the transaction was an asset acquisition. The court further determined the proper allocation of the purchase price to various assets, including service contracts and goodwill, and denied the deduction of interest accrued to a controlling shareholder because it was not paid within the statutory period.

Facts

North American Service Co. (NASCO) was in the highway advertising business. In 1951, NASCO's owner, D.A. Brumbaugh, decided to sell the business. After Brumbaugh refused to sell the assets directly to the acquiring group (Howard and Swaney), he agreed to sell the stock of NASCO to North American Service Co., Inc. (NASCO, Inc.), a newly formed corporation set up by Howard and Swaney. On October 26, 1951, NASCO, Inc. purchased all of NASCO's stock for $965,000. Immediately after the purchase, NASCO, Inc. partially liquidated NASCO, taking all of its assets (except $5,000 cash) subject to liabilities. NASCO was dissolved in 1955. NASCO, Inc. continued NASCO's business. NASCO, Inc. accrued, but did not pay, interest on loans from Howard, its controlling shareholder, within the 2.5-month period following the tax year's end.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in NASCO, Inc.'s income taxes. The deficiencies stemmed from whether the liquidation of NASCO was a taxable event, the proper allocation of the purchase price to various assets, and the deductibility of accrued interest paid to a controlling shareholder. The case was heard in the United States Tax Court.

Issue(s)

1. Whether the liquidation of NASCO was a complete liquidation under Internal Revenue Code § 112(b)(6), or whether NASCO, Inc. could use its acquisition

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cost as the assets' basis under the *Kimbell-Diamond* rule.
2. If the *Kimbell-Diamond* rule applied, what portion of the purchase price was allocable to service contracts.
3. Whether NASCO, Inc. could deduct accrued interest paid to its controlling shareholder in either 1951 or 1952.

Holding

1. Yes, because the purchase of the stock and immediate liquidation was, in substance, an asset purchase.
2. The portion of the acquisition cost allocable to the service contracts was $343,196.92.
3. No, because the interest accrued in 1951 was not deductible in either 1951 or 1952.

Court's Reasoning

The court applied the *Kimbell-Diamond* rule, which looks to the substance of a transaction, not its form. The court found that NASCO, Inc.'s intent was to acquire NASCO's assets, not simply the stock. The court noted the acquiring corporation's failure to integrate the purchased assets into its business might be evidence against this treatment. But here, the court found the substance of the deal was a purchase of assets, and not a tax-free subsidiary liquidation. The court then addressed the allocation of the purchase price to various assets. The court agreed with the IRS on the value of goodwill using A.R.M. 34. It disagreed on the value of the service contracts, estimating their fair market value at $500,000. Finally, the court considered the deduction of the accrued interest. Because the interest was not paid within 2.5 months of the end of the tax year, the court denied the deduction under § 24(c) of the 1939 Code, and it could not be deducted in the following year either.

Practical Implications

This case provides a detailed illustration of how courts apply the *Kimbell-Diamond* doctrine, emphasizing that substance over form governs the tax treatment of transactions. Attorneys should consider the intent and actions of the acquiring party to determine if a stock purchase followed by a liquidation is, in substance, an asset acquisition. The case highlights that the key is whether the acquiring corporation truly intends to purchase the underlying assets. This case also demonstrates the importance of allocating purchase price among assets and the need to pay interest to related parties within the required time to secure tax deductions. The case supports the idea that the acquiring corporation's actions after the acquisition are key in showing intent. Later cases frequently cite this case in defining the application of the *Kimbell-Diamond* rule.

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