***International State Bank v. Commissioner, 74 T. C. 181 (1980)***

In corporate liquidations under section 332, the basis of assets received by the parent corporation is determined by objective criteria under section 334(b), not by the subjective intent of the acquiring corporation.

**Summary**

International State Bank acquired the stock of its subsidiary, Swastika Hotel Corp. , to liquidate and acquire its hotel building for expansion. The bank claimed a stepped-up basis for the building, arguing that the stock purchase was in substance an asset purchase. The Tax Court rejected this, holding that section 334(b)(2) supplanted the Kimbell-Diamond subjective intent test with objective criteria. The court determined the bank's basis in the acquired assets should be Swastika's basis under section 334(b)(1), as the stock acquisition did not meet the 'purchase' requirements of section 334(b)(2).

**Facts**

International State Bank (the Bank) needed larger facilities and decided to acquire the hotel building owned by its subsidiary, Swastika Hotel Corp. (Swastika). On February 10, 1970, the Bank purchased all of Swastika's stock from Di Lisio Industries, Inc. (Industries) for $180,864. 07, paid in convertible debentures and cash. Immediately after, Swastika liquidated, transferring its assets, including the hotel building, to the Bank. The Bank claimed a basis of $180,000 in the building for depreciation. The IRS, however, asserted that the Bank's basis should be the same as Swastika's basis of $32,051. 11.

**Procedural History**

The IRS disallowed part of the Bank's depreciation deductions based on its determination of the basis in the hotel building. The Bank appealed to the Tax Court, arguing for a stepped-up basis under the Kimbell-Diamond doctrine. The Tax Court considered whether the Kimbell-Diamond doctrine, which focused on the taxpayer's subjective intent, remained applicable after the enactment of section 334(b)(2).

**Issue(s)**

1. Whether the Kimbell-Diamond doctrine, which allowed a stepped-up basis based on the taxpayer's subjective intent to acquire assets, remains applicable after the enactment of section 334(b)(2).
2. Whether the Bank's basis in the hotel building should be determined under section 334(b)(1) or section 334(b)(2).

**Holding**

1. No, because section 334(b)(2) replaced the subjective intent test of Kimbell-

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Diamond with objective criteria.
2. No, because the Bank did not meet the 'purchase' requirements of section 334(b)(2); therefore, the basis should be determined under section 334(b)(1) as Swastika's basis.

**Court's Reasoning**

The court reasoned that Congress, by enacting section 334(b)(2), intended to replace the subjective intent test of Kimbell-Diamond with objective criteria. The court noted that three Circuit Courts of Appeal had rejected the continued vitality of the Kimbell-Diamond doctrine post-section 334(b)(2). The court found that section 334(b)(2) was intended as an exception to the general rule of section 334(b)(1), and its objective criteria must be met for a stepped-up basis. Since the Bank did not meet these criteria, its basis in the hotel building must be the same as Swastika's under section 334(b)(1). The court cited the Senate report and regulations supporting this view, emphasizing that applying Kimbell-Diamond would render section 334(b)(2) meaningless.

**Practical Implications**

This decision clarifies that for corporate liquidations under section 332, the basis of assets received by the parent corporation must be determined under the objective criteria of section 334(b), not by the subjective intent of the acquiring corporation. Practitioners must ensure that stock acquisitions meet the 'purchase' requirements of section 334(b)(2) to claim a stepped-up basis. This ruling impacts tax planning for corporate reorganizations, requiring careful adherence to statutory provisions. It also aligns with subsequent cases like Pacific Transport Co. v. Commissioner, which have similarly rejected the Kimbell-Diamond doctrine. Businesses must now focus on meeting objective statutory criteria rather than relying on their intent in structuring asset acquisitions through stock purchases and liquidations.

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