New York Fruit Auction Corp. v. Commissioner, 79 T. C. 564 (1982)

A corporate merger does not entitle a surviving corporation to a step-up in basis of its assets unless it complies with the strict requirements of Section 334(b)(2).

Summary

In New York Fruit Auction Corp. v. Commissioner, the Tax Court ruled that a corporation cannot step up the basis of its assets following a merger unless it meets the specific criteria of Section 334(b)(2) of the Internal Revenue Code. The case involved Cayuga Corp. ‘s acquisition of New York Fruit Auction Corp. ‘s stock and a subsequent merger where Cayuga was absorbed into New York Fruit. The court rejected the corporation’s argument for a step-up in basis, emphasizing that the merger did not constitute a liquidation as required by Section 332(b), and dismissed the application of the Kimbell-Diamond doctrine, highlighting the importance of adhering to the form of the transaction chosen by the parties.

Facts

DiGiorgio Corp. sold its controlling interest in New York Fruit Auction Corp. to Monitor Petroleum Corp. , which assigned its rights to Cayuga Corp. Cayuga acquired 80. 27% of New York Fruit’s voting stock and 73. 22% of its nonvoting stock. Subsequently, C. Sub. Inc. , a wholly owned subsidiary of Cayuga, merged into New York Fruit to eliminate minority shareholders. Finally, Cayuga merged into New York Fruit in a downstream merger, advised by counsel, resulting in New York Fruit as the surviving entity.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in New York Fruit’s federal income taxes for 1974, 1975, and 1976, based on the disallowed step-up in basis of its assets. New York Fruit petitioned the Tax Court for a redetermination. The court heard arguments on whether New York Fruit was entitled to a cost-of-stock basis in its assets post-merger.

Issue(s)

1. Whether New York Fruit Auction Corp. is entitled to a step-up in the basis of its assets under Section 334(b)(2) following the merger with Cayuga Corp.
2. Whether the Kimbell-Diamond doctrine applies to treat the series of transactions as a purchase of New York Fruit’s assets by Cayuga Corp.

Holding

1. No, because the merger of Cayuga into New York Fruit did not result in the complete liquidation of New York Fruit as required by Section 332(b), which is a prerequisite for applying Section 334(b)(2).

2. No, because the Kimbell-Diamond doctrine does not apply since Cayuga did not acquire New York Fruit's assets, and the doctrine lacks vitality for transactions outside Section 332.

Court's Reasoning

The court applied the strict requirements of Section 334(b)(2), which necessitates a complete liquidation under Section 332(b). It determined that New York Fruit did not liquidate but remained an active corporation post-merger, thus failing to meet the statutory requirements. The court emphasized the importance of the form of the transaction, rejecting New York Fruit's plea to look through form to substance. Regarding the Kimbell-Diamond doctrine, the court found it inapplicable since Cayuga did not acquire New York Fruit's assets directly, and the doctrine has limited vitality outside Section 332. The court cited Yoc Heating Corp. v. Commissioner and Matter of Chrome Plate, Inc. v. United States to support its strict adherence to statutory requirements and the form of the transaction.

Practical Implications

This decision underscores the necessity of adhering to the specific requirements of Section 334(b)(2) for a step-up in basis following a corporate merger. Attorneys must carefully structure transactions to comply with these requirements, particularly ensuring a complete liquidation occurs if seeking a basis adjustment. The ruling also limits the application of the Kimbell-Diamond doctrine, affecting how similar cases involving asset acquisition through stock purchases and subsequent mergers are analyzed. Businesses planning mergers should be aware of the potential tax consequences and the inability to step up asset basis without meeting statutory conditions, influencing corporate structuring and tax planning strategies. Later cases have reinforced the importance of adhering to the form of the transaction as chosen by the parties, further limiting the ability to argue for a step-up in basis based on substance over form.