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Cost-of-Stock Basis For Assets Received From Acquired Corporation

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COST-OF-STOCK BASIS FOR ASSETS RECEIVED FROM ACQUIRED CORPORATION

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In determining the incidence of taxation, we must look through form and search out the substance of a transaction. . . . This basic concept of tax law is particularly pertinent to cases involving a series of transactions designed and executed as parts of a unitary plan to achieve an intended result. Such plans will be viewed as a whole regardless of whether the effect of so doing is imposition of or relief from taxation. The series of closely related steps in such a plan are merely the means by which to carry out the plan and will not be separated.[1]

I. INTRODUCTION

A. *Purchase-of-Asset Result*—Kimbell-Diamond *Doctrine*

The quoted passage is but one of the many declarations which acknowledge the prominence in our tax laws of a basic concept known as the step-transaction doctrine. A particular facet of this many-sided doctrine comes into play when there has been a purchase of the stock of a corporation which is to be liquidated for the sole purpose of obtaining its assets. If this sole purpose is found to have existed at the time the stock was purchased, the step-transaction doctrine will be applied and the exchange will be considered as a purchase of assets in which delivery was made at liquidation. Under this particular application of the step-transaction principle—specifically referred to as the *Kimbell-Diamond* doctrine[2]—the assets will have a basis in the new shareholder's hands as if they were purchased directly by the shareholder. Consequently, the assets will be carried at cost (of the stock), rather than at a carry-over basis or their fair market value at distribution. Therefore, if the assets received are reincorporated by a transfer of the assets into a new or existing corporation, there will be no reorganization result since the conclusion that the assets, rather than the stock, were purchased assumes the absence of a former ownership *of the stock*, a requisite under re-

1. Rives, J., in Kanawha Gas & Util. Co. v. Commissioner, 214 F.2d 685, 691 (5th Cir. 1954).

2. This doctrine derives its name from the case of Kimbell-Diamond Milling Co., 14 T.C. 74 (1950), *aff'd per curiam*, 187 F.2d 718 (5th Cir.), *cert. denied*, 342 U.S. 827 (1951). In the *Kimbell-Diamond* case the doctrine apparently was substantially entrenched by virtue of the positive and successful assertion of this aspect of the step-transaction doctrine by the Commissioner, rather than the taxpayer. See also Helvering v. Security Sav. & Commercial Bank, 72 F.2d 874 (4th Cir. 1934); Illinois Water Serv. Co., 2 T.C. 1200 (1943). Cases in which the purchase-of-assets-through-stock question was clearly in issue prior to *Kimbell-Diamond* are: Commissioner v. Ashland Oil & Ref. Co., 99 F.2d 588 (6th Cir.), *cert. denied,* 306 U.S. 661 (1938); Prairie Oil & Gas Co. v. Motter, 66 F.2d 309 (10th Cir. 1933); Koppers Coal Co., 6 T.C. 1209 (1946); Warner Co., 26 B.T.A. 1225 (1932).

organization principles. Furthermore, the basis of the assets to the new corporation into which the assets are transferred will, in most cases, be the same as the basis in the hands of the reincorporating shareholder, whether it is an individual or a corporation.[3]

B. *Purchase-of-Stock Result*

On the other hand, assume that the step-transaction doctrine does not apply and the purchase is found to have been of stock rather than of assets. Under this conclusion, if an individual acquired the assets upon liquidation, their fair market value at distribution will be considered the basis, and gain or loss will be recognized unless the assets are reincorporated and a reorganization is found to have resulted. If a corporation is the shareholder-distributee, the assets generally will be taken at their carryover basis either under the reorganization provisions[4] (even without a *new* corporation's receiving the assets in a reincorporation), or under the parent-subsidiary liquidation sections.[5] In the latter case, if the distributee was not a "parent" of the liquidating corporation—that is, it did not own eighty per cent or more of the liquidating corporation's stock —the basis would be the fair market value of the assets and gain or loss would be recognized.[6]

II. EFFECT OF TRANSACTION ON PARTIES

It can be seen that the two steps of purchasing the stock of a corporation and its subsequent liquidation are prime targets for the imposition of the step-transaction doctrine. If the purchaser is a corporation, it will seek to avoid the carryover basis generally required for the assets received upon liquidation of the purchased firm. If the purchaser is an individual, the fair market value of the assets at liquidation, in most cases, will be the same as his cost of stock. The resulting basis of the assets, therefore, would be the same whether the step-transaction doctrine was applied or not,[7] unless the individual reincorporated the assets, in which case, the crucial issue becomes whether assets or stock were purchased. The precarious nature of the acquisition could, of course, be alleviated by the simple device of a direct purchase of the assets. This route, however, might not be the most desirable for one or both parties to the transaction.

3. See INT. REV. CODE OF 1954, §§ 351 & 358.

4. INT. REV. CODE OF 1954, § 368.

5. INT. REV. CODE OF 1954, §§ 332 & 334.

6. See INT. REV. CODE OF 1954, § 331.

7. See Betty C. Stockvis, 20 P-H Tax Ct. Mem. 68 (1951), in which the taxpayer acquired the stock of the liquidating firm for the sole purpose of utilizing the assets to be received in a sole proprietorship. Since the liquidation followed the purchase of the stock by only one month, the fair market value of the assets at liquidation was the same as the price paid for the stock. Therefore, no gain or loss was realized. Neither the *Kimbell-Diamond* doctrine nor any aspect of the step-transaction was relied upon in the court's

A. *Seller*

1. DOUBLE TAXATION

From the shareholder-seller's point of view, perhaps the most pronounced advantage of executing a sale of stock, rather than having the corporation transact the sale of its assets directly, is the avoidance of a double tax. If the adjusted basis of the assets is less than their fair market value, which is usually the case in view of the liberalized depreciation allowances, a gain would be recognized to the corporation upon the sale. When the proceeds of the sale are then distributed in liquidation, the shareholders would recognize gain to the extent that the amount received exceeds the basis of their stock. On the other hand, if the shareholders sold their stock directly to the would-be purchaser of the assets, only one gain is realized. Because of his decidedly advantageous position, the seller may refuse to consider a direct sale of the assets, leaving the buyer no alternative but to purchase the stock in order to acquire the desired property.[8] Of course, section 337 might alleviate some of the drawbacks of a direct sale by the corporation.[9] However, at the corporate level, gain would still be recognized with respect to any section 1245 and section 1250 assets sold after December 31, 1962.[10]

2. MISCELLANEOUS CONSIDERATIONS

Other incidental reasons which would dictate a sale of stock might include the recognition that a conveyance of assets generally entails more time-consuming procedures.[11] Another possibility might be that the certificate of incorporation calls for unanimous approval of the shareholders in order to effectuate a sale of its assets, whereas an affirmation of only eighty per cent is required for a liquidation.

B. *Buyer—Basis of Assets*

As far as the buyer is concerned, generally he will be concerned primarily with acquiring the highest basis possible for the assets received.

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decision. It should be noted, however, that if the fair market value of the assets at distribution varied from what it was on the date the stock was purchased, then the *Kimbell-Diamond* doctrine would not be concerned with this variance, whereas § 331(a)(1) of the 1954 Code would require recognition of any gain or loss.

8. The seller might be persuaded to sell assets rather than stock if the sale price were boosted. The purchaser might be willing to pay the extra price if the parties agree to allocate as much of the purchase price as reasonably possible to the depreciable assets. For a further discussion of the various practical considerations that arise under an acquisition of a corporation, see Friedman & Silbert, *Acquisition of Corporate Business*, N.Y.U. 15TH INST. ON FED. TAX 659 (1957).

9. See text of section VII(C), *infra*.

10. INT. REV. CODE OF 1954, §§ 1245 & 1250. Both provisions require recognition of gain to the extent of depreciation recapture notwithstanding any other section of the Code dealing with income taxes. INT. REV. CODE OF 1954, §§ 1245(d) & 1250(h).

11. For a discussion of the various problems involved in the purchase and sale of a corporate enterprise, see Levin, *Purchase and Sale of Corporate Businesses: Tax Opportunities and Pitfalls*, 35 TAXES 942 (1957).

As mentioned previously, if the purchaser is an individual the resulting basis normally would be the same whether the transaction is considered as a purchase of assets or one of stock, unless there was a reincorporation and a reorganization result. A corporate purchaser, however, generally will be more concerned with acquiring a cost-of-stock basis for the assets. Of course, if the fair market value of the assets is lower than the adjusted basis in the hands of the selling corporation, a carryover basis would be more desirable. In addition, if a relatively minor variance existed between the two values, a purchase of stock would afford many carryover tax attributes under section 381[12] not available if assets were purchased, and might easily justify the choice.

One reason that the purchaser would balk at purchasing stock of a corporation, when only the assets are desired, is the possibility that undisclosed or contingent liabilities might arise against the firm after the transaction. It would seem that the buyer more readily would consent to the stock transfer if the seller agreed either to make suitable allowances in the price of the stock, or promised to satisfy any obligations which were incurred prior to the sale of the stock.[13] Of course, if the buyer assumes any liabilities of the purchased corporation and the transaction is found to be a purchase of assets, their basis in the purchaser's hands is accordingly increased.[14]

III. Intent to Acquire Assets

The prerequisite factor to be determined before the step-transaction doctrine is applied to the purchase-of-assets-through-stock situation is the *intent* of the purchaser to acquire assets at the time the stock is purchased. If the intent to acquire the assets is formed subsequently, the step-transaction doctrine will not apply.[15] However, it should be noted that "interdependence" is not a factor in that the absence of an obligation on the purchaser's part to liquidate will not necessarily require a purchase-of-stock result.[16] Conversely, if it can be shown that the intent at the time of the purchase was to obtain the stock in order to

12. Int. Rev. Code of 1954, § 381.

13. The reported decisions sometimes note that although the seller refused to execute a direct sale of assets, there was an express agreement to the effect that any undisclosed or contingent liabilities that related to the period prior to the transfer would be satisfied by the seller. See, *e.g.*, Estate of Suter, 29 T.C. 244 (1957); Koppers Coal Co., 6 T.C. 1209 (1946).

14. Montana-Dakota Util. Co., 25 T.C. 408 (1955); Texas Bank & Trust Co., 22 P-H Tax Ct. Mem. 544 (1953).

15. This posture is usually noted in the typical liquidation situation in which the intent to acquire the assets to be distributed is formed at some time subsequent to the acquisition of the stock of the liquidating corporation. See, *e.g.*, Distributors Fin. Corp., 20 T.C. 768 (1953).

16. "The fact that the purchaser was perfectly free to hold the stock, with no obligation to liquidate the corporation, is given no weight unless the idea of liquidating first occurred to the purchaser after he acquired the stock." Mintz & Plumb, *Step Transactions in Corporate Reorganizations*, N.Y.U. 12th Inst. on Fed. Tax 247, 281-82 (1954).

acquire control of the corporation and its business, a purchase-of-assets conclusion might not result.[17]

It appears that the number of corporations whose assets are purchased through an acquisition of their stock is not a significant factor as long as it is shown that the purchaser intended to acquire the assets of all the corporations.[18]

Although certainly not conclusive, the minutes of the purchaser-corporation's board of directors meetings have been considered as a likely repository for the manifestation of the presence or absence of the requisite intent.[19] Documents such as the contract between the purchaser and the seller of the stock[20] and the formal plan of liquidation[21] also have supplied information from which the necessary intent could be gleaned. Typically, the information sought will relate to the following factors: (1) unsuccessful negotiations to purchase assets directly; (2) prompt liquidation of the acquired corporation; (3) integration of the assets received into the purchaser's business; (4) cessation of operations of the acquired corporation; (5) stripping-down of the corporation prior to the sale of its stock; and, (6) lack of substantial relationship between the parties to the transaction. These factors will be considered separately.

A. *Unsuccessful Negotiations to Purchase Assets Directly*

The corporation's refusal to sell its assets directly, thereby making it impossible for the purchaser to acquire the desired property other than by purchasing the stock, is a circumstance frequently present in cases where the *Kimbell-Diamond* rule is asserted.[22] In *Long Island Water*

17. See John Simmons Co., 25 T.C. 635 (1955). In noting the apparently predominant motive for the purchase as being for the acquisition of control, the court distinguished the case from *Kimbell-Diamond* and cases of similar decisional basis:

> In each of those cases it appeared that an existing corporation had as its primary purpose or indeed its sole purpose, the purchase of a particular asset or a group of assets of another corporation, but was forced by circumstances beyond its control to effect the acquisition through the channels of first acquiring the stock and then liquidating the subsidiary. In those cases the acquiring corporation had no purpose of continuing the business of the old corporation in a new corporate form. [In this case] . . . the purpose and the negotiations were to acquire stock and thereby acquire control of the company and its business. *Id.* at 641-42.

But see the discussion of those cases in which a going business was the subject matter of the purchase and a cost-of-stock basis for the assets was sustained, in text of section III (D), *infra*.

18. United States v. M.O.J. Corp., 274 F.2d 713 (5th Cir. 1960) (four); Kanawha Gas & Util. Co. v. Commissioner, 214 F.2d 685 (5th Cir. 1954) (eight); Koppers Coal Co., 6 T.C. 1209 (1946) (six).

19. See Kimbell-Diamond Milling Co., 14 T.C. 74 (1950), *aff'd per curiam*, 187 F.2d 718 (5th Cir.), *cert. denied*, 342 U.S. 827 (1951); Trianon Hotel Co., 30 T.C. 156 (1958); Conte Equip. Corp., 27 P-H Tax Ct. Mem. 736 (1958).

20. Illinois Water Serv. Co., 2 T.C. 1200 (1943).

21. Kimbell-Diamond Milling Co., *supra* note 19.

22. Commissioner v. Ashland Oil & Ref. Co., 99 F.2d 588 (6th Cir.), *cert. denied*, 306 U.S. 661 (1938); Georgia Properties Co. v. Henslee, 138 F. Supp. 587 (M.D. Tenn. 1955); Long Island Water Corp., 36 T.C. 377 (1961); Estate of Suter, 29 T.C. 244 (1957); George

Corp.,[23] the impossibility of obtaining the assets directly was examined as to whether it was a prerequisite for the application of the step-transaction doctrine in this area or whether it was merely a factor to be considered along with the other circumstances. However, the precise point was not decided, since the court found that even if it were considered only a factor, a purchase of assets result would not have obtained. In addition to the fact that there was no evidence of any unsuccessful negotiations for a direct purchase, other circumstances pointed to the lack of an intent to acquire the assets at the time the stock was purchased.

Although the fact that the seller refused to allow a direct purchase of the assets would lend much support to the purchaser's contention that assets were acquired, the absence of this fact need not be fatal to his position. The step-transaction doctrine is bottomed on the familiar concept that substance should be regarded over form, which would not require any particular *reason* for the purchaser's having entertained the intent to purchase assets through the acquisition of stock.

B. *Prompt Liquidation of the Acquired Corporation*

If the purchase was truly one of assets, it is natural to assume that the purchaser would wish to acquire the assets as soon as possible in order to utilize them as he had intended. This assumption often prompts the courts to consider the time span between the purchase of the stock and the liquidation of the corporation as an indication of whether the requisite intent did exist.[24] There seems to have been a good deal of leniency on this point, however.[25] In one case, the final liquidating dis-

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Haiss Mfg. Co., 26 P-H Tax Ct. Mem. 938 (1957); Montana-Dakota Util. Co., 25 T.C. 408 (1955); S. Nicholas Jacobs, 21 T.C. 165 (1953), *aff'd*, 224 F.2d 412 (9th Cir. 1955); Texas Bank & Trust Co., 22 P-H Tax Ct. Mem. 544 (1953). *Cf.* Tube Bar, Inc., 15 T.C. 922 (1950).

It is interesting to note, however, that in the *Kimbell-Diamond* case, *supra* note 17, there was no explicit indication that this factor was present, although there were statements made in the corporate minutes from which previous unsuccessful negotiations to purchase assets directly could be inferred. The court's decision, rather, was based primarily on the plan enumerated in the taxpayer's minutes to purchase the stock for the sole purpose of liquidating the firm (which was accomplished three days after the purchase) in order to replace the assets the taxpayer had lost in a fire. It was noted also that because of building restrictions enacted subsequent to the firm's establishment, new facilities could not be constructed on the old site.

23. 36 T.C. 377 (1961).

24. See, *e.g.*, Kanawha Gas & Util. Co. v. Commissioner, 214 F.2d 685 (5th Cir. 1954) (sixth months); H. B. Snively, 19 T.C. 850 (1953) (six months); Ruth M. Cullen, 14 T.C. 368 (1950) (same day).

25. Individual purchasers might be prompted to take advantage of this leniency by delaying the liquidation as much as possible. As one writer pointed out, this tactic would be advantageous to the high bracket taxpayer who would prefer to allow his corporation to incur the tax liability on the income earned by the assets to be acquired. Merritt, *Real Estate: Methods of Acquisition—Assets or Stock?*, N.Y.U. 14TH INST. ON FED. TAX 235, 254 (1956).

tribution was not made until six months after the purchase of the stock, during which time the business was carried on as usual; the court noted that "the length of time consumed is not fatal to a determination that the corporation was in process of complete liquidation," and held that the basis of the assets would be the cost of the stock.[26] In another situation, the expiration of a full year before the assets were distributed in liquidation did not preclude the application of the step-transaction doctrine.[27]

C. *Integration of the Assets Received Into the Purchaser's Business*

A third factor considered by the courts in determining the presence of the purchaser's intent to acquire assets is whether the property distributed in liquidation was integrated into the taxpayer's existing business.[28] This factor of integration, however, certainly is no more determinative than any other factor which might manifest the requisite intent.[29] Under the light of this proposition, purchases of stock by

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26. H. B. Snively, 19 T.C. 850, 860 (1953).

27. Commissioner v. Ashland Oil & Ref. Co., 99 F.2d 588 (6th Cir.), *cert. denied,* 306 U.S. 661 (1938). An important consideration entertained by the court in its view of the one-year period between purchase of the stock and liquidation was the fact that there was an escrow agreement involved which required the delay until the entire purchase price was paid. In Trianon Hotel Co., 30 T.C. 156 (1958) however, where there was no restrictive escrow agreement or the like and circumstances pointed to a primary motive for acquiring the purchased stock based on reasons other than obtaining assets, the time span of one year added support to the court's decision against the taxpayer.

An interesting situation was recently considered by the Ninth Circuit in which the operating assets of the acquired corporation were distributed in the year the distributee acquired full ownership, the liquid assets being distributed in the following year. Because the operating assets were resold by the taxpayer immediately upon receipt, the question arose as to their proper basis in order to correctly compute the gain. The taxpayer asserted that he realized gain upon the liquidation of approximately $30,000, the difference between the fair market value of the operating assets (also the resale price he received) and the adjusted basis of all of his stock in the liquidating corporation. In the following year, approximately $101,000 (the remaining liquid assets of the firm) was distributed. This amount was treated as a long term capital gain. The government sought to assert the *Kimbell-Diamond* doctrine to construe the acquisition of the stock of the liquidating corporation as a purchase of assets, substantially all of which occurred in the same month as the resale. This approach would have resulted in the price paid for the stock being allocated among all the assets of the corporation in 1952, including the $101,000 in liquid assets. Consequently, the operating assets would have been held at a basis of $101,000 less than the total cost of the taxpayer's stock, which finally, would have resulted in a corresponding increase of the short term capital gain in 1952 (attributed to the resale rather than to the liquidation). In holding for the government, the court noted that "this appears to be the first case . . . in which application of the [*Kimbell-Diamond*] rule and the accompanying cost allocation urged by the Government would operate to place the capital gain in an earlier accounting period than would otherwise be the case." United States v. Mattison, 273 F.2d 13, 20 (9th Cir. 1959).

28. See, *e.g.*, Kimbell-Diamond Milling Co., *supra* note 19 (replacement of assets destroyed by fire) and Warner, Co., 26 B.T.A. 1225 (1932) (supply of sand and gravel) where the assets acquired were necessary for the continued operations of the purchaser firms.

29. See United States v. Mattison, 273 F.2d 13, 19 (9th Cir. 1959); North Am. Serv. Co., 33 T.C. 677, 691 (1960); Annot., 83 A.L.R.2d 718, 732 (1962). In the *North Am. Serv. Co.* case, the court noted:

non-operating holding companies have been examined with varying results.[30] There have been cases in which this factor was manifestly absent, and yet the application of the *Kimbell-Diamond* rule was considered appropriate. Two court of appeal decisions illustrate this situation.[31] Both cases involved a purchaser who intended to resell the assets upon receipt. The Tax Court reached a similar result in a case in which the taxpayer intended to make a gift of the assets acquired at some future date.[32]

D. *Cessation of Operations of the Acquired Corporation*

Another factor which has furnished substance to the proposition that the acquisition of stock was, in effect, a purchase of assets, is the cessation of the activities of the purchased corporation prior to the transfer of stock. Put another way, the question is whether the purchase of a going business and its continuation in a new corporate form will preclude the application of the *Kimbell-Diamond* doctrine. Logically, it would seem that if the entire business was the subject matter of the purchase, the clear intent was to purchase the means of its ownership—the stock. This conclusion has been favored when the purchased business continued to be operated in substantially the same manner after the purchase as before.[33] The more recent cases, however, expressly discount this factor as determinative and allow a purchase-of-assets result even when it was clear that the business of the purchased corporation was, in fact, continued without interruption.[34]

In determining whether, in substance, the objective of the transaction was the acquisition of property, it is necessary to consider all the relevant evidence, of which the failure to integrate the purchased assets into the business of the acquiring taxpayer may well be an important element. However, to make such failure conclusive of the determination, as contended by respondent, would introduce a new artificiality of form and create a rigidity of application inconsistent with the underlying purpose of the rule." *Id.* at 691.

30. See United States v. M.O.J. Corp., 274 F.2d 713 (5th Cir. 1960) (cost-of-stock basis); American Steel & Pump Corp., 31 P-H Tax Ct. Mem. 133 (1962) (cost-of-stock basis); Illinois Water Serv. Co., 2 T.C. 1200 (1943) (carryover basis).

In George Haiss Mfg. Co., 26 P-H Tax Ct. Mem. 938 (1957), an integration of assets caused by a statutory merger rather than a liquidation was not preclusive of the *Kimbell-Diamond* doctrine.

31. United States v. Mattison, 273 F.2d 13 (9th Cir. 1959), and Georgia-Pacific Corp. v. United States, 264 F.2d 161 (5th Cir. 1959).

32. H. B. Snively, 19 T.C. 850 (1953).

33. Trianon Hotel Co., 30 T.C. 156 (1958); Garden State Developers, Inc., 30 T.C. 135 (1958); John Simmons Co., 25 T.C. 635 (1955). In Garden State Developers, Inc., the court refused to allow a cost-of-stock basis, notwithstanding that the taxpayer was absolutely precluded from liquidating the purchased firm under the terms of his contract. *But see* Helvering v. Security Sav. & Commercial Bank, 72 F.2d 874 (4th Cir. 1934).

34. United States v. M.O.J. Corp., 274 F.2d 713 (5th Cir. 1960); American Steel & Pump Corp., 31 P-H Tax Ct. Mem. 133 (1962); North Am. Serv. Co., Inc., 33 T.C. 677 (1960); Henning Corp., 29 P-H Tax Ct. Mem. 519 (1960).

In United States v. M.O.J. Corp., after the shares of stock of four corporations were purchased, the corporate structures were dissolved into the firm that was organized for the purpose of continuing the businesses, which was done without interruption. The court explained its position by stating:

Following a consistent approach, the courts have held that the *Kimbell-Diamond* doctrine will apply even though the intangible as well as the tangible assets are the alleged subject matter of the purchase.[35] A statutory merger of a going business into the taxpayer, however, was found to be an inappropriate transaction for the application of the *Kimbell-Diamond* doctrine, but primarily on the ground that it was not shown that there were unsuccessful negotiations for the direct purchase of the assets.[36] In *Commissioner v. Ashland Oil & Ref. Co.,*[37] one of the leading cases in this area of the step-transaction doctrine, the fact that the purchased corporation and the parent filed consolidated tax returns did not preclude a finding that the basis of the assets upon liquidation one year after the purchase would be the cost of the stock. An important factor in that case, however, was that the purchaser was not free to liquidate the acquired corporation until it did so, because of the restrictive escrow agreement involved.[38]

E. *Stripping-Down of the Corporation Prior to the Sale of its Stock*

At the opposite end of the spectrum from the situation in which a going business is acquired, the courts have recognized the significance of the stripping-down of a corporation prior to the sale of its stock. If the purchaser is interested in acquiring particular assets, there would seem to be no reason why he would pay for all the properties of the corporation to be purchased. In most instances, therefore, when it is shown that all but the desired assets had been distributed to the former shareholders prior to the sale, the *Kimbell-Diamond* doctrine is applied with relatively little reluctance.[39] Of course, it has been carefully noted that

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The essential thing is that here is a corporation that wishes to acquire the assets of another corporation; it does not want the intervening corporate structure; it never intends to keep it in existence for any of the many reasons that one corporation may desire to operate a wholly owned subsidiary as a separate entity; it therefore never intends for it to be a real subsidiary and it never is, in fact, except just long enough to be dissolved. Assuming the correctness of the decision of all the courts that when this situation exists as a part of a plan to buy specific property the purchase of the stock and liquidation of the corporation owning the property is disregarded *we perceive no difference conceptually when it exists as a part of a plan to buy a going business.*" *Id.* at 717. (Emphasis added.)

It should be noted that the Internal Revenue Service has expressly indicated that it would follow the *M.O.J. Corp.* case. Rev. Rul. 246, 1960-2 CUM. BULL. 462. The Service has also indicated that the purchase of a going business would not preclude the application of § 334(b)(2) of the 1954 Code. Rev. Rul. 262, 1960-2 CUM. BULL. 114. See text in section V *infra.*

35. United States v. Mattison, 273 F.2d 13 (9th Cir. 1959); American Steel & Pump Corp., 31 P-H Tax. Ct. Mem. 133 (1962) (names of acquired corporations retained in order to utilize good will).

36. Long Island Water Corp., 36 T.C. 377 (1961).

37. 99 F.2d 588 (6th Cir.), *cert. denied,* 306 U.S. 661 (1938).

38. See *supra* note 27.

39. See Kanawha Gas & Util. Co. v. Commissioner, 214 F.2d 685 (5th Cir. 1954); Commissioner v. Ashland Oil & Ref. Co., *supra* note 35; Prairie Oil & Gas Co. v. Motter,

"[T]he failure to 'strip-down,' although an important circumstance in determining whether the intent and purpose were to purchase assets or to purchase stock, cannot be regarded as prohibiting a finding that the intent and purpose were to purchase assets, especially when other circumstances indicate otherwise."[40]

F. *Lack of Substantial Relationship Between the Parties to the Transaction*

Somewhat related to the acquisition of a going business is the relationship between the purchaser and the corporation, the assets of which allegedly are the subject of the transaction. Typically, when there is truly a purchase-of-assets-through-stock situation, the shareholders of the corporation with the assets are entirely unrelated to the purchaser of the stock.[41] If the purchaser is a corporation and its shareholders are also the shareholders of the "selling" corporation, the intent to acquire assets might be found to be missing.[42] Although this circumstance is not necessarily treated independently, it affords greater weight to the proposition that the basic purpose of the exchange was oriented more toward inter-corporate political considerations rather than with an eye toward the acquisition of any particular assets.

The fact pattern under scrutiny in this section generally entails the purchase of stock of a corporation, and its subsequent liquidation or use of other means by which the assets are acquired by the purchaser of the stock. The above examination of the factors which have been considered relevant to the existence of the intent to acquire assets at the time the stock of the "selling" corporation is purchased should indicate clearly that the presence or absence of any one factor is not determinative. All the circumstances will be considered, with the primary object of searching out the true substance of the transaction.

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66 F.2d 309 (10th Cir. 1933); George Haiss Mfg. Co., 26 P-H Tax Ct. Mem. 938 (1957); Koppers Coal Co., 6 T.C. 1209 (1946); Carter Publications, Inc., 28 B.T.A. 160 (1933).

40. Estate of Suter, 29 T.C. 244, 259 (1957). See also Orr Mills, 30 T.C. 150 (1958).

41. In the pronouncement indicating that it would follow the case of United States v. M.O.J. Corp., *supra* note 34, the Internal Revenue Service made express mention of its reliance upon the fact that there was no substantial relationship between the parties to the transaction: "The acquisition of assets through the purchase-liquidation method in the instant case was by a corporation owned by an entirely different group of stockholders from the group which owned the acquired corporations." Rev. Rul. 246, 1960-2 CUM. BULL. 462.

42. See North Am. Serv. Co., 33 T.C. 677 (1960); John Simmons Co., 25 T.C. 635 (1955). See also Illinois Water Serv. Co., 2 T.C. 1200 (1943). A substantial similarity betwen the parties' directors and officers, as well as shareholders, afforded the foundation for a similar carryover basis conclusion in Trianon Hotel Co., 30 T.C. 156 (1958). At least one source has considered this factor of a lack of substantial relationship between the parties to the transaction as prerequisite rather than merely persuasive. See 3 CCH 1964 STAND. FED. TAX REP. ¶ 2434.01.

IV. NATURE OF PARTIES TO THE TRANSACTION

A. *Individual Purchaser*

In addition to examining carefully the various factors which may lead to a cost-of-stock basis conclusion, the courts have inquired into the nature of the purchaser. Although generally the rule expressly relied upon by the courts is known as the *Kimbell-Diamond* doctrine, and the case to which this doctrine owes its appellation involved a corporate purchaser, the rationale of the decision contemplates individuals as well.[43] The rule has been applied expressly to situations in which individuals purchased the stock with a view to reselling the assets upon receipt,[44] to making a gift of the acquired property to members of the purchaser's family,[45] or to transferring the assets to a newly formed corporation.[46]

B. *Corporate Purchaser*

Corporate purchasers also have made use of the newly formed subsidiary corporation established for the sole purpose of receiving the assets from the liquidated corporation. The new firm might acquire the stock itself[47] or have the assets transferred to it by the parent.[48] In the latter situation, when the recipient corporation had not been formed at the time the purchaser acquired the stock, the requisite intent has been ascribed to it.[49] It would appear that in those situations when the individual or corporation which acquired the stock "controlled" the recipient corporation, a statutory avenue of approach could be taken without the necessity of ascribing the requisite intent. Assuming that it already had

43. See Ruth M. Cullen, 14 T.C. 368 (1950), decided only two months after the *Kimbell-Diamond* decision, in which the court held that an individual taxpayer was entitled to carry the assets acquired for its sole proprietorship at the cost of the stock purchased for the purpose of obtaining the liquidated corporation's property. See also Betty C. Stockvis, 20 P-H Tax Ct. Mem. 68 (1951), which also involved an individual and a sole proprietorship. In this case, however, the court reached the same result without applying the *Kimbell-Diamond* rule. See *supra* note 7 and accompanying text.

One writer has noted that in light of the statutory incorporation of the *Kimbell-Diamond* principles, explicitly with regard to corporations, in § 334(b)(2) of the 1954 Code, "it seems unlikely that application of the *Kimbell-Diamond* doctrine will be denied in the case of individual purchasers since the doctrine is only a variation of the fundamental rule that substance prevails over form, and since Congress has not specified any special rules for individuals." Mansfield, *The* Kimbell-Diamond *Situation: Basis to the Purchaser in Connection with Liquidation*, N.Y.U. 13TH INST. ON FED. TAX. 623, 634 (1955).

44. United States v. Mattison, 273 F.2d 13 (9th Cir. 1959). See discussion of this case, *supra* note 27.

45. H. B. Snively, 19 T.C. 850 (1953).

46. Georgia Properties Co. v. Henslee, 138 F. Supp. 587 (M.D. Tenn. 1955); Estate of Suter, 29 T.C. 244 (1957). In both of the above cases the new corporations were formed after the stock had been purchased by the individuals. In Carter Publications, Inc., 28 B.T.A. 160 (1933), an individual purchaser was considered as the agent of the already existing corporation for which he executed the transaction.

47. See Koppers Coal Co., 6 T.C. 1209 (1946).

48. See American Steel & Pump Corp., 31 P-H Tax Ct. Mem. 133 (1962).

49. Orr Mills, 30 T.C. 150 (1958).

been established that the purchaser was entitled to the cost-of-stock basis for the assets, section 362(a) would require the basis to be the same for the recipient corporation as it was in the hands of the transferor.[50]

V. 1954 CODIFICATION OF *Kimbell-Diamond* DOCTRINE—SECTION 334(B)(2)

Another statutory avenue of approach is open to the corporate purchaser through the 1954 codification of the *Kimbell-Diamond* rule.[51] This provision, which was drafted exclusively for corporate purchasers,[52] has been construed as not requiring the intent-to-acquire-assets element that had been considered earlier.[53]

Prior to 1954, a parent was permitted to liquidate its subsidiary tax-free under the predecessor of section 332 and the basis of the assets received in liquidation was prescribed by the predecessor of section 334, which caused the subsidiary's basis to be carried over to the parent. If, however, the parent was able to show that the stock of its subsidiary was purchased for the sole reason of acquiring its assets, a cost-of-stock basis for the assets might have resulted. The 1954 Code has introduced an exception to the carryover basis effect of section 334 which, as mentioned earlier, is not concerned with the intent of the purchaser. This exception is found in the provisions of section 334(b)(2).[54]

Congress, concerned with the established and oft-quoted concept that the "substance of a transaction will prevail over its form," attempted through section 334(b)(2) to attain some degree of certainty in an area formerly plagued with the tenuous standard of subjective intent—at least so far as corporate purchasers might be concerned.

Whether the provisions of section 334(b)(2) operate to the qualify-

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50. If property was acquired on or after June 22, 1954, by a corporation . . . in connection with a transaction to which section 351 (relating to transfer of property to corporation controlled by transferor) applies . . . then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain recognized to the transferor on such transfer. INT. REV. CODE OF 1954, § 362(a).

51. INT. REV. CODE OF 1954, § 334(b)(2). For two very fine discussions of the operation of this section, see Merritt, *Real Estate: Methods of Acquisition—Assets or Stock?*, N.Y.U. 14TH INST. ON FED. TAX. 235 (1956), and Schwartz, *Acquisition of Stock of Another Corporation in Order to Acquire Assets*, U. So. CAL. 1957 TAX INST. 45.

52. "If property is received *by a corporation* in a distribution in complete liquidation of another corporation . . . ." INT. REV. CODE OF 1954, 334(b)(2). (Emphasis added.) See also S. REP. No. 1622, 83d Cong., 2d Sess. 258 (1954).

53. See text in section III *supra*.

54. The language used in the Code, "the basis of the property in the hands of the distributee *shall be* the adjusted basis of the stock with respect to which the distribution was made," would seem to indicate that the intent element is immaterial. INT. REV. CODE OF 1954, § 334(b)(2). (Emphasis added.) The Service has also taken this position in referring to the effect of strict compliance with the Code provisions: "In this connection, the formal steps themselves are significant under the 1954 Code and the element of purpose or intent is immaterial." Rev. Rul. 262, 1960-2 CUM. BULL. 114, 115.

ing corporation's advantage or disadvantage depends upon the relationship between the cost paid for the stock by the parent and the basis of the assets in the subsidiary's hands. A lower-than-cost-basis situation will result in a benefit to the parent to the extent of the step-up in basis permitted in the acquired property. The converse, a higher-than-cost-basis situation, will deprive the parent of a portion of the subsidiary's basis that it would have been entitled to depreciate, etc., under the pre-1954 Code provisions. As is noted below, although the provisions appear to operate automatically, the parent effectively can elect to qualify by a proper timing of the acquisition of the subsidiary's stock, the adoption of the plan of liquidation, or the period over which the distributions are made. Therefore, in most cases it is reasonable to assume that section 334(b)(2), when applicable, will operate to the parent's advantage.

Whatever the economic implications might be, the Code will allow a parent to operate an acquired subsidiary for a period of years on a trial basis. If the firm is successful, liquidation need not be considered. If, however, it appears that the firm's assets could be put to better use elsewhere, the parent still will be able to enjoy the cost-of-stock basis for the property to be relocated.

A. *Requirements for Qualification*

To qualify under this exception, the corporation must have purchased[55] eighty per cent or more of the subsidiary's stock during a period of not more than twelve months.[56] This section also provides that the plan of liquidation must have been adopted not more than two years after the requisite eighty per cent was purchased.[57] In addition, because the provisions of section 332(b) also must be complied with,[58] the parent must own the eighty per cent at the date of the adoption of the plan and continuously until the property is received.[59] Finally, the transfer of the property in liquidation must occur either within one taxable year or within three years from the end of the year in which the first distribution is made.[60]

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55. "Purchase" is defined by § 334(b)(3) as being any acquisition of stock other than one in which a substituted basis prevails or in which the basis is determined under § 1014(a). Also not qualifying are those acquisitions to which § 351 would apply or where § 318(a) would operate to construe the one who is to acquire the stock as the owner.

56. INT. REV. CODE OF 1954, § 334(b)(2)(B).

57. INT. REV. CODE OF 1954, § 334(b)(2)(A)(ii).

58. "For purposes of this subsection, the term 'distributee' means only the corporation which meets the 80 percent stock ownership requirements specified in section 332 (b)." INT. REV. CODE OF 1954, § 334(b)(4).

59. But § 332 will apply only if "the corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock . . . ." INT. REV. CODE OF 1954, § 332(b)(1).

60. INT. REV. CODE OF 1954, §§ 332(b)(2) and (3).

B. *Acquisition of Stock and Liquidation*

1. "SERIES OF PURCHASES"

As stated above, the provisions of section 334(b)(2) allow the parent two years from the time that eighty per cent of the subsidiary's stock is purchased to adopt the plan of liquidation. When the eighty per cent or more is purchased in one block and in one transaction, there are no complications in computing this statutory holding period. However, it would not be unusual for the requisite percentage of ownership to be acquired in a "series of purchases."[61] In this type of acquisition, it is possible to have the two-year period run from a date other than that on which the eighty per cent was acquired. This result will obtain when the last purchase (representing anything from eighty-one per cent to 100 per cent) is made within a twelve-month period in which *some* eighty per cent block is acquired.[62] However, if instead of a "series of purchases" situation, the requisite eighty per cent was acquired in a "single transaction," the two-year period would begin to run from that date.[63]

2. SINGLE TRANSACTION

In connection with this "single transaction" concept, it was interesting to find that an appropriate application of the step-transaction doctrine might be involved. It is interesting because section 334 (b)(2) is itself a codification of the specific step-transaction doctrine established in the *Kimbell-Diamond* case. This application is seen when a relatively close-in-time series of purchases results in an eighty per cent ownership. The series might be considered as a single transaction,[64] the date of which will be that of the last purchase. Therefore, even if a subsequent purchase of twenty per cent or less of stock takes place within a twelve-month period from the date of the first purchase in the series, because the entire series could be considered as a single transaction, the two years will

61. "Except as provided in subdivision (ii) of this subparagraph, in the case of a series of purchases of stock, the two-year period specified in section 334(b)(2)(A) shall begin on the day following the earliest date which is the end of a period of twelve months or less within which the amount of stock [80%] required by section 334(b)(2)(B) was acquired." Treas. Reg. § 1.334-1(c)(3)(i) (1958).

62. The regulations provide the following example of this situation:

[A]ssume that 20 percent of the stock of corporation A is purchased on each of the following dates: April 1, 1956, June 30, 1956, September 30, 1956, December 31, 1956, and June 1, 1957. The two-year period shall begin on January 1, 1957. However, if the first purchase of 20 percent of the stock occurs on November 1, 1955 (instead of April 1, 1956), then the two-year period shall begin on June 2, 1957. Treas. Reg. § 1.334-1(c)(3)(i) (1958).

63. The regulations specifically refer to a "series of purchases." See note 61, *supra*.

64. There may be cases in which a series of acquisitions occur as a result of a plan which results in the acquisition of 80 percent of such stock and which was intended to so result within a comparatively short period, for example, within one year. In a proper case such a series of acquisitions could qualify as one transaction. H.R. REP. No. 1337, 83d Cong., 2d Sess. A133 (1955).

continue to run from the date on which the first eighty per cent was acquired.[65]

C. *Basis of Assets*

The primary object of section 334(b)(2) is to allow—or require, as the case may be—the parent to carry the assets received from its liquidated subsidiary at a basis equal to the cost incurred for the subsidiary's stock. The regulations provide that the cost of *all* of the subsidiary's stock held by the parent shall be considered in this respect, regardless of the date or manner of acquisition.[66] The regulations are also quite explicit with regard to the computations that might be required in order to adjust the cost of the purchased stock to the proper basis for the assets received.[67] Generally, the purpose of these adjustments is to "maintain the basis of the assets distributed in complete liquidation as closely as possible to the basis which they would have were liquidation to proceed promptly."[68]

Very briefly, the regulations first call for the adjusted basis of the subsidiary's stock to be *reduced* by the amount of all distributions received by the parent from the subsidiary during the period beginning on the day on which the section 334 stock was purchased (or from the earliest purchase of such stock in the case of a series of purchases), and

65. An example of this situation would be where eighty per cent of the corporation's stock is purchased during the period of January 1, 1964 and April 1, 1964. The remaining twenty per cent is purchased on December 1, 1964. Although the last purchase is within the same twelve months period in which some eighty per cent is acquired, if the initial eighty per cent acquisition will be treated as a single transaction, the two-year period will run from April 2, 1964 rather than from January 1, 1965. For a discussion of the single transaction problem, see Merritt, *Tax-Free Acquisition of Corporate Business*, N.Y.U. 13TH INST. ON FED. TAX. 693, 723-25 (1955).

66 "The basis of the stock used in determining the basis of the assets is the total basis of all stock held by the parent corporation whether or not such stock was acquired by purchase and whether or not such stock is the stock acquired during the [two-year] period . . . ." Treas. Reg. § 1.334-1(c)(1) (1958). Compare this computation required under § 334(b)(2) with a similar situation under the *Kimbell-Diamond* doctrine as applied to an individual, as in Ruth M. Cullen, 14 T.C. 368 (1950). Cullen was a twenty-five per cent owner of Cullen Corp., who purchased the remaining seventy-five per cent from the other owners. The taxpayer paid an amount in excess of the fair market value of all of the corporation's assets. On the same day that the stock was purchased, the taxpayer liquidated the corporation and transferred the assets to a sole proprietorship. Cullen claimed a short term capital loss as represented by the difference between the fair market value of the corporation's assets distributed in liquidation and the basis of the stock that was surrendered (the original twenty-five per cent plus the subsequently purchased seventy-five per cent). The court held that there was no loss on liquidation since the petitioner simply had purchased the assets rather than the stock. The petitioner did realize long term capital gain on the liquidation, however, as if he were still the owner of only twenty-five per cent of the stock. The gain was based on the difference between the original cost of the twenty-five per cent of the stock and the fair market value of a twenty-five per cent interest of the total assets.

67. Treas. Reg. § 1.334-1(c)(4)(i) (1958). For a detailed review of the regulations dealing with the basis adjustments, see Schwartz, *Acquisition of Stock of Another Corporation in Order to Acquire Assets*, U. So. CAL. 1957 TAX INST. 45.

68. Merritt, *Real Estate: Methods of Acquisition—Assets or Stock?*, N.Y.U. 14TH INST. ON FED. TAX 235, 255 (1956). See generally *id.* at 255-59.

ending on the date when the plan of liquidation was adopted. Second, further adjustments are required upon receipt of the liquidating distributions.[69] The adjusted basis must be *increased* by the "unsecured liabilities assumed by the parent"[70] and the "portion of the subsidiary's earnings and profits (less the amount of any distributions therefrom) of the period beginning on the date of purchase and ending upon the date of the last distribution in liquidation attributable to the stock of the subsidiary held by the parent."[71] Finally, the adjusted basis is required to be *decreased* "by the amount of any cash and its equivalent received"[72] and "by the portion of the subsidiary's deficit in earnings and profits of the period beginning on the date of purchase and ending upon the date of the last distribution in liquidation attributable to the stock of the subsidiary held by the parent."[73]

D. *Anomalous Results under Section 334(b)(2)*

As with many statutory enactments which endeavor expressly to provide for the gamut of possibilities under its language, section 334(b)(2) has engendered speculation about some rather anomalous results which, theoretically, could obtain.

1. BASIS OF CASH

Consider the situation in which the parent causes the subsidiary to sell all of its assets for an amount equal to their basis in the subsidiary's hands[74] at a time almost two years from the date at which the subsidiary's

69. Treas. Reg. §§ 1.334-1(c)(4)(i)-(iv) (1958).
70. Treas. Reg. § 1.334-1(c)(4)(v)(*a*)(*1*) (1958).
71. Treas. Reg. § 1.334-1(c)(4)(v)(*a*)(*2*) (1958).
72. Treas. Reg. § 1.334-1(c)(4)(v)(*b*)(*1*) (1958).
73. Treas. Reg. § 1.334-1(c)(4)(v)(*b*)(*2*) (1958).

If the purchaser of the corporation's stock is an individual, the above regulations do not apply. Consequently, instead of there being required adjustments to the basis of the stock in the event of pre-liquidation corporate earnings or losses (so as to result in the time-of-purchase basis for the assets when received), the individual's basis of his stock will remain the same. Because of the absence of a basis of *stock* adjustment, the end result is a basis of *assets* adjustment. This position assumes, of course, that the period of delay is not so extended so as to preclude the application of the *Kimbell-Diamond* doctrine. For example, if the firm earned income prior to liquidation, there would be more liquid assets for distribution than had existed when the stock was purchased. Therefore, the cost of the stock would have to be allocated over more assets, resulting in a decrease of basis of those assets originally "purchased." On the other hand, if the firm sustained a loss during this period, there would be fewer liquid assets over which the cost of stock would be allocated, resulting in a higher basis for each. If liabilities were incurred by the firm which the purchaser was required to assume, he would be entitled to step-up his total basis to that extent (as if he had paid more for the stock). For an interesting discussion of this distinction between corporate and individual purchasers as to basis adjustment, see Merritt, *Real Estate: Methods of Acquisition—Assets or Stock?*, N.Y.U. 14TH INST. ON FED. TAX 235, 253-55 (1956).

74. Since no gain or loss would be realized by the subsidiary, no adjustment would be required under Treas. Reg. § 1.334-1(c)(4)(v)(*a*)(*2*) (1958) or Treas. Reg. § 1.334-1(c)(4)(v)(*b*)(*2*) (1958). See notes 71 and 73, *supra*.

stock was purchased. While the subsidiary's only asset is cash, and still within the two-year period, the parent causes the subsidiary to liquidate. If the parent paid either more or less for the subsidiary's stock than the adjusted basis of the assets, which the subsidiary sold at neither gain nor loss, the literal application of section 334(b)(2) would require the cash to be taken by the parent at a figure different from the face value. This anomaly has been recognized and discounted by at least one writer.[75]

2. OPTION TO PURCHASE STOCK

Another writer has observed what might have been a "ridiculous result" under a literal application of sections 318(a) and 334(b)(2) were it not for the fact that a regulation had rendered the literal interpretation academic.[76] If a purchaser takes an option to buy the stock of a totally unrelated person's corporation, and subsequently exercises the option, section 318(a) would require the optionee to be considered as the owner of the stock.[77] This interpretation would result literally in a purchase from himself. However, as mentioned, a regulation specifically provides for this situation and the stock is considered as having been purchased on the date the option was acquired, rather than on the date of exercise.[78]

3. INSTALLMENT RECEIVABLES

Another interesting situation has been recognized in connection with the treatment of installment receivables carried by the subsidiary.[79] If the installment sales qualified under section 453, no income would be realized until and to the extent that the receivables are collected. Section

75. Perhaps the basis of the purchasing corporation's other assets must be reduced or perhaps the Government will claim a taxable gain upon the liquidation, but no warrant for either of these possibilities can be found in the statute. . . . Section 334(b)(2) must yield to more fundamental principles with respect to the basis of cash. Mansfield, *The* Kimbell-Diamond *Situation: Basis to the Purchaser in Connection with Liquidation*, N.Y.U. 13TH INST. ON FED. TAX 623, 632-33 (1955).

76. See Schwartz, *Acquisition of Stock of Another Corporation in Order to Acquire Assets*, U. SO. CAL. 1957 TAX INST. 45, 52.

77. "If any person has an option to acquire stock, such stock shall be considered as owned by such person." INT. REV. CODE OF 1954, § 318(a)(3).

78. For the purposes of section 334(b)(2) the term 'purchase' means any acquisition of stock, but only if . . . the stock is not acquired from a person the ownership of whose stock would, under section 318(a), be attributed to the person acquiring such stock. However, if a corporation acquires stock pursuant to an option to buy such stock from a person who, *without regard to such option*, is not a person the ownership of whose stock would, under section 318(a), be attributed to such corporation, *such stock shall be considered to have been purchased on the date of the acquisition of such option*, if such option is exercised on or before the last day of a period of 12 months beginning on the day of the earliest purchase of stock (including the stock subject to such option) used in determining the applicability of section 334(b)(2) and for this purpose the stock with respect to which the option was exercised shall be deemed to have been purchased on the date such option was acquired. Treas. Reg. § 1.334-1 (c)(6)(iii) (1958). (Emphasis added.)

79. See Schwartz, *supra* note 76, at 63.

453(d)(4) provides, in effect, that in a section 332 liquidation, no acceleration of the receivable occurs, *i.e.*, there is no gain or loss. Since there is no exception made for a section 334(b)(2) transaction, it would appear that the parent could take over the receivables at their fair market value (approximately the face amount), which would be the price of the stock paid by the parent, and cause the unrealized installment ordinary income to escape tax completely.[80]

E. *Failure to Comply with Provisions*

Up to this point, it has been assumed that the primary reason of the corporation or the individual for purchasing the stock of another corporation was to acquire its assets. In the case of an individual, this reason must be established affirmatively as the sole purpose in order for the assets received to be carried at a cost-of-stock basis. Since 1954, however, a corporation is no longer required to establish this reason or intent to obtain the basis desired. Consequently, a corporation may wish to acquire another corporation for the sole purpose of taking advantage of the several tax attributes which may be carried over under section 381. In this state of affairs, section 334(b)(2) exists as a pitfall for the unwary corporate purchaser. Since this section applies irrespective of intent,[81] if the stock of the subsidiary is purchased within a twelve-month period and the liquidation takes place within two years of the purchase, a cost-of-stock basis will be the *automatic* result and section 381 will not apply.[82]

With regard to the tax attributes carryover situation, one writer has suggested the possibility of a "have-your-cake-and-eat-it-too" opportunity, at least with respect to the operating loss carryover. This may be obtained, he states, "by continuing the corporation in existence for slightly less than two years, using up the loss carryover and then liquidating. This defers the use of the stepped-up basis, but does not reduce the step-up."[83]

1. WILLFUL NON-COMPLIANCE

Therefore, it is obvious that if the corporate purchaser desires to make full use of section 381 and to obtain the assets of the subsidiary

80. The author notes that there is a difference of opinion among the commentators as to whether this result was intentional. To date, there is no regulation or ruling which modifies the effect of the strict application of the code as explained in the text.

81. For a consideration of the intent element see notes 53 and 54, *supra*.

82. "In the case of the acquisition of assets of a corporation by another corporation . . . in a distribution to such other corporation to which section 332 (relating to liquidations of subsidiaries) applies, *except* in a case in which the basis of the assets distributed is determined under section 334(b)(2) . . . ." INT. REV. CODE OF 1954, § 381(a)(1). (Emphasis added.)

83. Levin, *Purchase and Sale of Corporate Businesses: Tax Opportunities and Pitfalls*, 35 TAXES 942, 944 (1957). Of course, this position assumes that the acquired corporation carries on substantially the same business as it did previous to the purchase as required by § 382(a)(1)(C).

at an amount other than the cost incurred for the stock, it must avoid section 334(b)(2). First, if the parent desires to "carry over" the subsidiary's higher than fair market value basis, it must qualify the transaction under section 332 and either have purchased the stock over a period of more than twelve months or have delayed the adoption of a plan of liquidation for more than two years after the stock was acquired. Second, if the fair market value of the assets is higher than both the cost of the stock and the subsidiary's basis, sections 334(b)(2) and 332 must be avoided. This can be accomplished by acquiring less than eighty per cent of the subsidiary's stock or by reducing the holding to less than eighty per cent prior to the receipt of any property from the subsidiary.[84] These provisions also may be avoided by extending the liquidating distributions of the property over a period of more than three years.[85] Of course, in order for the fair market value to govern the basis of the assets received, a gain will be recognized by the parent.[86]

2. INADVERTENT NON-COMPLIANCE

Notwithstanding section 381 and the other possible reasons considered that might cause the corporate purchaser to prefer to avoid the provisions of section 334(b)(2), a question arises as to the position of a parent which expressly desires to qualify under section 334(b)(2), but for one reason or another fails to do so. Most writers seem to take the position that a corporation's exclusive avenue to obtain a cost-of-stock basis for the assets received in liquidation is section 334(b)(2).[87] It has been recognized, however, that there is the possibility that the *Kimbell-Diamond* doctrine still has vitality with respect to corporate purchasers who do not qualify under the provisions of the statute.[88]

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84. [A] distribution shall be considered to be in complete liquidation only if . . . the corporation receiving such property was, on the date of the adoption of the plan of liquidation, *and has continued to be at all times until the receipt to the property*, the owner of stock (in such other corporation) possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 percent of the total number of shares of all other classes of stock . . . . INT. REV. CODE OF 1954, § 332(b)(1).

85. [I]f the transfer of the property is not completed within the three-year period allowed by section 332 or if the recipient corporation does not continue qualified with respect to the ownership of stock of the liquidating corporation as required by that section, gain or loss shall be recognized with respect to each distribution and the tax liability for each of the years covered in whole or in part by the liquidation shall be recomputed without regard to the provisions of section 332 or section 334(b) . . . . Treas. Reg. § 1.332-4(b) (1955).

86. See INT. REV. CODE OF 1954, §§ 331(a)(1) and 334(a).

87. See, *e.g.*, Mansfield, *The* Kimbell-Diamond *Situation: Basis to the Purchaser in Connection with Liquidation*, N.Y.U. 13TH INST. ON FED. TAX 623, 634; Merritt, *Real Estate: Methods of Acquisition—Assets or Stock?*, N.Y.U. 14TH INST. ON FED. TAX 235, 255 (1956); Schwartz, *Acquisition of Stock of Another Corporation in Order to Acquire Assets*, U. So. CAL. 1957 TAX INST. 45, 66; 3 CCH 1964 STAND. FED. TAX REP. ¶ 2434.01. Mansfield points out that whether the corporation was at fault or not in its failing to comply with the statutory provisions would be immaterial to the fact of qualification.

88. [T]he Code fails to make clear whether section 334(b)(2) is an exclusive provision or if the section bars resort to the judicially developed *Kimbell-Diamond*

VI. Gain or Loss on Receipt of Assets

Whether the purchaser is an individual who satisfied the requirements of the *Kimbell-Diamond* doctrine, or a corporation which came under the provisions of section 334(b)(2), the result is the same with regard to the basis of the acquired assets. This cost-of-stock-basis result assumes that there will be no gain or loss upon the receipt of the liquidating ditributions. There have been instances, however, addressed specifically to the resultant gain or loss on receipt of the assets, rather than to the basis of property question.

Typically, if the purchaser paid an amount in excess of the fair market value of the assets at the time of the liquidation, he might wish to settle for a fair market value basis and deduct the difference as a loss upon liquidation.[89] On the other hand, if less than the fair market value were paid, the Commissioner might seek to tax the difference as a gain.[90] It is fairly well settled, however, that the *Kimbell-Diamond* concept encompasses this type of situation, and if the *Kimbell-Diamond* doctrine or the provisions of section 334(b)(2) are found to be applicable, there will be neither gain nor loss on the liquidation.[91]

> rule in cases where the transaction fails to meet the specific time limitations of the section. . . . Whether the courts, however, will . . . apply the intent test of *Kimbel-Diamond* and restrict the basis of the assets to the cost of the stock even though the specific requirements of section 334(b)(2) are not satisfied has not yet been answered. Chielstein & Surrey, World Tax Series—Taxation in the United States 757-58 (1963).

See also Cohen, Gelberg, Surrey, Tarleau & Warren, *Corporate Liquidations Under the Internal Revenue Code of 1954*, 55 Colum. L. Rev. 37, 43 & 44 (1955):

> It is somewhat disquieting to contemplate the coexistence of a precise statutory rule based on objective criteria and a more nebulous judicial rule based on subjective intent. Yet such a possibility cannot be ruled out summarily. The courts may be puzzled by a statute which purports to prescribe a definite rule without the right of election, yet states the rule in such a way that an election is actually permitted in not one, but many ways.

The means of election alluded to by the authors include the twelve-month and two-year rules. It is also noted that there is authority to support the proposition that a taxpayer may take steps for the specific purpose of avoiding the application of the section.

89. "If property is received in a distribution in partial or complete liquidation (other than a distribution to which section 333 applies), and if gain or loss is recognized on receipt of such property, then the basis of the property in the hands of the distributee shall be the fair market value of such property at the time of the distribution." Int. Rev. Code of 1954, § 334(a). See also Int. Rev. Code of 1954, § 331(a).

90. *Ibid.*

91. *Gain not recognized*: Commissioner v. Ashland Oil & Ref. Co., 99 F.2d 588 (6th Cir.), *cert. denied*, 306 U.S. 661 (1938); H. B. Snively, 19 T.C. 850 (1953). *Loss not recognized*: Helvering v. Security Sav. & Commercial Bank, 72 F.2d 874 (4th Cir. 1934); Ruth M. Cullen, 14 T.C. 368 (1950).

The theory of nonrecognition of gain or loss was well expressed by the *Cullen* court:

> The petitioner paid more than the book value or fair market value of the assets in order to purchase the stock without delay . . . . After acquiring the stock and dissolving the corporation pursuant to his plan, he had neither more nor less than he had paid for. . . . . We do conclude that he had, after the liquidation of the corporation, everything he had paid for when he bought all of the corporation's stock. He sustained no loss on the transaction." Ruth M. Cullen, *supra* at 373-74.

A similar position was taken by Professor Boris I. Bittker when he analogized the above

Of course, it should be noted that in many instances where a reorganization is not found and the fair market value of the assets at distribution prevails, the result will be the same as if the *Kimbell-Diamond* concepts were applied. This similarity of result occurs when the fair market value is the same as the cost paid for the stock and is a plausible situation when there is a prompt liquidation.[92]

VII. SELLER'S POINT OF VIEW

Up to this point, this article has been concerned primarily with the application of the step-transaction doctrine in connection with the purchaser. It was noted that the most direct method by which the purchaser could obtain the desired cost basis for the assets would be through a direct purchase. The corporate seller, however, would often object to this procedure because of the double taxation possibility previously considered.[93] It has been suggested,[94] therefore, that the tax effect of the sale might be overcome if the buyer were willing to pay more for the assets on a direct sale than he would for the stock, and that an inducement for this action might be to allocate a greater part of the purchase price to the depreciable assets.[95]

situation with that involved in the demolition cases, which hold that "a taxpayer who purchases real estate for the purpose of destroying an existing structure suffers no loss when he carries out his intention." BITTKER, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS 262 (1959).

92. In many cases the courts have recognized the possible applicability of the *Kimbell-Diamond* doctrine but found the application unnecessary since the result reached would not have been changed. See Henning Corp., 29 P-H Tax Ct. Mem. 519 (1960); Southwell Combing Co., 30 T.C. 487 (1958); Austin Transit, Inc., 20 T.C. 849 (1953). See also Betty C. Stockvis, 20 P-H Tax Ct. Mem. 68 (1951).

93. See text of section II(A)(1) *supra.*

94. Friedman & Silbert, *Acquisition of Corporate Business*, N.Y.U. 15TH INST. ON FED. TAX 659, 664-65.

95. Of course, the seller would have to contend with the new provisions of § 1245, enacted in 1962, which would require that the gain realized on the sale of the depreciable property, to the extent that it does not exceed depreciation deducted since December 31, 1961, be taxed as ordinary income. This consideration exists as another strong inducement for the seller to execute the transaction by a sale of stock. On the other hand, the purchaser will have to anticipate his being subject to the provisions of § 1245 when he liquidates the firm acquired through a stock deal. Section 1245(d) provides that "this section shall apply notwithstanding any other provisions of this subtitle," and since a § 334(b)(2) basis is not included in the exceptions, the purchaser will have to recognize ordinary income to the extent that the difference between the fair market value of the § 1245 assets and the adjusted basis of the assets in the hands of the liquidating corporation equals or is less than the post-1961 depreciation deductions. Of course, it is the liquidating corporation which sustains the tax burden, but in most cases the purchaser will assume the liability, and consequently, the purchaser's basis in the assets will be increased to the extent of the obligation assumed. See note 14 *supra* and accompanying text. If the corporation should have sufficient liquid assets to satisfy the tax obligation (not stripped prior to the sale), and it sets aside the money instead of including it in the distributions, the purchaser will receive fewer assets than he bargained for and will therefore, once again, be entitled to increase his basis in those assets he does acquire. See notes 66-73 *supra* and accompanying text. The purchaser's position would seem to be similar whether his basis in the assets was determined under § 334(b)(2) (corporation) or under the *Kimbell-Diamond* doctrine (individual). See

Another manner by which the double tax might be avoided is to have the corporation distribute the assets in liquidation to the shareholders who will take them at their fair market value, and then have the sale of the assets executed by the shareholders individually. Of course, the pitfall here is the *Court Holding Co.* doctrine which, if held to be applicable, would charge the sale of the assets to the corporation notwithstanding the antecedent distributions in liquidation.[96]

A. *Natural Corollary of Purchase of Assets—Sale of Assets*

With the readily acceptable *Kimbell-Diamond* doctrine and the provisions of section 334(b)(2) available, it is more than likely that a buyer will not balk at being required to purchase the stock of the corporate seller in order to secure its assets. The question still arises, however, as to whether there being, in substance, a *purchase of assets*, there was not also, in substance, a corresponding *sale of assets*. At this stage of development of the *Kimbell-Diamond* concept the question appears to be academic.[97] It has been recognized that because only a "unilateral intention" of the (individual) purchaser to acquire assets is required for the application of *Kimbell-Diamond* doctrine, it is not incongruous to have a purchase of assets on one side of the transaction and a sale of stock on the other.[98]

In the leading case of *Commissioner v. Ashland Oil & Ref. Co.*,[99] the lower court refused to allow a cost-of-stock basis to the purchaser because the corporation which owned the assets was never a party to the transaction, and therefore, there could not have been a *purchase* of assets without a *sale* of assets. The Sixth Circuit, however, reversed on appeal, basing its decision primarily on a purchaser-oriented approach. The dissent expressed concern over the court's rationale in that it ignored the existence as a separate entity of the corporation which owned the assets in determining that though there was a purchase of assets, there

Gallacher, *Section 1245—Depreciation Recapture*, N.Y.U. 22D INST. ON FED. TAX 503 (1964). See also the provisions enacted in 1964 which require ordinary income treatment on the sale of business realty previously excepted under § 1245. INT. REV. CODE OF 1954, § 1250.

96. If it can be shown that negotiations for the sale were entered into by the corporation prior to the liquidation, a corporate tax might be imposed notwithstanding the execution of the sale directly by the shareholders subsequent to liquidation. See Commissioner v. Court Holding Co., 324 U.S. 331 (1945). For a careful analysis of the application of the *Court Holding Co.* doctrine and a good review of the cases, see Steubenville Bridge Co., 11 T.C. 789 (1948). See also Landry, *Some Tax Considerations in the Sale or Purchase of a Corporate Business*, 9 SYRACUSE L. REV. 210 (1958).

97. It should be noted, however, that as of the time of this writing, the Internal Revenue Service has not taken a specific position on whether or not there must be a corresponding sale of assets whenever the *Kimbell-Diamond* doctrine or the provisions of § 334(b)(2) are held to be applicable.

98. Mintz & Plumb, *Step Transactions in Corporate Reorganizations*, N.Y.U. 12TH INST. ON FED. TAX 247, 282 (1954).

99. 99 F.2d 588 (6th Cir.), *cert. denied*, 306 U.S. 661 (1938).

was not also a corresponding sale of assets. This case was one of the earlier decisions to recognize what was later to be known as the *Kimbell-Diamond* doctrine, and it apparently set the scene for the now readily accepted proposition that the *Kimbell-Diamond* doctrine is a purchaser-oriented remedial device, the application of which should in no way affect the transaction from the seller's point of view.

This proposition was re-emphasized clearly in a case in which a purchaser was allowed to carry the assets received in liquidation at the cost of his stock,[100] notwithstanding that earlier there had been a judicial determination that the corporation from which he received the property had not been involved in a sale of assets.[101]

One argument made in defense against the quest for "symmetry" is that the seller might not be able to determine (if it were required to do so) the purchaser's motive in acquiring its stock.[102] It was conceded, however, that certain circumstances might exist which would be consistent with a sale of assets conclusion. These circumstances are: (1) knowledge that the purchaser will liquidate immediately after acquisition of the stock; (2) sale of stock being a last minute idea in negotiations for a sale of the assets; (3) stripping-down the corporation so that only the desired asset or assets remain prior to the stock purchase, and (4) sale of stock during the dissolution of the corporation.[103]

B. *Income Earned Prior to Liquidation*

Although it is fairly well settled that a "sale of assets" need not result every time there is a "purchase of assets" under the *Kimbell-Diamond* concept, if the corporation does not liquidate immediately, any income earned by it (even if earned directly from the assets which were

100. Texas Bank & Trust Co., 22 P-H Tax Ct. Mem. 544 (1953).

101. Dallas Downtown Dev. Co., 12 T.C. 114 (1949) (note dissenting opinion).

102. It was noted also that the Internal Revenue Code is replete with instances where the only concern is the nature of the sale rather than the use to which the subject matter is to be put—in other words, the seller is not required to be aware of the purchaser's disposition of the subject matter. See Atlas, *Buying Stock to Get Assets or Caveat Emptor and Venditor,* N.Y.U. 12TH INST. ON FED. TAX 1029 (1954).

103. *Id.* at 1043. In S. Nicholas Jacobs, 21 T.C. 165 (1953), *aff'd,* 224 F.2d 412 (9th Cir. 1955), the specific asset desired by the purchaser was transferred to a dormant corporation owned by the taxpayer, the stock of which passed as the subject matter of the sale. The court found, however, that there was in fact a sale of the asset rather than of stock and the taxpayer was charged with ordinary income. In Virginia W. Stettinius Dudley, 32 T.C. 564 (1959), *aff'd per curiam,* 279 F.2d 219 (2d Cir. 1960), not only did the court find that the transfer of the desired assets to a new corporation formed by the taxpayer and the subsequent sale of the stock resulted in a sale of the assets, but also, that dividend income was realized by the taxpayer's shareholders, who held the beneficial interest in the new company's stock.

It should be noted that the two cases in which a *Kimbell-Diamond* situation resulted in a "sale of assets" were those in which the disposition of the stock was preceded by a transfer of the property involved into a separate corporation. In the absence of this step, it would appear safe to expect that the seller's side of the transaction will be treated as a sale of stock.

the subject matter of the purchase) will be taxed to the corporation rather than to "the owner of the assets."[104] Similarly, during this taxable period prior to liquidation, the corporation probably will be required to depreciate its own adjusted basis rather than the cost-of-stock basis that the purchaser will be permitted to utilize upon receipt.[105]

At first glance there would appear to be a conceptual conflict between "disregarding the corporate entity"[106] when examining the purchase (and sale) of its assets, and requiring that the corporation bear the tax burden on income earned by those same assets prior to the liquidation but subsequent to the purchase of the stock. However, it should be borne in mind that the taxing statutes characteristically are applied independently to each side of any given transaction—*e.g.*, although a receipt may be income to one party the disbursement is not necessarily a deductible expense to the other. In this situation, the purchaser acquires stock with the concurrent intent of liquidating the firm as soon as possible, if not immediately. The step-transaction doctrine is applied and the event is treated as a purchase of assets. The seller, which is the shareholder of the corporation with the desired assets, is involved only in a sale of his stock. In the meantime, prior to liquidation, the corporation does exist as a separate entity and will be treated as such. There is nothing in the Code which provides for the corporate nonrecognition of income earned by the firm unless the sales are made pursuant to a plan of liquidation and certain statutory requirements are satisfied.[107]

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104. See H. B. Snively, 19 T.C. 850 (1953), in which the tax burden for income earned subsequent to the purchase of stock (assets) was imposed upon the corporation under the predecessor of § 482 which allows the Commissioner:

> In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, . . . [to] distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses. INT. REV. CODE OF 1954, § 482.

In explaining its holding that the corporation should be charged with the income earned during the interim, the court stated: "The stock purchase coupled with the intent to dissolve the corporation and the taking of some steps to that end, in our opinion did not *ipso facto* either destroy the existence of the corporation as a taxable entity or permit the petitioner to appropriate as his own income which would otherwise be taxable to the corporation." H. B. Snively, *supra* at 858.

105. Since the corporation is required to recognize any income it earns prior to its liquidation, even if earned directly by the "assets sold," it would naturally follow that any deductions that accrue prior to liquidation will also be computed without regard to the sale. Although the point has not been decided specifically, at least two writers have taken the above position. See Mansfield, *The* Kimbell-Diamond *Situation: Basis to the Purchaser in Connection with Liquidation*, N.Y.U. 13TH INST. ON FED. TAX 623, 631 (1955); Merritt, *Real Estate: Methods of Acquisition—Assets or Stock?*, N.Y.U. 14TH INST. ON FED. TAX 235, 254-55 (1956).

106. See the dissenting opinion in Commissioner v. Ashland Oil & Ref. Co., *supra* note 99.

107. INT. REV. CODE OF 1954, § 337. See discussion in text, section VII(C), *infra*.

C. *Direct Sales Under Section 337*

It was stated that perhaps the primary reason that a corporation would decline to sell its assets directly is the possibility that there would be a double taxation on the transaction—once, to the corporation on the sale, and again, to the shareholders upon liquidation. Under the 1954 Code, however, a corporation which is to be liquidated—either by its current shareholders or by the purchaser of the stock—could utilize the provisions of section 337 and avoid a tax on the corporate level notwithstanding the direct sale of assets.[108]

Generally, under the terms of section 337, if "a corporation adopts a plan of liquidation . . . and within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation . . . then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period."[109]

1. ADVANTAGES TO PURCHASER

Even though in most cases the purchaser would be able to obtain a cost-of-stock basis without resort to section 337, there are certain advantages to the purchaser that might accrue by engaging in a direct purchase: (1) only the assets desired need be purchased; (2) a cost basis is available without the necessity of liquidating the firm; (3) the corporate structure with its attendant contingent liabilities does not pass; and (4) a more desirable allocation of cost can be made among the assets purchased.

2. ADOPTION OF THE PLAN OF LIQUIDATION

Since section 337 provides for the non-recognition of gain or loss on the sale of assets transacted within the twelve-month period after the plan of liquidation had been adopted, a corporation may be tempted to dispose of its "loss assets" prior to the adoption of a plan. However, the regulations appear to have provided for this situation under the familiar step-transaction concept. If the sale at a loss prior to the adoption of the plan involves a portion of the firm's assets, but less than "substantially all of its property,"[110] the formal adoption date of the plan of liquidation might not control.[111]

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108. For a concise discussion of §§ 337 and 334(b)(2), see Lewis & Schapiro, *Sale of Corporate Business: Stock or Assets?*, N.Y.U. 14TH INST. ON FED. TAX 745 (1956).

109. INT. REV. CODE OF 1954, § 337(a).

110. Treas. Reg. § 1.337-2(b) (1955).

111. Under the language of the regulations, if "substantially all" of the firm's property is sold either before or after the adoption of the plan of liquidation, the date of the resolution will control and gain or loss will or will not be recognized depending upon the relative time of sale. However, if a good portion, but not "substantially all," of the firm's property is sold either before or after the resolution is adopted, the regulations

If the plan is determined to have been adopted earlier than the date of the formal resolution, two consequences might result. First, the loss sustained prior to the formal adoption will not be recognized since it will be considered to have occurred within the twelve-month period. Second, and perhaps more significant, is the possibility that the entire series of sales will fall outside the provisions of section 337. This result might obtain if the final liquidating distribution of the corporation's assets is made exactly twelve months after the date on which the plan of liquidation was formally adopted, in an effort to stay within the provisions.

3. LIMITED RECOGNITION OF GAIN

There is a limitation on the non-recognition of gain provisions in section 337 that relates to section 334(b)(2).[112] This limitation would apply after the stock of the corporation to be liquidated has been purchased by one who is able to qualify under section 334(b)(2). Consequently, sales made by the corporation within the section 337 period might result in a taxable gain to the corporation to a limited extent. Any gain resulting from a sale of property by the corporation, which if distributed in liquidation would have been taken at a cost-of-stock basis, shall be recognized to the extent of its appreciation from the date on which the stock was purchased.[113] Appreciation, in this sense, refers to any difference between the allocable portion of the cost of the stock to the assets sold and the actual amount realized from the sale of the assets.[114]

VIII. CONCLUSION

Whatever direct effect section 334(b)(2) proves to have upon the economic scene, it would appear that Congress has taken a step in the right direction by introducing some guidelines upon which a corporate purchaser of assets-through-stock can rely. Although this area is not particularly litigious, the total absence as of this writing of any case directly concerned with the effect or application of the 1954 provisions of section 334(b)(2)[115] would seem to indicate that some degree of success has been attained.

prescribe that "the date of the adoption of the plan of liquidation shall be determined from all the facts and circumstances." Treas. Reg. § 1.337-2(b) (1955). For a discussion of the problems caused by the vague language in § 337 with regard to the date of adoption, see Friedman & Silbert, *Acquisition of Corporate Business*, N.Y.U. 15TH INST. ON FED. TAX 659, 669-70 (1957), and Roberts, *Statutory Solution to the* Court Holding Company *Enigma*, 34 TAXES 431 (1956).

112. INT. REV. CODE OF 1954, § 337(c)(2). In addition to the gain specifically recognized under § 337(c), the depreciation recapture provisions of §§ 1245 and 1250 may cause recognition of gain with respect to certain assets. For a detailed discussion of the effect of the recapture provisions on corporate liquidations, see Gardner, *The Impact of Sections 1245 and 1250 on Corporate Liquidations*, 17 U. FLA. L. REV. 58 (1964).

113. INT. REV. CODE OF 1954, § 337(c)(2). See also Treas. Reg. § 1.337-4 (1955).

114. See example in Treas. Reg. § 1.337-4(b) (1955).

115. The only pronouncement which deals specifically with the provisions of § 334(b)(2) is Rev. Rul. 262, 1960-2 CUM. BULL. 114. See note 34 *supra*.

The next step would be to utilize further the apparent virtues of this statutory approach by extending its application to controlling individuals. Under the present state of the law, one individual who forms a corporation for the purpose of acquiring the stock of another corporation can decide almost two years later to liquidate the firm in order to acquire the assets personally, and still enjoy a cost-of-stock basis. Another individual who does not go through the technical steps of forming a new corporation and who decides, almost two years after personally purchasing the stock of another corporation, to liquidate, will not enjoy a cost-of-stock basis. There seems to be no pressing need for such a strict dichotomy.

A dichotomy which should prevail, however, is that of the tax implications arising from actions taken by a seller and a buyer in any given transaction. Independent consideration is a necessary concomitant to a realistic application of the tax laws. The Internal Revenue Service should define its position in this matter and, preferably, adopt the position of the courts[116] to the effect that a purchase of assets-through-stock approach by the buyer is not necessarily a consideration in determining whether there has been a corresponding sale of assets.[117]

Under the principle exemplified by the step-transaction doctrine, the *Kimbell-Diamond* rationale still exists as a sound expression of tax law theory. Therefore, even if provisions are enacted to give a section 334(b)(2) route to a stock purchase by an individual, and presently, even when a corporation inadvertently or unavoidably fails to comply with the statutory provisions,[118] the subjective intent test of the *Kimbell-Diamond* doctrine should not be absolutely foreclosed to the taxpayer. For example, if a corporation is unable to purchase eighty per cent of another firm's stock within a period of twelve months, it should still be permitted a substance-over-form result if each purchase, made whenever possible, was with the intent to acquire the other firm's assets.

Because of the statutory periods of time included in the provisions of sections 334(b)(2) and 337, the step-transaction doctrine becomes particularly significant in at least two areas. The first deals with the single transaction conclusion as opposed to a series of purchases of stock toward the eighty per cent prerequisite.[119] Greater definition is possible in this area and could be attained by allowing the two-year period to run from the acquisition of the first eighty per cent, whenever it may occur, without sacrificing any serious statutory purpose. The second, however, must perhaps exist in a state of flexibility. This problem involves the date on which the plan of liquidation had been adopted.[120]

116. See notes 99-101 *supra*.
117. See discussion in text, section VII(A) *supra*.
118. See discussion in text, section V(E)(2) *supra*.
119. See discussion in text, section V(B) *supra*.
120. See discussion in text, section VII(C)(2) *supra*.

The flexibility afforded by the "substantially all of its property" and "from all the facts and circumstances" language,[121] is necessary to discourage abuse in the disposition of loss assets prior to the formal adoption of the resolution to liquidate.

The concepts of the step-transaction doctrine have served well to afford a realistic approach to the solution of tax problems in the past and will undoubtedly continue to play an important role in the many appropriate areas of application within the Internal Revenue Code.

121. Treas. Reg. § 1.337-2(b) (1955). See *supra* note 110 and accompanying text.