

**DUSTING OFF *KIMBELL-DIAMOND*: THE CONTINUED
VIABILITY OF THE ASSET ACQUISITION DOCTRINE
FOR NON-CORPORATE PURCHASERS**

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I.	OVERVIEW.....	1443
	A. <i>Introduction</i>	1443
	B. <i>The Kimbell-Diamond Doctrine</i>	1444
II.	DEVELOPMENT OF THE DOCTRINE	1448
	A. <i>The Corporate Kimbell-Diamond Doctrine</i>	1448
	B. <i>The Non-corporate Kimbell-Diamond Doctrine</i>	1461
III.	CURRENT STATE OF THE NON-CORPORATE KD DOCTRINE..	1470
	A. <i>Scope of the Doctrine</i>	1470
	B. <i>Factors Affecting Viability</i>	1473
IV.	CONCLUSION.....	1481

I. OVERVIEW

A. *Introduction*

Assume two large corporations form a partnership (“Partnership”) that acquires, for cash, all of the stock of another corporation (“Target”) that is promptly liquidated after its acquisition to effectuate Partnership’s ultimate goal of acquiring Target’s appreciated assets. Might Partnership, citing the *Kimbell-Diamond* Doctrine (hereinafter, the “KD Doctrine”), claim that Target is exempt from paying income tax for the gain that is

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otherwise recognized upon a liquidating corporation's distribution of appreciated property?¹

Partnership would be invoking a doctrine that, since the middle of the twentieth century, was an analytical touchstone of income tax analysis. The doctrine generally held that an acquiring party (often a corporation) that purchased the stock of Target could treat its acquisition as though it had directly purchased Target's assets, if that was the acquirer's intent, it otherwise would have purchased the assets directly, and if Target was promptly liquidated following the acquisition. However, because of statutory changes with respect to corporate purchasers, the doctrine was fast fading from prominence by 1980, when an appellate court held "definitively and absolutely that the *Kimbell-Diamond* doctrine is extinct."² Any remaining doubt about the viability of the doctrine was ostensibly eliminated in 1982, when Congress, with the enactment of section 338,³ explicitly stated that such provision was intended to replace any non-statutory treatment under the KD Doctrine.⁴

As discussed within this Article, though, it is unclear whether the doctrine was ever completely eliminated. And especially with respect to non-corporate acquirers such as Partnership, it is questionable whether the doctrine's scope has been limited at all, leaving these taxpayers with strong arguments for claiming exemption from a gain recognition provision of the Code.

B. *The Kimbell-Diamond Doctrine*

The KD Doctrine, which has also been referred to as the "asset acquisition doctrine," is illustrative of yet another impressive "doctrine" that informs corporate income tax analysis: the step transaction doctrine.⁵ The step transaction doctrine is a recurring

1. All references to "Code" are to the Internal Revenue Code of 1986, as amended ("I.R.C.").

2. *Chrome Plate, Inc. v. Dist. Dir. Of Internal Revenue (In Re Chrome Plate)*, 614 F.2d 990, 1000 (5th Cir. 1980).

3. All references to "section," unless otherwise noted, are to the applicable section of the Code.

4. H.R. CONF. REP. NO. 97-760, at 536 (1982), *reprinted in* 1982 U.S.C.A.N. 781, 1310.

5. *See Sec. Indus. Ins. Co. v. United States*, 702 F.2d 1234, 1244 (5th Cir. 1983) ("The step-transaction doctrine is a corollary of the general tax principle that the incidence of taxation depends upon the substance of a transaction rather than its form.").

and fundamental theme permeating the tax law and has been the subject of numerous articles and commentary, which this Article will not attempt to aggrandize.⁶ Suffice to say that, when the step transaction doctrine applies, a series of formally separate steps will be consolidated and treated as a single transaction if the steps are, in substance, integrated, interdependent, and focused toward a particular result. This “doctrine,” in turn may be viewed as derived from the principle that the substance of a transaction should triumph over its form⁷ and that tax consequences should be based on the whole of what happened rather than on artificially separated parts; at least the government (if not the taxpayer) should have the option of being able to assert substance-over-form analysis when necessary.

The KD Doctrine takes its name from the holding of *Kimbell-Diamond Milling Co. v. Commissioner*,⁸ although, as discussed below, the doctrine⁹ pre-dated that case. As used throughout this Article, references to the KD Doctrine will adopt the following definition:

[W]hen stock in a corporation is purchased for the purpose and with the intent of acquiring its underlying assets and that purpose continues until the assets are taken over, no independent significance taxwise attaches to the several steps of a multiple step transaction. The final step [the liquidation] is, therefore, viewed not as independent of the stock purchase but simply as one of the steps in a unitary transaction, the purchase of assets The essence of the doctrine . . . in short, is that tax significance attaches not to the separate steps after the first one but to the transaction as a whole, each step in

6. See, e.g., Lewis R. Steinberg, *Form, Substance and Directionality in Subchapter C*, 52 TAX LAW. 457 (1999) (discussing applications of the step transaction doctrine); Joseph Isenbergh, *Musings on Form and Substance in Taxation*, 49 U. CHI. L. REV. 859 (1982) (discussing the place of doctrine in deciding tax disputes).

7. Or, substance triumphs over *empty* forms, as articulated by Judge Frank Easterbrook of the Seventh Circuit Court of Appeals. See *Sears, Roebuck & Co. v. Comm’r*, 972 F.2d 858, 862 (7th Cir. 1992).

8. 14 T.C. 74 (1950), *aff’d per curiam*, 187 F.2d 718 (5th Cir. 1951).

9. It has also been referred to as a “rule” or “principle.” Because “doctrine” seems to be the prevailing nomenclature during recent decades, this Article will use such term, without delving into the subject of the difference between a doctrine, rule or principle. See, e.g., *In re Chrome Plate*, 614 F.2d 990 (5th Cir. 1980) (using the term “doctrine”); *Griswold v. Comm’r*, 400 F.2d 427 (5th Cir. 1968) (using the term “rule”); *United States v. Mattison*, 273 F.2d 13 (9th Cir. 1959) (using the term “rule”); *Estate of Suter v. Comm’r*, 29 T.C. 244 (1957) (using the term “principle”); Rev. Rul. 90-95, 1990-2 C.B. 67 (using the term “doctrine”).

which is viewed as an integral part of a single transaction, the purchase of assets.¹⁰

The KD Doctrine is focused solely upon the transaction from the purchaser's perspective, does not offer to account for the seller's treatment of the transaction,¹¹ and represents an instance where the federal income tax consequences accorded an overall transaction do not strictly follow the transaction's "form." This may well reflect a judicial reluctance to place too heavy a premium upon strictly following form.¹² However, this is an area of tension, as much of federal income tax practice is form-driven, and corporate income tax practice is no exception.¹³

This tension between form and substance is illustrated by the following example. Building upon the example introduced previously, assume that Partnership paid \$1,000,000 for the stock of Target.¹⁴ The "form" of the transaction is comprised of two steps: a purchase of stock and a liquidation of the purchased corporation. The tax consequences attending the form are that Partnership has a basis of \$1,000,000 in the stock of Target, as determined under section 1012.¹⁵ Assume as well that Target's aggregate asset basis is \$500,000 (Target's "inside asset basis") with a fair market value of \$1,000,000 (assuming no consideration of the inherent tax liability).¹⁶ Thus, when Partnership, as Target's sole shareholder, causes Target to dissolve under applicable state law, section 336 would require that corporate-level gain be recognized upon the distribution of property in complete liquidation.¹⁷ Assuming the assets are properly valued at \$1,000,000, Target thus has \$500,000 of recognized gain, and, at a thirty-five percent effective tax rate, a

10. *Georgia-Pacific Corp. v. United States*, 264 F.2d 161, 163 (5th Cir. 1959).

11. *See infra* note 224 and related text.

12. *But see* *Comm'r v. Sansome*, 60 F.2d 931, 933 (2d Cir. 1932) (criticizing judicial recourse, in certain taxation issues, to such "vague alternatives as 'form' and 'substance,' anodynes for the pangs of reasoning").

13. *See* Steinberg, *supra* note 6, at 457.

14. For purposes of simplicity, also assume that Target has no liabilities.

15. I.R.C. § 1012 (1986).

16. As the example illustrates, it is a mistake to assume that "inside" asset value equals "outside" stock value where the inside assets are appreciated and one cannot directly hold the assets without the incidence of taxation. *See* BORIS I. BITTKER & JAMES S. EUSTICE, *FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS* ¶ 10.41[4] (7th ed. 2000) [hereinafter BITTKER & EUSTICE].

17. I.R.C. § 336(a) (2001). ("Except as otherwise provided in this section or section 337, gain or loss shall be recognized to a liquidating corporation on the distribution of property in complete liquidation as if such property were sold to the distributee at its fair market value.").

federal income tax liability of \$175,000, which Partnership has effectively inherited.

But Partnership always intended to acquire Target's assets and promptly liquidated Target to effect that objective, since it could not directly purchase the assets from Target. Indeed, had Partnership instead negotiated a direct asset purchase, it would have a \$1,000,000 basis in the acquired assets and would not have inherited a \$175,000 tax liability. Given Partnership's ultimate aim, the application of the step transaction doctrine and the KD Doctrine would collapse the intervening step by which, for a moment, Target is a wholly-owned subsidiary corporation, and instead view the transaction as though Partnership paid \$1,000,000 to Target's seller in exchange for Target assets. This shortens a two-step acquisition into a one-step acquisition, at least from Partnership's perspective. As such, the liquidation provisions of the Code would play no role in determining the federal income tax consequences to Partnership. Instead, Partnership would take a basis in the assets of \$1,000,000, as determined under section 1012.

The discussion in Part II traces the development of the KD Doctrine in an era where corporate liquidations generally had less federal income tax consequences than they do now.¹⁸ Part III considers what relevance the KD Doctrine has now, where corporate liquidations may have considerably greater tax consequences.¹⁹ As the following discussion illustrates, the KD Doctrine has developed along two major tracks: the predominant one involving corporate purchasers and referred to hereinafter as the "Corporate KD Doctrine," and the less predominant manifestation of the KD Doctrine involving non-corporate purchasers, referred to hereinafter as the "Non-corporate KD Doctrine." Since much (if not all) of the Corporate KD Doctrine has been replaced by section 338 and the regulations thereunder, most of the focus of this Article is upon the Non-corporate KD Doctrine.

18. *See infra*, Part II.

19. *See infra* Part III.

II. DEVELOPMENT OF THE DOCTRINE

A. *The Corporate Kimbell-Diamond Doctrine*1. *Kimbell-Diamond Milling Co.*

Curiously, the case of *Kimbell-Diamond Milling Co. v. Commissioner* was not the first to establish what became known as the KD Doctrine.²⁰ However, its facts are sufficiently illustrative and, thus, are recited below.

A mill property of the Kimbell-Diamond Milling Company was destroyed by fire in August of 1942.²¹ Upon receipt of insurance proceeds, the company negotiated the purchase of another nearby milling property operating in corporate form, the Whaley Mill & Elevator Company (“Whaley”).²² The board of directors of Kimbell-Diamond issued a resolution stating that, as soon as practicable after the purchase of the stock of Whaley, “all necessary steps be taken to completely liquidate the said corporation by transferring its entire assets, particularly its mill and milling equipment, to Kimbell-Diamond Milling Company in cancellation and redemption of the entire issued and outstanding capital stock of Whaley Mill & Elevator Company”²³ Consistent with this declaration, the stock of Whaley was acquired on December 26, 1942 for \$210,000.²⁴ Three days later, a plan of liquidation was entered into by Whaley and Kimbell-Diamond, which provided that, among other things, the stock was being acquired primarily for the purpose of enabling the Kimbell-Diamond Milling Company to obtain direct possession and ownership of the flour mill and milling plant assets owned by Whaley, and that the parties agreed that said assets would be conveyed to Kimbell-Diamond by Whaley in complete liquidation of Whaley, thus canceling the shares of Whaley held by Kimbell-Diamond.²⁵ The liquidation was formally completed on December 31, 1942, less than a week after

20. See *infra* notes 37-41 and accompanying text.

21. *Kimbell-Diamond Milling Co. v. Comm’r*, 14 T.C. 74, 75 (1950).

22. *Id.* at 75-76.

23. *Id.* at 76.

24. *Id.* The \$210,000 was comprised of \$118,200.16 in insurance proceeds to cover the destroyed assets as well as additional funds of \$91,799.84. *Id.*

25. *Id.* at 76-77.

the stock acquisition.²⁶

Consistent with the form of the transaction, Kimbell-Diamond, the purchasing corporation, treated the transaction as comprised of two independent steps: a stock purchase and a liquidation of a wholly-owned subsidiary. The tax law provided then (much as it does now under section 332) that a corporate shareholder would recognize no gain or loss upon the receipt of property in complete liquidation of another corporation²⁷ and would take a carryover basis in property received from a liquidating corporation.²⁸ Since the aggregate adjusted basis of the depreciable Whaley assets (in the hands of Whaley) was approximately \$139,522, Kimbell-Diamond used this amount as its basis in the assets upon the liquidation of Whaley.

Although initially unchallenged, the Service later amended its position with respect to depreciable asset basis.²⁹ The deficiency notice issued by the Service to Kimbell-Diamond asserted that the milling company took too high a basis in the Whaley assets (and correspondingly larger-than-warranted depreciation deductions, among other items,) and thus owed additional income tax, declared value excess profits tax, and excess profits tax for the taxable years ending 1945 and 1946.³⁰ The government asserted a basis in the depreciable Whaley assets of approximately \$110,722. It arrived at this amount by using Kimbell-Diamond's adjusted basis in the destroyed assets, \$18,921.90, and adding to that amount the difference between the total amount expended in acquiring

26. *Id.* at 77.

27. I.R.C. § 112(b)(6) (1939). *Cf.* I.R.C. § 332(a) (CCH 2001).

28. I.R.C. § 113(a)(15) (1939). This provision, as amended, shares many similarities with current section 334(b), which generally provides for a carryover basis upon property received in complete liquidation of a subsidiary (generally, a corporation in which the parent corporation owns at least eighty percent of the stock of the subsidiary). *See* I.R.C. § 334(b) (2001).

29. The government initially challenged Kimbell-Diamond's treatment of the acquired assets as qualifying as tax-free under the involuntary conversion provision in existence at that time, although it lost on this score. In this first round of litigation, the government also sought to challenge the basis given the assets by Kimbell-Diamond, but the Tax Court declined to address the issue then because of an undeveloped evidence record. *See* *Kimbell-Diamond Milling Co. v. Comm'r*, 10 T.C. 7 (1948).

30. *Kimbell-Diamond Milling Co. v. Comm'r*, 14 T.C. 74 (1950), *aff'd by*, 187 F.2d 718 (5th Cir. 1951). The declared value excess profits tax and the excess profits tax were wartime revenue-raising mechanisms which have since been repealed. Act of Aug. 16, 1954, c. 736, § 1, 68A Stat. 5 (superseding Internal Revenue Service Code of 1939 by Internal Revenue Service Code of 1954).

Whaley (\$210,000) less the amount received from the insurance company (\$118,200.16), or \$91,799.84 (\$18,921.90 + \$91,799.84 = \$110,721.74). The government asserted that Kimbell-Diamond really acquired assets, and not stock, from Whaley.

Kimbell-Diamond asserted that the transaction's form should be respected and that it had received the Whaley assets in liquidation of another corporation and thus was entitled to the higher carryover basis in the assets. The Tax Court cited the familiar refrain that "the incidence of taxation depends upon the substance of a transaction."³¹ The court stated that this issue should be governed by the principles of *Commissioner v. Ashland Oil & Refining Co.*³² In *Ashland Oil & Refining Co.*, the Sixth Circuit Court of Appeals reversed a Board of Tax Appeals decision holding that a corporate purchaser was entitled to a stepped-up basis in the assets of a liquidated corporation that it had purchased.³³ Although the purchasers in *Ashland* had held on to their stock for nearly a year, the *Ashland* court stated "transitory ownership of stock is not necessarily of legal significance."³⁴ Thus, the *Kimbell-Diamond* court held that "the purchase of Whaley's stock and its subsequent liquidation must be considered as one transaction, namely, the purchase of Whaley's assets which was petitioner's sole intention."³⁵ Here, what later became known as the KD Doctrine was applied to the eponymous milling company to reduce its basis in acquired assets, thus representing a victory for the government, which was upheld on appeal to the Fifth Circuit.³⁶

2. Other Illustrative Rulings

As noted, the holding in *Kimbell-Diamond* was not without precedent. For example, in *Kimbell-Diamond* the Tax Court cited *Ashland Oil & Refining Co.*, a case that was decided twelve years

31. *Kimbell-Diamond Milling Co.*, 14 T.C. at 80 (citing *Comm'r v. Court Holding Co.*, 324 U.S. 331 (1945)).

32. *Id.* (citing *Comm'r v. Ashland Oil & Ref. Co.*, 99 F.2d 588 (6th Cir. 1938), *cert. denied*, 306 U.S. 661 (1939)).

33. *Ashland Oil & Ref. Co.*, 99 F.2d at 593.

34. *Id.* at 591.

35. *Kimbell-Diamond Milling Co.*, 14 T.C. at 80.

36. 187 F.2d 718, 718 (5th Cir. 1951), *cert. denied*, 342 U.S. 827 (1951). Perhaps the reason "*Kimbell-Diamond* rule" became the phrase describing the treatment accorded a stock purchase and liquidation was because it represented a government victory and the government's subsequent use of the phrase. See M. L. Cross, Annotation, *Income tax: Corporate Assets As Received In Liquidation Or By Purchase Where Stock Is Purchased To Acquire Assets*, 83 A.L.R.2d 718, 721 n.3 (1962).

earlier.³⁷ In *Ashland*, the Sixth Circuit Court of Appeals was called upon to review a decision of the Board of Tax Appeals, which had concluded that a purchasing corporation was entitled to a stepped-up basis in the assets of an acquired corporation that it had liquidated.³⁸ The government argued on appeal that the liquidation was to be accorded independent significance, in that the purchasing corporation owned the stock for nearly a year (while the stock was formally held by an escrow agent) and had included the target corporation's income in its own consolidated return in 1925.³⁹ The Sixth Circuit framed the issue:

[W]hether if the entire transaction, whatever its form, was essentially in intent, purpose and result, a purchase by Swiss [the purchasing corporation] of property, its several steps may be treated separately and each be given an effect for tax purposes as though each constituted a distinct transaction. It is true that Swiss acquired all of the stock of Union [the target corporation]. But this is not decisive, for a transitory ownership of stock is not necessarily of legal significance. It has been said too often to warrant citation that taxation is an intensely practical matter, and that the substance of the thing done and not the form it took must govern.⁴⁰

"It seems clear," the court concluded, that the transaction, although formally structured as a stock purchase and liquidation, was in substance a purchase of the assets belonging to the target corporation, since they could not otherwise be acquired.⁴¹

Many other cases, both prior to and following the celebrated *Kimbell-Diamond* case, adopted the KD Doctrine,⁴² and the Service eventually acquiesced where the Service had been arguing against its application.⁴³

37. *Ashland Oil & Ref. Co.*, 99 F.2d 588.

38. *Id.* at 590.

39. *Id.* at 590-91.

40. *Id.* at 591 (citation omitted).

41. *Id.*

42. *See, e.g.*, *United States v. M.O.J. Corp.*, 274 F.2d 713, 717 (5th Cir. 1960); *Georgia-Pacific Corp. v. United States*, 264 F.2d 161, 162-63 (5th Cir. 1959); *Prairie Oil & Gas Co. v. Motter*, 66 F.2d 309, 311 (10th Cir. 1933); *N. Am. Serv. Co. v. Comm'r*, 33 T.C. 677, 692 (1960); *Mills v. Comm'r*, 30 T.C. 150, 154-55 (1958); *Montana-Dakota Util. Co. v. Comm'r*, 25 T.C. 408, 414-15 (1955); *Koppers Coal Co. v. Comm'r*, 6 T.C. 1209, 1218 (1946); *Spang, Chalfant & Co., Inc. v. Comm'r*, 31 B.T.A. 721, 723 (1934); *Warner Co. v. Comm'r*, 26 B.T.A. 1225, 1228 (1932).

43. *See, e.g.*, *Suter v. Comm'r*, 29 T.C. 244 (1957), *acq.* 1958-2 C.B. 8; and *Montana-Dakota Util. Co.*, 25 T.C. at 414.

3. *Section 334(b)(2) of the 1954 Code*

a. *Enactment of Section 334(b)(2)*

Application of the KD Doctrine was based upon an analysis of the intent of the purchaser: i.e., whether the purchaser intended to acquire a target corporation's assets all along.⁴⁴ Such a standard, of course, involves significant subjectivity. In an attempt to bring more objectivity and certainty to the tax treatment of stock purchases followed by liquidations,⁴⁵ the House of Representatives, in 1954, proposed a new provision in the tax code by which "the principle of *Kimbell-Diamond Milling Co.* . . . is effectuated."⁴⁶ As explained by the House report, it provided that "a shareholder will in general be permitted to receive the purchase price for his stock as his basis for the assets distributed to him in liquidation irrespective of the assets' cost to the corporation."⁴⁷ The Senate, while agreeing that such language would effectuate the principle of *Kimbell-Diamond*, cut back on the statutory language proposed in the House, noting that since the application of the KD Doctrine "is primarily in the area of liquidations by a parent corporation of its subsidiary, the rule has been limited . . . to liquidations of this type."⁴⁸ Thus, 1954 Code section 334(b)(2) as enacted generally provided an exception to carryover basis treatment for property received by a parent acquiring corporation from a subsidiary in "complete liquidation."⁴⁹ The exception provided that, under certain conditions, a corporation liquidating a recently purchased subsidiary may use the cost of the purchased stock (adjusted by regulations) as the basis of the acquired assets, if at least eighty percent of the target corporation stock was acquired by purchase

44. See *Kimbell-Diamond Milling, Co. v. Comm'r*, 14 T.C. 74, 80 (1950).

45. See Michael W. Dolan, *Kimbell-Diamond, Chrome Plate, and Taxpayer Intent in the Liquidation of Subsidiaries: Should Congress Reexamine Section 334(b)(2)?*, 8 J. CORP. TAX'N 281, 286-87 (1982) (citing American Law Institute's draft "Federal Income Tax Statute" that noted the uncertainty in the application of the rule of *Kimbell-Diamond*, and suggested that all liquidations be eligible for a basis marked by either the cost of the assets or the cost of the stock).

46. H.R. REP. NO. 83-1337 (1954), *reprinted in* 1954 U.S.C.C.A.N. 4017, 4063.

47. *Id.*

48. S. REP. NO. 83-1622, at 48 (1954), *reprinted in* 1954 U.S.C.C.A.N. 4621, 4679.

49. I.R.C. § 334(b)(2) (1954) (amended 1982 & 1988) (original at Internal Revenue Code of 1954, ch. 736, 68A Stat. 104 (1954)).

within a twelve-month period.⁵⁰

b. *Treatment of the Liquidation: Pittsburgh Realty*

The remedy provided by 1954 Code section 334(b)(2) did not ignore the liquidation event, as was often the case in the application of the KD Doctrine, but simply provided a different mechanism for determining the basis in assets acquired pursuant to such liquidation. This point was illustrated well in 1976 when the Tax Court decided a case that involved many “typical” *Kimbell-Diamond* facts. In *Pittsburgh Realty Investment Trust v. Commissioner*,⁵¹ a realty trust that qualified as a “real estate investment trust” (“REIT”) under section 856,⁵² sought to acquire certain real estate assets of a target corporation.⁵³ Although the initial negotiations conducted by representatives of the trust with the sellers were with a view toward the direct purchase of the assets, the seller later insisted, upon advice of counsel, that the transaction take the form of a stock sale; they believed this structure would avoid the imposition of state real estate transfer taxes.⁵⁴ On the purchasing side, however, representatives of the trust were concerned about the effect such a sale structure would have upon the trust’s continued qualification as a REIT.⁵⁵ The acquiring trust thus applied for a private ruling from the Service that the trust’s qualification as a REIT would not be adversely affected by the acquisition of the target corporation, which would “be immediately followed by the liquidation of . . . [the target] pursuant to Section 332”⁵⁶ An additional ruling requested was that, pursuant to

50. See, e.g., *Broadview Lumber Co., Inc. v. United States*, 561 F.2d 698, 714 (7th Cir. 1977) (explaining stock was not acquired by purchase since it was acquired from a related party; purchaser ineligible for 1954 Code section 334(b)(2) treatment).

51. 67 T.C. 260 (1976).

52. A REIT is defined to mean a “corporation, trust or association” that, among other things, would otherwise be taxable as a domestic corporation. See I.R.C. § 856(a), (a)(3) (West Supp. 2001).

53. *Pittsburgh Realty Inv. Trust*, 67 T.C. at 263.

54. *Id.*

55. *Id.* at 266. Under the rules in place at that time, at the end of each quarter, not more than twenty-five percent of a REIT’s total assets could be represented by securities. Apparently, the value of the stock of the target corporation (which would be considered “securities” for this purpose) would be large enough such that the trust’s securities holdings would be in excess of twenty-five percent of its total assets. See generally I.R.C. § 856(c)(4) (West Supp. 2001).

56. *Pittsburgh Realty Inv. Trust*, 67 T.C. at 266.

section 336 of the 1954 Code, “no gain or loss will result to the subsidiary . . . upon the disposition of its assets in complete liquidation.”⁵⁷

The Service issued a ruling that essentially granted the trust’s request as to its REIT qualification.⁵⁸ One of the additional rulings stated that “[p]ursuant to section 336 of the Code, no gain or loss will be recognized to [the target corporation] upon the distribution of its property to [the trust] (*except as provided in sections 47, 453(d), 1245 and 1250 of the Code*).”⁵⁹ In addition, another ruling stated that “[p]ursuant to section 334(b)(2), the basis of the property of [the target corporation] received by [the trust] will be the adjusted basis of the shares of [the target corporation] Common with respect to which the distribution is made.”⁶⁰ Around this time, the target corporation was liquidated as planned.⁶¹

In litigation, the government asserted that the acquiring trust was the transferee of the target corporation and that the target corporation was liable for depreciation recapture gains from the disposition of depreciable property under section 1245 and on depreciable real property under section 1250.⁶² The acquiring trust did not challenge the existence of the tax liability, but claimed it could not be called upon to pay the liability, apparently believing the income tax liability should be borne by the selling shareholders.⁶³ The trust asserted that, under the KD Doctrine, the substance of the transaction was a purchase of assets.⁶⁴ The court disagreed, stating that the taxpayer’s attempt to re-characterize the transaction was precluded by the *Danielson* rule, the law of the circuit to which an appeal would be taken.⁶⁵ Thus, absent a showing of fraud, mistake, or the like, the taxpayer was bound by the form of the transaction it had chosen.⁶⁶ Moreover, the court

57. *Id.* at 267.

58. *Id.* at 268.

59. *Id.* (emphasis added).

60. *Id.*

61. *Id.* at 269.

62. *Id.* at 271.

63. *Id.* at 269.

64. *Id.* at 273-74.

65. *Comm’r v. Danielson*, 378 F.2d 771, 775 (3d Cir. 1967) (explaining that a party can challenge the tax consequences of his agreement as construed by the Service only by adducing proof which in an action between the parties to the agreement would be admissible to alter that construction or to show its unenforceability because of mistake, undue influence, fraud, duress, etc.).

66. *Pittsburgh Realty Inv. Trust*, 67 T.C. at 274.

stated that neither *Kimbell-Diamond* nor its statutory counterpart (section 334(b)(2)) “warrants re-characterization of the transaction for other than basis purposes. Quite simply, the fact that the transaction may be viewed in the basis context as a single-step asset purchase in no way vitiates the transfer element for purposes of section 6901 [the transferee liability provision].”⁶⁷ The court noted that the section 334(b)(2) exception does not dispense with the fact that a liquidation has taken place.⁶⁸

c. Scope of Section 334(b)(2)

Pittsburgh Realty illustrates one reason why section 334(b)(2) of the 1954 Code was not as popular with taxpayers as the original KD Doctrine. While former section 334(b)(2) generally provided a basis step-up in the target corporation assets equal to the cost of the stock, it did so in the context of a liquidation that was otherwise given effect for federal income tax purposes; and, as such, the depreciation recapture rules would override the general non-recognition rules of former section 336.⁶⁹ To be sure, former section 334(b)(2) represented a more mechanical, and objective, means of obtaining a stepped-up basis in a purchased corporation’s assets, rather than relying on such vagaries as intent.⁷⁰ However, courts and practitioners disagreed on whether it was the exclusive means for a corporate purchaser to obtain a stepped-up basis in a purchased corporation’s assets or whether the KD Doctrine continued to remain viable in some contexts.⁷¹

Would, for example, the KD Doctrine apply if a corporate purchaser took more than twelve months to complete its qualifying purchase? In *American Potash & Chemical Corp. v. United States*,⁷² the purchaser took fourteen months to effect its acquisition of the target corporation.⁷³ Although not specifically applying the KD Doctrine (it returned the case to the trial commissioner,) the Court of Claims stated that 1954 Code section 334(b)(2) was a safe

67. *Id.* at 276.

68. *Id.* (citing *Cabax Mills v. Comm’r*, 59 T.C. 401, 409 (1972)).

69. *See* I.R.C. § 336 (1954).

70. *See* Tech. Adv. Mem. 92-45-004 (Jul. 28, 1992) (stating section 334(b)(2) of the 1954 Code improved upon the KD Doctrine “because it provided predictable results”).

71. *See* Dolan, *supra* note 45, at 289 (discussing the reactions to the enactment of 334(b)(2)).

72. 399 F.2d 194 (Ct. Cl. 1968).

73. *Id.* at 197.

harbor provision, and not a preemption of the KD Doctrine.⁷⁴ According to the Court of Claims, “the principle of section 334(b)(2) is *derived* from the broader, more general rule of *Kimbell-Diamond*,” and it is a precise, narrow and objective application of the broader doctrine.⁷⁵ Reviewing the legislative history of the provision, the Court of Claims also reasoned that:

[W]e cannot conclude that Congress intended to differentiate between corporate and individual taxpayers and permit the use of the judicial *Kimbell-Diamond* doctrine by an individual who has acquired stock during a period in excess of twelve months, and to deny its application to a corporate taxpayer under the same circumstances.⁷⁶

Other courts, such as the Fifth Circuit Court of Appeals in 1980, entertained less doubt on the matter. “[W]e hold definitively and absolutely that the *Kimbell-Diamond* doctrine is extinct under the 1954 code regarding corporate taxpayers.”⁷⁷

4. *Preemption/Codification in Section 338*

The operation of former section 334(b)(2) was unsatisfactory in many respects. For example, it mandated the liquidation of the purchased corporation to qualify for the asset basis step-up.⁷⁸ It provided a series of complex adjustments, which were subject to manipulation, for the period between a purchase and a liquidation.⁷⁹ In part to combat the complexity of section 334(b)(2), Congress repealed it in 1982 and enacted a new provision “intended to replace any non-statutory treatment of a

74. *Id.* at 198.

75. *Id.* at 208.

76. *Id.*

77. *In re Chrome Plate, Inc.*, 614 F.2d 990, 1000 (5th Cir. 1980); *see also* *Broadview Lumber Co. v. United States*, 561 F.2d 698, 711-12 (7th Cir. 1977) (reversing the district court, the court found that Congress preempted the application of the KD Doctrine to corporate purchasers in the enactment of former section 334(b)(2)).

78. I.R.C. § 334(b)(2) (1954); *see* *N.Y. Fruit Auction Corp. v. Comm’r*, 79 T.C. 564, 569-70 (1982) (stating neither former section 334(b)(2) nor the KD Doctrine is applicable where purchasing corporation merged *downstream* into acquired target corporation).

79. *See* BORIS I. BITTKER & JAMES S. EUSTICE, *FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS* ¶ 11.45 (4th ed. 1979) (discussing the KD Doctrine, section 334(b)(2) and the adoption of section 338).

stock purchase as an asset purchase under the *Kimbell-Diamond* doctrine.”⁸⁰

Section 338 is similar to former section 334(b)(2) in that it provides a means for a purchasing corporation to obtain a step-up in the basis of target corporation’s assets when the target corporation is acquired pursuant to a qualifying purchase. Unlike former section 334(b)(2), however, the mechanism provided under section 338 is elective at the option of the purchaser, or is made jointly by the purchasing corporation and the seller in certain qualifying transactions.⁸¹

Under section 338, a target corporation must be acquired in a “qualified stock purchase,” which generally means the acquisition of at least eighty percent of the outstanding stock of the target corporation in a purchase transaction.⁸² Only a corporation can make a qualified stock purchase; other non-corporate purchasers are ineligible.⁸³ A purchasing corporation generally has up to nine-and-a-half months to elect stepped-up basis treatment for the target corporation’s assets, following its acquisition.⁸⁴ If it makes the election, a “new” target corporation is deemed to purchase all the target corporation assets from an unrelated party. The “old” target corporation is deemed to sell all of its assets to an unrelated buyer. The cost of this step up, of course, is tax on the deemed sale, which

80. H.R. CONF. REP. No. 97-760, at 536 (1982).

81. I.R.C. § 338(h)(10) (CCH 2001); Treas. Reg. § 1.338(h)(10)-1 (as amended in 2001).

82. A qualified stock purchase means any transaction or series of transactions in which stock (meeting the requirements of section 1504(a)(2)) of one corporation is acquired by another corporation by purchase during the twelve-month acquisition period. I.R.C. § 338(d)(3) (CCH 2001). A purchase:

[M]eans any acquisition of stock, but only if (i) the basis of the stock in the hands of the purchasing corporation is not determined (I) in whole or in part by reference to the adjusted basis of such stock in the hands of the person from whom acquired, or (II) under section 1014(a) (relating to property acquired from a decedent), (ii) the stock is not acquired in an exchange to which section 351, 354, 355, or 356 applies and is not acquired in any other transaction described in regulations in which the transferor does not recognize the entire amount of the gain or loss realized on the transaction, and (iii) the stock is not acquired from a person the ownership of whose stock would, under section 318(a) (other than paragraph (4) thereof), be attributed to the person acquiring such stock.

I.R.C. § 338(h)(3) (CCH 2001). In short, a purchase generally entails an acquisition of stock from an unrelated person in a taxable transaction. *Id.*

83. Treas. Reg. § 1.338-3(b)(1) (2001).

84. Treas. Reg. § 1.338-2(d) (2001).

the buyer generally inherits when it acquires the target corporation.⁸⁵ However, the availability of the election does not hinge upon the liquidation of the target corporation; the purchasing corporation may decide to keep the target corporation in existence indefinitely.⁸⁶

5. *Revenue Ruling 90-95*

In 1990, the Service issued Revenue Ruling 90-95,⁸⁷ which squarely addressed the corporate KD Doctrine. Revenue Ruling 90-95 addresses two different factual situations. In the first situation, the Service ruled that if an acquiring corporation organizes a subsidiary solely for the purpose of acquiring the stock of a target corporation in a reverse subsidiary cash merger,⁸⁸ the acquiring corporation is treated as having acquired the stock of the target in a qualified stock purchase under section 338 of the Code.

The other factual situation involves a classic *Kimbell-Diamond* transaction, in which an acquiring corporation acquires all of the stock of a target corporation (again, by means of a reverse cash merger as in the first situation) and immediately liquidates the target corporation as part of an integrated plan to acquire the target corporation's assets, which was partly motivated by a state law that prohibited the acquiring corporation from owning the stock of the target corporation.⁸⁹

Addressing this second factual situation, the Service held that the acquiring corporation is treated as having acquired the stock in a qualified stock purchase under section 338, rather than having

85. This is generally true for a "regular" section 338(g) election. However, when the purchasing corporation makes a joint election under section 338(h)(10) with the selling consolidated group, selling affiliate, or S corporation shareholders, the deemed sale tax consequences are generally borne by the sellers. See Treas. Reg. § 1.338-10(a) (2001); Treas. Reg. § 1.338(h)(10)-1(d)(3) (2001).

86. See Treas. Reg. § 1.338-3(c) (2001) (discussing the effect of post-acquisition events).

87. Rev. Rul. 90-95, 1990-2 C.B. 67 (1990).

88. A reverse subsidiary cash merger is a means by which one corporation can acquire another corporation in a taxable transaction. Typically, it involves the formation of a wholly-owned subsidiary, which then merges into the target corporation, with the target corporation surviving and the target corporation shareholders receiving consideration comprised exclusively or mostly of cash or something other than stock. The merger subsidiary's life is brief and it is often treated as transitory for federal income tax purposes, as it was in Revenue Ruling 90-95. *Id.*

89. *Id.*

made an acquisition of assets pursuant to the KD Doctrine.⁹⁰ The Service states that, under section 338, asset purchase treatment turns on whether a section 338 election is made (or is deemed made) following a qualified stock purchase of target stock and not on whether the target's assets are acquired through a prompt liquidation of the target. The ruling does not address non-corporate purchasers.⁹¹

Revenue Ruling 90-95 is therefore consistent with Congress' intent to afford wide discretion to corporations to either make a section 338(g) election and obtain a cost basis in a target's assets or not make a section 338(g) election and obtain a carryover basis in target's assets.⁹² In this context, however, intent to obtain a cost basis may only be manifested through an election under section 338.

6. *Revenue Ruling 2001-46*

Revenue Ruling 2001-46 recently distinguished Revenue Ruling 90-95.⁹³ In Revenue Ruling 2001-46, the Service again presented two factual situations. In the first situation, pursuant to an integrated plan, an acquiring corporation acquires all of the stock of a target corporation in a statutory merger of a newly formed merger subsidiary of the acquiring corporation into the target corporation (the "Acquisition Merger").⁹⁴ The shareholders of target exchange their target stock for a consideration mix of seventy percent acquiring corporation voting stock and thirty percent cash.⁹⁵ As part of the same plan, target merges upstream into the acquiring corporation in a statutory merger (the "Upstream Merger.")⁹⁶

The ruling assumes that, absent some prohibition against application of the step transaction doctrine, the Acquisition Merger and Upstream Merger would be treated as a single integrated acquisition by the acquiring corporation of all of the target corporation assets, as though the target corporation merged directly into the acquiring corporation. Thus, the Acquisition

90. *Id.*

91. *Id.*

92. *Id.*

93. Rev. Rul. 2001-46, 2001-42 I.R.B. 1 (Sept. 24, 2001).

94. *Id.*

95. *Id.*

96. *Id.*

Merger is effectively ignored, and the two steps are treated as a single statutory merger of the target corporation into the acquiring corporation in a transaction that qualifies as a reorganization under section 368(a)(1)(A).

This approach is similar to that taken in Revenue Ruling 67-274, where the acquiring corporation acquires all of the stock of the target corporation solely in exchange for acquiring corporation voting stock and, thereafter, target corporation completely liquidates into acquiring corporation.⁹⁷ That ruling holds that because the two steps are parts of a plan of reorganization, they cannot be considered independently of each other.⁹⁸ Thus, the steps do not qualify as a reorganization under section 368(a)(1)(B) followed by a liquidation under section 332, but instead qualify as a single acquisition of the target's assets in a reorganization under section 368(a)(1)(C).⁹⁹

Thus, Revenue Ruling 2001-46 distinguishes the second situation of Revenue Ruling 90-95.¹⁰⁰ Despite the fact that the Acquisition Merger, standing alone, would otherwise be treated as a qualified stock purchase under section 338(d)(3), Revenue Ruling 2001-46 holds that, given the effect of the second step (the Upstream Merger) and the fact that the acquiring corporation would have a carryover basis in the target corporation assets when the two steps are integrated, "a section 338 election may not be made in such a situation."¹⁰¹

The Service explains that Revenue Ruling 90-95 rejects the approach reflected in Revenue Ruling 67-274 where the application of that approach would treat the purchase of a target corporation's stock without a Section 338 election, followed by the liquidation or merger of the target corporation, as the purchase of the target corporation's assets resulting in a cost basis in the assets under Section 1012.¹⁰² According to the Service, such an approach would be contrary to congressional intent that Section 338 "replaces any nonstatutory treatment of a stock purchase as an asset purchase under the *Kimbell-Diamond* doctrine."¹⁰³

97. See Rev. Rul. 67-274, 1967-2 C.B. 141 (1967) (defining corporate reorganization).

98. *Id.*

99. *Id.*

100. Rev. Rul. 2001-46, 2001-42 I.R.B. 1 (Sept. 24, 2001).

101. *Id.*

102. *Id.*

103. *Id.*

In contrast, according to the Service, the policy underlying section 338 is not violated by treating the first situation of Rev. Rul. 2001-46 as a single statutory merger of the target corporation into the acquiring corporation, because such treatment results in a transaction that qualifies as a reorganization under section 368(a)(1)(A) in which the acquiring corporation acquires the assets of the target corporation with a carryover basis under section 362 and does not result in a cost basis for those assets under Section 1012.¹⁰⁴

B. The Non-corporate Kimbell-Diamond Doctrine

The enactment of 1954 Code section 334(b)(2) and the subsequent enactment of section 338 have served to heighten the distinction between corporate purchasers and non-corporate purchasers in the application of the KD Doctrine. Unlike corporate purchasers, the KD Doctrine as applied to non-corporate purchasers was never the subject of explicit statutory focus.

1. Cullen

One of the first cases to affirm the KD Doctrine's application to individuals was *Cullen v. Commissioner*, decided by the Tax Court in the same year as *Kimbell-Diamond*.¹⁰⁵ In *Cullen*, Mr. Cullen held twenty-five percent of the stock of a corporation that bore his name and which was engaged in the business of manufacturing and selling orthopedic appliances.¹⁰⁶ He acquired the remaining seventy-five percent of the shares by buying out the other shareholders and liquidated the corporation on the same day in which he acquired all of the remaining shares.¹⁰⁷

Mr. Cullen claimed a short-term capital loss with respect to the liquidation of the seventy-five percent interest that had been acquired through the buyout, based upon the book value of the distributed tangible assets.¹⁰⁸ The Tax Court held that loss treatment was not warranted, concluding that the taxpayer had, after liquidation of the corporation, everything he paid for when

104. *Id.*

105. 14 T.C. 368 (1950), *acq.* 1950-2 C.B. 1.

106. *Id.* at 368-69.

107. *Id.* at 371.

108. *Id.*

he bought all the corporation's stock.¹⁰⁹ Citing *Kimbell-Diamond*, the Tax Court noted that the taxpayer's purpose "was not to buy the stock as such . . . [but rather] to liquidate the corporation so that he could operate the business as a sole proprietorship. The several steps employed in carrying out that purpose must be regarded as a single transaction for tax purposes."¹¹⁰ Thus, Mr. Cullen was treated as purchasing seventy-five percent of the corporation's assets directly, rather than receiving them as a result of a liquidating distribution. In contrast, the Tax Court sustained a determination that liquidating proceeds received with respect to the twenty-five percent "old and cold" interest should be treated as long-term capital gain arising from the exchange of stock.¹¹¹

The court did not challenge the valuation of the tangible assets ascribed by Mr. Cullen, but rather treated the assets (at least seventy-five percent of them) as acquired directly.¹¹² Thus, Mr. Cullen got what he paid for, and did not suffer a loss as to seventy-five percent of the assets. The court thus apparently adopted a bifurcated view of the liquidation, in which it was respected as to the "old and cold" twenty-five percent interest, but disregarded as to the remaining interest.

2. *Snively*

Three years after *Cullen*, the Tax Court spoke approvingly of the application of the KD Doctrine to a situation where an individual taxpayer purchased all of the stock of a corporation and caused the corporation to liquidate within six months of the purchase, where the individual's "intention right along was to dissolve" the target corporation.¹¹³ The Tax Court rejected the government's contention that the separate existence of the corporation for a six-month period should be respected (apparently the purchase and liquidation occurred within the same taxable year as the individual taxpayer) and instead treated the transaction as a unified asset acquisition.¹¹⁴

109. *Id.* at 372-73.

110. *Id.* at 373 (citing *Kimbell-Diamond Milling Co. v. Comm'r*, 14 T.C. 74 (1950)).

111. *Id.* at 373. The Tax Court disallowed the IRS's attempt, however, to increase the amount of capital gain by attempting to add intangible assets to the proceeds received by the taxpayer. *Id.*

112. *Id.*

113. *Snively v. Comm'r*, 19 T.C. 850, 859 (1953), *acq.* 1956-2 C.B. 8.

114. *Id.* at 858.

The case of *Snively v. Commissioner*¹¹⁵ involved the purchase by the individual taxpayer of all of the stock of Meloso, a corporation which owned and operated a citrus grove.¹¹⁶ The individual taxpayer, Mr. Snively, was advised by his attorney and accountant to liquidate the corporation upon its purchase.¹¹⁷ The stock of Meloso was delivered by the seller to an escrow agent in July of 1943.¹¹⁸ The agent, which was also a bank, held the certificates as collateral for a loan, which was repaid in October 1943, at which time Mr. Snively received the stock certificates.¹¹⁹ Although the liquidation of the Meloso stock was originally intended to take place in July, 1943, it was not formally dissolved until December 31, 1943.¹²⁰ One of the issues before the Tax Court was whether income earned during the fall of 1943 should have been reported on Mr. Snively's return or the corporation's.¹²¹ The Tax Court held that the income earned during this period belonged to the corporation. While the court agreed with Mr. Snively that he should be treated as directly acquiring the assets of Meloso, the court disagreed with his assertion that such treatment effectively prevented Meloso from earning, receiving or being taxed on income following the date of the stock purchase in July, 1943.¹²² 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.¹²³

Thus, while Meloso earned income during the fall of 1943, the court nevertheless held that the formal liquidation of the corporation on December 31, 1943 would be ignored for federal income tax purposes and Mr. Snively would be instead treated as directly purchasing assets.¹²⁴ The court stated that the income

115. 19 T.C. 850 (1953).

116. *Id.*

117. *Id.* at 851.

118. *Id.*

119. *Id.* at 852.

120. *Id.* at 853.

121. *Id.* at 850.

122. *Id.* at 858.

123. *Id.*

124. *Id.* Mr. Snively reported taxable gain with respect to the liquidation of Meloso on his 1943 return. In the ensuing litigation, he claimed that position was

earned by Meloso during the fall of 1943 should be reported on Meloso's return.¹²⁵

Originally, Mr. Snively reported long-term capital gain upon the liquidation of Meloso.¹²⁶ Before the court, he argued this treatment was in error and the stock purchase and liquidation should be "taken as a single transaction,"¹²⁷ citing *Ashland Oil & Refining Co.*¹²⁸ The Tax Court found this assertion "well taken,"¹²⁹ noting that in *Ashland Oil & Refining Co.* "no taxable gain was realized on the liquidation."¹³⁰

3. *Suter*

*Estate of Suter v. Commissioner*¹³¹ is another case applying the KD Doctrine to individuals who had reported short-term capital gain on their individual returns with respect to the liquidation of a recently acquired target corporation named Rondout.¹³² In *Suter*, three individuals desired to purchase a paper mill that operated in corporate solution.¹³³ The seller, advised by tax attorneys, refused to allow the corporation to sell the assets directly but agreed to sell the stock.¹³⁴ Approximately a month after the purchasers received the stock, they voted to sell Rondout, thus causing its liquidation.¹³⁵ Within a few days of the formal liquidation of Rondout, a new corporation with the same name was formed ("New" Rondout).¹³⁶

New Rondout was initially capitalized with relatively small amounts of cash contributed by each of the individuals in exchange for stock of New Rondout.¹³⁷ These individuals then "sold" the assets they had received in liquidation of "Old" Rondout to New Rondout.¹³⁸ Consideration for the latter consisted primarily of the

in error. *Id.* at 859 (citing *Comm'r v. Ashland Oil & Ref. Co.*, 99 F.2d 588 (6th Cir. 1938)).

125. *Id.* at 859.

126. *Id.* at 856.

127. *Id.* at 859.

128. *See supra* text accompanying notes 37-41.

129. *Snively*, 19 T.C. at 859.

130. *Id.*

131. 29 T.C. 244 (1957), *acq.* 1958-2 C.B. 8.

132. *Id.*

133. *Id.* at 247.

134. *Id.* at 247-48.

135. *Id.* at 250.

136. *Id.* at 251.

137. *Id.*

138. *Id.*

assumption by New Rondout of the purchase money indebtedness issued by the individuals in their purchase of the Old Rondout stock.

The Service asserted that the transaction was a tax-free reorganization and that the individual purchasers received a dividend to the extent of current and accumulated earnings and profits of the old target corporation and the new target corporation.¹³⁹ The Service argued that the new corporation thus had a carryover basis in the assets acquired from the old target corporation.

The Tax Court disagreed with the reorganization assertion, since the shareholders of New Rondout were not the same shareholders as those of Old Rondout, and found that the new target corporation took a basis of \$500,000 in the assets it received by way of the individual purchasers, which was the price they had paid for the stock.¹⁴⁰ Interestingly, the Tax Court viewed New Rondout as the purchaser of the assets of Old Rondout.

4. *Mattison*

The Service successfully invoked the KD Doctrine in *United States v. Mattison*.¹⁴¹ Here, Continental Oil Company negotiated to buy Westcott Oil Company, but the negotiations were not consummated because of a disagreement over price.¹⁴² Mr. Mattison, a Westcott shareholder, then obtained an offer from Continental to buy the operating assets of Westcott.¹⁴³ Mattison purchased the remainder of the stock in Westcott and caused the corporation to distribute its operating assets in partial liquidation, which he reconveyed to a subsidiary of Continental, in exchange for cash.¹⁴⁴ Mattison received the remaining assets within the next year and reported capital gains totaling approximately \$123,000 with respect to both taxable years as a result of the liquidation.¹⁴⁵

The Service appealed from a district court ruling that respected the liquidation.¹⁴⁶ On appeal, the Service asserted the

139. *Id.* at 260.

140. *Id.* at 258-60.

141. *United States v. Mattison*, 273 F.2d 13 (9th Cir. 1959).

142. *Id.* at 15.

143. *Id.*

144. *Id.* at 15-16.

145. *Id.* at 16.

146. *Mattison v. United States*, 163 F.Supp. 754 (D. Idaho 1958).

KD Doctrine, arguing that Mattison had purchased the assets from Westcott which he subsequently sold to Continental.¹⁴⁷ The Service asserted that the lump sum purchase price should be allocated across all of the assets and that the cash should have a basis equal to its value.¹⁴⁸ Viewed this way, certain non-liquid assets had a lower basis in Mattison's hands, resulting in a greater taxable gain to Mattison upon the subsequent asset sale to Continental than was treated as gain realized in liquidation.

The Ninth Circuit, noting the liquidation treatment used by Mattison, stated:

There is, however, an established exception to the rule giving effect to liquidating distributions, which is known as the *Kimbell-Diamond* rule. Under this doctrine, when a taxpayer who is interested primarily in a corporation's assets first purchases the stock and then liquidates the corporation in order to acquire the desired assets, the separate steps taken to accomplish the primary objective will be treated as a single transaction.¹⁴⁹

The appellate court thus agreed with the Service that the KD Doctrine applied and that Mattison should be treated as having purchased the assets from Westcott, with no significance given to the formal liquidation of Westcott.¹⁵⁰

5. *Griswold*

In *Griswold v. Commissioner*,¹⁵¹ the Fifth Circuit decided the KD Doctrine's applicability to a case involving two individual purchasers, who, upon advice of their accountant, sought to obtain a stepped-up basis in the assets of a target corporation by invocation of the KD Doctrine.¹⁵² The individual purchasers, majority shareholders in cigarette vending machine companies, acquired the stock of Independent Cigarette Service, Inc. ("Independent") for cash and notes, as the sellers of Independent would not sell the assets directly.¹⁵³ The notes were put into escrow,

147. *Id.*

148. *Id.* at 757.

149. *United States v. Mattison*, 273 F.2d 13, 17 (9th Cir. 1959).

150. *Id.* at 18.

151. *Griswold v. Comm'r*, 400 F.2d 427 (5th Cir. 1968).

152. *Id.*

153. *Id.* at 431.

along with the stock of Independent as collateral.¹⁵⁴ However, under the terms of the purchase agreement, the corporate existence of Independent was to be maintained at all times.¹⁵⁵ Although Independent was actually liquidated about nine months after the purchase, the government claimed that the KD Doctrine did not apply because the purchase agreement itself expressly provided that Independent was to retain its corporate identity.¹⁵⁶ The Tax Court agreed with this argument.¹⁵⁷

On appeal, the Fifth Circuit concurred.¹⁵⁸ It rejected the taxpayers' argument that they had instructed their attorney, when he was drafting the purchase agreement, that they wished to liquidate the corporation, and that the court should thus recognize the "intent" of the taxpayers.¹⁵⁹ The appellate court stated that while evidence of a single, integrated transaction may be shown from circumstances other than formal agreements, it did not believe the contents of such agreements could simply be ignored.¹⁶⁰ Accordingly, it accepted the Tax Court's finding that the taxpayers did not engage in or consummate a single, integrated transaction to acquire the assets of Independent.¹⁶¹ Since the assets were reincorporated into a new corporation, the Fifth Circuit concluded that the overall transaction was a tax-free reorganization under section 368(a)(1)(D) and (F).¹⁶²

6. Other Rulings

The KD Doctrine became commonplace, even with regard to non-corporate purchasers. Thus, in *Fox & Hounds, Inc. v. Commissioner*,¹⁶³ there was no dispute that the KD Doctrine applied, where individual purchasers acquired all of the stock of a target corporation and then promptly liquidated the corporation, with

154. *Id.* at 428.

155. *Id.*

156. *Id.* at 435.

157. *Griswold v. Comm'r*, 45 T.C. 463, 473-74 (1966).

158. *Griswold*, 400 F.2d at 431-32.

159. *Id.* at 432.

160. *Id.*

161. *Id.*

162. *Id.* See generally Brian B. Gibney, *Liquidation-Reincorporation and Fictional Stock in Related Corporation Asset Transfers*, 81 J. TAX'N 144 (1994) (discussing various tax consequences that attend the liquidation of a subsidiary and reincorporation of the assets into a newly-formed corporation).

163. *Fox & Hounds, Inc. v. Comm'r*, 21 T.C.M. (CCH) 1216 (1962).

their intent evidenced in the purchase agreement.¹⁶⁴ The issue in *Fox & Hounds* went simply to the allocation of costs (basis) and whether the purchasers were required to shift the allocation of the purchase price from depreciable assets to goodwill, for which no amortization deductions were generally available at that time.¹⁶⁵ In addition, while other courts wrestled with whether the corporate KD Doctrine had been completely preempted by 1954 Code section 334(b)(2), there was very little, if any, debate about the viability of the non-corporate KD Doctrine.¹⁶⁶ Nevertheless, the courts continued to insist upon the requisite elements: as in *Griswold*, the individual purchasers must acquire their target corporation stock for the sole purpose of liquidating the target corporation in order to reach its assets.¹⁶⁷

The non-corporate KD Doctrine was to be found in rulings from the Service, as well. In Revenue Ruling 69-242,¹⁶⁸ the individual taxpayer, as a result of a public condemnation of his real estate, desired to acquire certain other real estate to qualify for a tax-free exchange under the rule of then-existing section 1033.¹⁶⁹ The desired property was an asset of a corporation. While the corporation would not sell the asset directly to the taxpayer, it did offer to sell its stock. Pursuant to a prearranged plan, the taxpayer purchased the stock and promptly liquidated the corporation. If the taxpayer were treated as purchasing stock, he would recognize a certain amount of gain under section 1033; however, if the taxpayer were treated as purchasing assets, he would recognize no gain. Citing *Suter* and *Cullen*, the ruling notes that:

164. *Id.*

165. *Id.* Cf. I.R.C. § 197 (CCH 2001) (providing a fifteen-year amortization period for goodwill and enacted in 1993). Statements of the pre-section 197 status of goodwill still exist in regulations. *Id.* See Treas. Reg. § 1.167(a)-3 (2000) (“No deduction for depreciation is allowable with respect to goodwill.”).

166. See, e.g., *Am. Potash & Chem. Corp. v. United States*, 399 F.2d 194 (Ct. Cl. 1968) (“The Kimbell-Diamond doctrine, without question, remains viable for individual taxpayers because section 334(b)(2) is applicable only to corporate taxpayers.”).

167. See *Lang v. Comm’r*, 43 T.C.M. (CCH) 874 (1982) (holding that KD Doctrine did not give individuals (or the newly formed corporation) an asset basis step-up, where target corporation was not liquidated until nearly three years after its purchase by individuals, followed by the prompt reincorporation of the assets into a newly formed corporation; tax-free reorganization rules applied).

168. Rev. Rul. 69-242, 1969-1 C.B. 200.

169. *Id.* Section 1033 still generally provides tax-free treatment for condemned property that is exchanged for qualified replacement property. I.R.C. § 1033 (2001).

In cases involving individuals who have acquired the stock of a corporation and then liquidated the newly acquired corporation pursuant to a prearranged plan, it has been held that no gain or loss was recognized on such liquidations on the theory that the transaction is in essence an acquisition of assets.¹⁷⁰

The Service concluded that the taxpayer purchased the assets since his purpose in acquiring the corporation's stock was to acquire its assets directly. No mention was made about the application of recapture provisions such as sections 1245 or 1250.¹⁷¹

Private rulings of the Service also affirmed the relevance of the non-corporate KD Doctrine. In one such ruling,¹⁷² the Service ruled that the purchase by a partnership ("Partnership I") of the stock of another corporation ("Corp I"), followed by the transfer of such stock to another partnership ("Partnership VII") would be treated as the purchase of assets of the corporation followed by the transfer of such assets to Partnership VII. In its ruling, the Service noted that "sufficient facts have been submitted which indicate that Partnership I intended to liquidate Corp I at the time of the stock purchase so as to acquire thereby the underlying assets of Corp I."¹⁷³ Thus, the ruling explicitly ignores the transfer by Partnership I of its stock interest in Corp I "because of the absence of any evident business purpose motivating such transfer."¹⁷⁴ However, from the seller's side, the Service stated that sale of the Corp I stock "will nevertheless be respected as such."¹⁷⁵

In another ruling issued about a year later,¹⁷⁶ the Service ruled that the purchase of all of the stock of Target corporation followed by its planned merger into the Purchaser would be treated as a purchase of Target's assets, where the Purchaser was an "S"

170. Rev. Rul. 69-242, 1969-1 C.B. 200, 201 (citing *Estate of Suter v. Comm'r*, 29 T.C. 244 (1957); *Cullen v. Comm'r*, 14 T.C. 368 (1950)).

171. In this regard, the revenue ruling is similar to a private ruling issued in 1966, which reached a similar conclusion regarding the treatment of the stock acquisition and liquidation as an asset purchase for section 1033 purposes. See Priv. Ltr. Rul. 6610205770A (Oct. 20, 1966) (expressing no opinion as to the applicability of section 1250).

172. Priv. Ltr. Rul. 87-17-056 (Jan. 28, 1987). Although private letter rulings do not carry precedential status, they nonetheless reflect the Service's reasoning on a particular fact situation. See I.R.C. § 6110(k)(3) (CCH 2001).

173. Priv. Ltr. Rul. 87-17-056 (Jan. 28, 1987).

174. *Id.*

175. *Id.*

176. Priv. Ltr. Rul. 88-18-049 (May 6, 1988) *revoked by* Priv. Ltr. Rul. 93-23-024 (June 11, 1993).

corporation and was treated as an individual, and thus ineligible to make a qualified stock purchase under section 338.¹⁷⁷ The ruling cites Revenue Ruling 69-242 for this proposition.¹⁷⁸ In this private ruling, the Service also ruled that the shareholders of Target would be treated as having sold their shares of Target stock to Purchaser and will recognize gain or loss accordingly under section 1001. The Service ruled no gain or loss would be recognized by Target under section 336 because of the deemed asset sale.¹⁷⁹ It should be noted that this ruling was revoked in 1993, with no rationale given other than the earlier ruling “was in error.”¹⁸⁰

III. CURRENT STATE OF THE NON-CORPORATE KD DOCTRINE

A. *Scope of the Doctrine*

As illustrated above, the corporate KD Doctrine has been largely preempted by section 338.¹⁸¹ The non-corporate KD

177. During the years at issue, section 1371 provided that for “purposes of Subchapter C, an S corporation in its capacity as a shareholder of another corporation shall be treated as an individual.” I.R.C. § 1371(a)(2) (prior to repeal by Pub. L. No. 104-188, Aug. 20, 1996). Later rulings, however, allowed an S corporation to make a section 338 election. *See* Tech. Adv. Mem. 92-45-004 (Jul. 28, 1992).

178. Priv. Ltr. Rul. 88-18-049, *supra* note 176. The ruling also cites *In re Chrome Plate*, 614 F.2d 990, 1000 (5th Cir. 1980).

179. However, this arose in a pre-*General Utilities* repeal context. *See infra* notes 199-205 and accompanying text.

180. Priv. Ltr. Rul. 93-23-024 (June 11, 1993). One interpretation is that the Service simply changed its mind regarding the ability of an S corporation to make a qualified stock purchase. This was the position explicitly adopted in Technical Advice Memorandum 92-45-004 (S corporation can make a qualified stock purchase and an election under I.R.C. § 338). Tech. Adv. Mem. 92-45-004 (Nov. 6, 1992). *See* MARTIN GINSBURG & JACK LEVIN, *MERGERS, ACQUISITIONS & BUYOUTS* ¶ 1105.6.1 at 11-108 (June 2001 ed.) [hereinafter GINSBURG & LEVIN] (stating the Service’s initial determination in Private Letter Ruling 88-18-049 was “wildly wrong”).

181. However, this is not to suggest that no vestiges of the KD Doctrine remain for corporate purchasers. On one hand, and somewhat ironically, the KD Doctrine remains vibrant in the tax-free reorganization context. *See* Rev. Rul. 67-274, 1967-2 C.B. 141 (describing acquisition of all of the stock of a target corporation in exchange for acquiring corporation voting stock, followed by a prompt liquidation of the target, treated as a unitary stock-for-assets acquisition by the acquiring corporation and a tax-free reorganization under section 368(a)(1)(C)). The Service subsequently explained, in Revenue Ruling 74-35, that, although Revenue Ruling 67-274 “makes no reference to *Kimbell-Diamond*, the holding that the initial acquisition of stock is to be disregarded as transitory and that the transaction is to be treated as an acquisition of assets represents an

Doctrine, in contrast, has not been specifically preempted, and presumably remains a viable doctrine. However, as discussed below, depending upon the scope of the non-corporate KD Doctrine, certain factors may mitigate the practical effect of its viability.

One of the critical inquiries in assessing the practical effect of the continued viability of the non-corporate KD Doctrine is the extent to which the doctrine ignores or respects the liquidation event. On one hand, there are cases, such as *Pittsburgh Realty Investment Trust*, that suggest a more limited view of the doctrine's effect, in that it applies to ignore the liquidation for basis step-up purposes only, but that the liquidation event retains independent significance for other purposes (such as transferee liability, as in *Pittsburgh Realty Investment Trust*).¹⁸²

However, one must keep in mind that while former section 334(b)(2) was meant to effectuate the "principles" of *Kimbell-Diamond*,¹⁸³ it was not simply a wholesale codification of the KD Doctrine. Thus, rather than suggesting a narrow view of the KD Doctrine (one in which the unitary asset transaction exists for basis purposes only), the court in *Pittsburgh Realty Investment Trust* might be viewed as simply construing former section 334(b)(2), which always operated within the context of a corporate liquidation and by its terms required recapture and not the KD Doctrine as such (or at least the non-corporate KD Doctrine). If however, the

application of the *Kimbell-Diamond* principle." Rev. Rul. 74-35, 1974-1 C.B. 85. "Under that principle, whenever a corporation acquires all the stock of another corporation pursuant to a prearranged plan to liquidate that corporation in order to acquire its assets, the transaction is treated, as to the acquiring corporation, as an acquisition of assets." *Id.*

Consider also the situation where a corporation purchases for cash a large amount of stock (say, seventy percent) of a target corporation with the intent to acquire seventy percent of its assets. If the purchase does not constitute a qualified stock purchase within the meaning of section 338(d)(3) (and does not constitute a section 368 reorganization), could the purchasing corporation invoke the KD doctrine to treat its acquisition of the target corporation assets pursuant to a prompt liquidation of target as a direct purchase of the assets? See, e.g., Tech. Adv. Mem. 97-42-039 (Apr. 2, 1997) (explaining acquisition of target stock does not qualify for "purchase" treatment under section 338(h)(3) and apparently is not acquired in a tax-free reorganization either); see also Priv. Ltr. Rul. 2000-04-025 (Oct. 29, 1999) (describing that the acquisition of less than all of the stock of a target corporation, followed by its dissolution in which the acquiring corporation did not acquire all of the target's assets, will be treated as a direct transfer of assets that qualifies as a tax-free reorganization under section 368(a)(1)(D)).

182. See *supra* notes 51-68 and accompanying text.

183. See *supra* notes 45-50 and accompanying text.

Pittsburgh Realty Investment Trust view applies to the KD Doctrine generally (including the non-corporate KD Doctrine) then its continued viability may not have any more practical effect than following the current statutory regime governing liquidations. This is because, under the current liquidation provisions, property received by a non-corporate shareholder in a distribution in complete liquidation in which gain or loss is recognized takes as its basis the fair market value of the property at the time of the distribution.¹⁸⁴

This limited view of the doctrine (in which the liquidation event is respected for other purposes) may be seen in rulings from the Service. For example, in relatively recent private rulings, the Service has ruled that a two-step acquisition following the *Kimbell-Diamond* model may be viewed as a direct asset acquisition. In one ruling,¹⁸⁵ an acquiring corporation acquired all of the stock of a target corporation through a tax-free reverse triangular merger under section 368(a)(2)(E) (“Acquisition Merger,”) although “it was desired to have the businesses of the two corporation [*sic*] operated in a single corporation.”¹⁸⁶ For various reasons, it could not acquire the target corporation assets directly.¹⁸⁷ When these impediments are removed, however, it proposes to merge the target corporation “upstream” into the acquiring corporation (“Upstream Merger”), much as described in Revenue Ruling 2001-46. The Service rules that this two-step acquisition will be treated as though the acquiring corporation acquired the target assets directly, citing Revenue Ruling 67-274.

In addition, the Service also ruled that, for the period between the Acquisition Merger and the Upstream Merger, the target corporation “will be treated for tax purposes as remaining in existence” and will accordingly be included in the acquiring corporation’s consolidated return until the end of the date of the Upstream Merger.¹⁸⁸ Such a ruling affirms the principle that the

184. I.R.C. § 334(a) (CCH 2001).

185. Priv. Ltr. Rul. 1999-15-013 (Apr. 16, 1999).

186. *Id.*

187. Such reasons often involve complications with the assignability of valuable target corporation contacts, for example.

188. Priv. Ltr. Rul. 1999-15-013 (Apr. 6, 1999) (holdings 1, 4); *see also* Priv. Ltr. Rul. 98-40-004 (Oct. 2, 1998) (similar). These rulings reflect a reversal of an earlier position of the Service, in that the target corporation did not become a member of the acquiring corporation’s consolidated group during the period preceding the liquidation. *See* Tech. Adv. Mem. 88-37-003 (Sept. 16, 1988); *see also* ANDREW J. DUBROFF ET AL., FEDERAL INCOME TAXATION OF CORPORATIONS FILING

separate existence of a corporation, apart from its shareholders, is generally unquestioned¹⁸⁹ and forms the premise for the corporate liquidation provisions of the tax code.¹⁹⁰

On the other hand, there is a line of cases, such as *Mattison*, that clearly state from the purchaser's perspective the formal liquidation event is not a taxable event for federal income tax purposes¹⁹¹ and the purchaser is simply treated as acquiring assets directly from an unrelated seller.¹⁹² Revenue Ruling 69-242 might also be viewed as illustrative of this broader application of the KD Doctrine, in which the liquidation event is simply ignored. Recall that no mention was made of depreciation recapture in that ruling and the ruling held that the substance of the transaction was that the relevant property was directly acquired for federal income tax purposes.

As the example in the beginning of this Article illustrates, to the extent the non-corporate KD Doctrine is viewed in this broader fashion, it would have a significant practical effect, particularly where the aggregate basis of the assets "inside" the acquired target corporation is relatively low compared to the fair market value of the assets.

B. Factors Affecting Viability

It is clear that the basic corporate KD Doctrine¹⁹³ has been preempted by section 338 and the regulations thereunder.¹⁹⁴ Congress and the Service have reiterated that form controls where an acquiring corporation acquires all of the stock of Target in a

CONSOLIDATED RETURNS § 11.03 (2d ed. Oct. 2000).

189. See *Moline Props., Inc. v. Comm'r*, 319 U.S. 436, 438-39 (1943) (explaining corporation generally treated as a separate taxable entity, although it may be disregarded when its formation or existence is a sham).

190. See generally I.R.C. §§ 331-337 (CCH 2001).

191. See *United States v. Mattison*, 273 F.2d 13, 22 n.11 (9th Cir. 1959).

192. Cf. Treas. Reg. § 1.338-1(a)(1) (2001) (describing that as a consequence of a section 338 election, a "new" target corporation is treated as acquiring all of its assets from an unrelated person).

193. "Basic" should be read to be synonymous with qualified stock purchase; i.e., the application of the KD Doctrine in a situation where a corporation has engaged in a qualified stock purchase within the meaning of I.R.C. section 338(d)(3).

194. Somewhat ironically, if the actual facts of the *Kimbell-Diamond* case were to arise today, the separate steps (i.e., the acquisition and the liquidation) would be respected, as the *Kimbell-Diamond Milling Company* originally desired. See Rev. Rul. 90-95, 1990-2 C.B. 67; cf. Rev. Rul. 2001-46, 2001-42 I.R.B. 1 (Sept. 25, 2001).

qualified stock purchase and then liquidates Target; i.e., each of two steps (the purchase and the liquidating distribution) are given independent significance, as long as the overall transaction would not qualify as a section 368 reorganization under the rationale of Revenue Ruling 2001-46). While *Kimbell-Diamond* generated hundreds of citations over the course of five decades, relatively few have been made since the 1980s, a phenomenon that is in accord with all the congressional and judicial announcements of its preemption and extinction.

But what does the dearth of citations say of the con-corporate KD Doctrine? Does it suggest that it is extinct as well?¹⁹⁵ When the Fifth Circuit in *Chrome Plate* spoke of the extinction of the KD Doctrine, it was speaking with regard to “*corporate taxpayers*.”¹⁹⁶ Indeed, the Fifth Circuit noted that the Court of Claims was troubled, in *American Potash*, by the fact that Congress would preempt the KD Doctrine in enacting section 334(b)(2) of the 1954 Code, but leave it available for individual or non-corporate taxpayers.¹⁹⁷ It stated that “Congress either ignored or chose to exclude the individual taxpayers, but we may not assume from either alternative that this court thus has the right to equalize the situation. Congress has specifically provided for corporate taxpayers, and we are bound by that legislation.”¹⁹⁸ What follows is a brief discussion of factors affecting the continued viability of the KD Doctrine to non-corporate purchasers.

1. *Repeal of General Utilities*

Probably the most significant development in corporate income tax law since the observation made by the *Chrome Plate* court has been the repeal of the *General Utilities* doctrine,¹⁹⁹ which represents the biggest cloud over the continued viability of the Non-corporate KD Doctrine. Under the *General Utilities* doctrine, later codified in section 311 of the 1954 Code, corporations were generally able to make distributions of appreciated property to their shareholders without the recognition of gain at the corporate level, with exceptions added over time for certain recapture items.

195. See *In re Chrome Plate*, 614 F.2d 990, 1000 (5th Cir. 1980)

196. *Id.* (emphasis added).

197. *Id.*

198. *Id.*

199. So named for the holding in *General Utilities & Operating Co. v. Helvering*, 296 U.S. 200 (1935).

With the repeal of this doctrine, as part of the Tax Reform Act of 1986, Congress generally endorsed a double-tax system for distributions of appreciated property: i.e., the imposition of tax upon gain at the corporate level upon distribution and the imposition of tax at the shareholder level upon receipt of such property.²⁰⁰ This treatment extended not only to liquidations, but to ordinary dividend distributions, too.²⁰¹

The repeal of *General Utilities* may be thought to have also repealed the KD Doctrine. Generally, when the KD Doctrine was applied, the target corporation's distribution of property in liquidation was effectively ignored.²⁰² Thus, if the KD Doctrine remains viable, it presents a way of avoiding corporate-level taxation.²⁰³

Significantly, there has not been a reported case involving the non-corporate KD Doctrine since the repeal of *General Utilities*. This may well reflect an implicit recognition that the operating assumptions existing when cases such as *Suter*, *Snively*, and *Cullen* arose do not exist anymore, bringing the validity of such cases into

200. See I.R.C. § 301 (CCH 2001); cf. I.R.C. § 355 (CCH 2001) (providing a mechanism for a corporation to spin off a controlled subsidiary with no corporate or shareholder level gain recognition). See generally BITTKER & EUSTICE, *supra* note 16, ¶ 8.20 (discussing the *General Utilities* doctrine and its repeal).

201. See I.R.C. § 311(b); I.R.C. § 336 (CCH 2001). Congress retained the model by which liquidating distributions to a parent corporation shareholder that held at least eighty percent of the liquidating corporation's stock would continue to generally be a nonrecognition event. See I.R.C. §§ 332(a), 334(b), 337(a) (CCH 2001).

202. See, e.g., Robert Willens, *Recent IRS Rulings Give 'Kimbell-Diamond' Doctrine Continuing Vitality*, 2001 DAILY TAX REP. (BNA) 202, J-1 (Oct. 22, 2001) (describing that, while the KD Doctrine may continue to be viable, in light of *General Utilities* repeal, the acquisition of target corporation assets "is certainly taxable"); David S. Miller, *The Devolution and Inevitable Extinction of the Continuity of Interest Doctrine*, 3 FLA. TAX REV. 187, 234 (1996) (describing that after "repeal of *General Utilities*, an acquiror cannot make a qualified stock purchase, decline to make a section 338 election, merge the target into acquiror's wholly-owned subsidiary, and simply claim a cost basis in target's stock"); Benjamin G. Wells, *Does the Asset Acquisition Doctrine Apply after TRA '86?*, 69 J. TAX'N 386, 389 (1988) (explaining "[t]he repeal of the *General Utilities* [doctrine] for corporate liquidations represents a determination that there should be no step-up in the basis of [target corporation] assets without recognition of a corporate level tax"); cf. GINSBURG & LEVIN, *supra* note 180, ¶ 208.3 at 2-225 (discussing implications of Private Letter Ruling 88-18-049, authors suggest that KD Doctrine still lives, particularly the non-corporate KD Doctrine).

203. See *supra* Part I.A. (describing a transaction that involves only a single level of taxation: i.e., upon the shareholders of Target if their stock in Target is appreciated). See generally I.R.C. § 1001 (West 2001).

question. Before the repeal of *General Utilities*, a liquidating corporation generally did not recognize gain or loss upon the distribution of property in complete liquidation, except for LIFO recapture amounts.²⁰⁴ Presumably, this is the reason that the Service has not issued rulings in this area. It may also explain why one of the last rulings to apply the non-corporate KD Doctrine was within the transition period provided by the Tax Reform Act of 1986, in which liquidating distributions could continue to be made without corporate-level taxation.²⁰⁵

2. *Lack of Explicit Repeal*

The strongest counter-argument to the notion that the non-corporate KD Doctrine has been repealed through the repeal of *General Utilities* is the fact that it has not been explicitly repealed. Simply put, *Suter*, *Snively*, *Cullen*, and others like them, have not been overruled, and the Service has not withdrawn its published acquiescence to these decisions. In addition, Revenue Ruling 69-242 has not been modified or revoked.

Moreover, the Service, even after the repeal of *General Utilities*, seems to acknowledge that the non-corporate KD Doctrine might be available. On this point, the discussion by the Service in a 1992 technical advice memorandum is telling.²⁰⁶ The primary issue discussed therein²⁰⁷ was whether an S corporation should be treated as a corporation when it acquires the stock of a target corporation and promptly liquidates the target.²⁰⁸ If the purchaser in this context is not treated as a corporation, then the S corporation shareholders (typically, individuals) are treated as the purchasers.²⁰⁹ The Service discussed the KD Doctrine, former section 334(b)(2), the enactment of section 338, and the enactment in 1982 of a provision that provided an S corporation in its capacity as a shareholder of another corporation is treated as an individual, for

204. See I.R.C. § 336 (West 1954).

205. See Priv. Ltr. Rul. 87-17-056 (Jan. 28, 1987) (conditioning ruling on the liquidation of Corp I occurring before January 1, 1987, lest such delay would cause corporate-level gain or loss to be recognized); Tax Reform Act of 1986, Pub. L. No. 99-514, § 631(a), 100 Stat. 2085 at § 631(a) (codified as amended at 26 U.S.C. § 336 (2001)).

206. Tech. Adv. Mem. 92-45-004 (July 28, 1992).

207. *Id.*

208. See *supra* notes 173-179 and accompanying text.

209. Tech. Adv. Mem. 92-45-004, *supra* note 206.

purposes of subchapter C of the Code.²¹⁰ Noting that this provision was enacted less than two months after the enactment of section 338, the Service stated that “[w]e do not believe that Congress intended to return S corporations to the law as it existed before the 1954 Code, when it was necessary to ascertain the intent of the acquiring corporation at the time of the stock purchase in order to determine whether the transaction would be treated as an asset purchase.”²¹¹

Thus, although the Service concludes that an S corporation should be treated as a corporation (and thus subject to section 338 and regulations underlying) it implicitly acknowledged that the non-corporate KD Doctrine remains viable. However, the Service also determined that such a conclusion would not “give rise to abuse under today’s federal tax system, such as the avoidance of *General Utilities* gain,” since any built-in gain in the target corporation assets would carry over to the acquiring corporation under section 332 and 334.²¹² Because of the repeal of *General Utilities*, it is likely that the Service would come to a different conclusion under different facts (involving a non-corporate purchaser) if gain is avoided altogether through invocation of the non-corporate KD Doctrine.

The fundamental fact remains that the legislative history of section 338 and the pronouncement of the *Chrome Plate* court,²¹³ which involve explicit declarations of the revocation of the KD Doctrine, involved contexts of traditional application: where a *corporate* purchaser acquires all of the stock of a target corporation and promptly liquidates the target.²¹⁴ No discussion exists in the section 338 legislative history regarding non-corporate purchasers because section 338 by definition, was limited to corporate purchasers and the application of the KD Doctrine to individuals and other non-corporate purchasers was never codified.²¹⁵ In

210. *Id.*

211. *Id.*

212. *Id.*

213. *See supra* note 2.

214. I.R.C. § 338(d)(3); Treas. Reg. § 1.338-3(b)(1) (2001).

215. Moreover, under the “reenactment doctrine,” Congress’s reenactment without significant change of a statutory provision that has been the subject of judicial construction might be viewed as giving legislative imprimatur to such interpretation. *See Hecht v. Malley*, 265 U.S. 144, 153 (1924) (stating that when “adopting the language used in an earlier act, Congress [is] considered to have adopted [the same language adopted by the court], and to have made it part of the enactment”).

addition, while federal income tax law is intensely statutory, it is also informed by a rich history of non-statutory principles.²¹⁶ Therefore, its judicial interpretations are not exempt from *stare decisis*.²¹⁷

Finally, significant administrative materials are on record as endorsing the non-corporate KD Doctrine. Chief among these materials is Revenue Ruling 69-242, in which the Service affirmed the notion that no gain or loss would be recognized upon the liquidation of the acquired corporation where such corporation was acquired with a view toward obtaining its assets as qualified replacement property. Although Revenue Ruling 69-242 addressed the application of the non-corporate KD Doctrine in the context of section 1033, the ruling nevertheless clearly holds that the purchaser is treated as purchasing assets, and not stock.²¹⁸

In this sense, Revenue Ruling 69-242 resembles *Kimbell-Diamond* itself, which involved the purchaser's basis in qualified replacement property under the predecessor to section 1033. Moreover, Congress granted the Service and Treasury rulemaking authority "as may be necessary or appropriate to carry out the purposes" of the Tax Reform Act of 1986, including regulations "to ensure that such purposes may not be circumvented through the use of any provision of law or regulations . . ."²¹⁹ Presumably, Treasury and the Service have the authority to issue regulations that would deny invocation of the non-corporate KD Doctrine in order to avoid corporate-level taxation under section 336.²²⁰ To date, however, no regulations have been proposed or finalized.

3. *Lack of a Complete Model; Whipsaw*

The KD Doctrine is not a complete model. One of its more troubling aspects is that it does not adequately explain what

216. See, e.g., *Gregory v. Helvering*, 293 U.S. 465, 469-70 (1935) (showing the classic substance-over-form case often cited for the proposition that how a transaction is viewed for tax purposes does not depend simply upon the literal compliance with the text of a statute, but must be informed by the underlying purposes of the law as well).

217. See generally, Paul L. Caron, *Tax Myopia, or Mamas Don't Let Your Babies Grow up to be Tax Lawyers*, 13 VA. TAX REV. 517, 520-54 (1994) (arguing that tax law practitioners would be better served by not viewing tax law as wholly different from other non-tax law).

218. *Id.*

219. I.R.C. § 337(d) (CCH 2001).

220. See, e.g., Treas. Reg. § 1.337(d)-4 (1998) (requiring gain recognition upon the conversion of a taxable entity to a tax-exempt entity).

happens to the selling shareholders. When a purchaser invokes the KD Doctrine, and asserts that its acquisition is actually a direct asset purchase for federal income tax purposes, the seller is almost certainly treating the “other side” of the transaction as a sale of corporate stock. Purists are left to ask: “What happened to the target corporation? How (and when) did it simply disappear?” This is not an insignificant concern for a system that places a great premium upon internal symmetry and consistency.²²¹ Thus, if the effect of the continued application of the non-corporate Doctrine is that, as in *Snively*, the liquidation exchange between the shareholder and the corporation is not a taxable exchange, and from the seller’s perspective the transaction is viewed simply as a stock sale, then the non-corporate KD Doctrine presents significant dissymmetry.

This inconsistent treatment of both sides of the same transaction presents “whipsaw” concerns, in that both sides of a transaction are not treating it the same way. Generally, the administration of the federal income tax system requires consistent treatment by parties to the transaction to avoid “whipsaw,” where parties might claim inconsistent characterizations, each to their respective advantage. This is, in some respects, a variation of the *General Utilities*-repeal concern expressed above: if a seller is able to treat a transaction as a stock sale and the buyer is able to treat the same transaction as an asset purchase, what happens to the corporation in the meantime? In the “post-*General Utilities* repeal world, a corporate liquidation is not a transaction step that can be glossed over.”²²²

Troubling as these issues might be for those desiring a complete model, they are not new.²²³ Such inconsistencies may be found in the original application of the KD Doctrine. For example, in *Dallas Downtown Development Co. v. Commissioner*,²²⁴ the government pursued the *sellers* of a target corporation that was acquired and liquidated under the theory that the corporation had

221. See *Comm’r v. Keystone Consol. Indus.*, 508 U.S. 152, 159 (1993) (stating “the [Internal Revenue] Code must be given ‘as great an internal symmetry and consistency as its words permit.’”) (quoting *Comm’r v. Lester*, 366 U.S. 299, 304 (1961)).

222. GINSBURG & LEVIN, *supra* note 180, ¶ 208.3 at 2-226.

223. See *id.* ¶ 608.4 at 6-108 (discussing instances in which both parties do not treat the transaction the same way for tax purposes).

224. *Dallas Downtown Dev. Co. v. Comm’r*, 12 T.C. 114 (1949).

sold *assets* when they had in fact sold stock.²²⁵ The Tax Court disagreed and found the selling shareholders had engaged in a stock sale.²²⁶

Moreover, the Service has issued rulings that do not present a complete model in a somewhat similar factual setting. For example, in Revenue Ruling 99-6,²²⁷ the Service describes the federal income tax consequences that arise when a partner in a partnership sells his or her half interest in the partnership to the remaining partner who owns the other half of the partnership, thus causing a termination of the partnership under section 708(b)(1)(A).²²⁸ The Service ruled that the selling partner is treated as though he or she sold his or her partnership interest, i.e., the tax consequences follow the form.²²⁹ Because of this termination, the partnership is treated as liquidating, distributing *all* of its assets to the purchasing partner.²³⁰

With little explanation, however, the Service then proffers that the purchasing partner is treated as though he bought assets, taking a cost basis under section 1012 in the one half of the partnership's *assets* attributable to the selling partner.²³¹ The buyer is also precluded from tacking on the holding period for which those assets were held by the partnership.²³² Here, the Service states that section 735(b), which normally allows tacking of the holding period of property received in a distribution from a partnership, "does not apply with respect to the assets that [buyer] is deemed to have purchased from [seller]."²³³ In other words, the liquidating distribution normally made by a partnership in a technical termination of the partnership is ignored.

225. *Id.* at 123.

226. *Id.* at 123-25. *See also* Tel. Answering Serv. Co. v. Comm'r, 63 T.C. 423, 432 (1974), *aff'd*, 546 F.2d 423 (4th Cir. 1976) (finding that I.R.C. § 337 required recognition of the gain realized on a sale); Pressed Steel Car Co. v. Comm'r, 20 T.C. 198, 200 (1953) (concluding that tax consequences are determined by the purpose for which petitioner paid for stock).

227. Rev. Rul. 99-6, 1999-6 I.R.B. 6.

228. *Id.*

229. *Id.*

230. *Id.*

231. *See also* Priv. Ltr. Rul. 87-17-056, *supra* note 205 (describing asset purchase on buyer side, stock sale on seller side).

232. Rev. Rul. 99-6, *supra* note 227.

233. *Id.*

4. *Taxpayer's Ability to Assert "Substance"*

Any taxpayer concluding that form does not govern (and that the stock transaction should actually be treated as an asset sale) should be cognizant of a tendency in the tax law by which taxpayers are "stuck" with the form they choose, even though the government may have the prerogative to assert "substance over form."²³⁴ However, while ordinarily a taxpayer must live with the chosen form, where there is substantial authority in the form of case law and Service rulings that treat certain transactions in a manner different than their form, the established law and rulings prevail over "form" treatment.

For example, in the context of sale versus lease treatment, "the principal Service ruling on the . . . issue establishes standards that can evidently be invoked by taxpayers to establish that a purported lease is a sale."²³⁵ And revenue rulings, such as Revenue Ruling 69-242 and Revenue Ruling 67-274, are published with the knowledge and expectation that taxpayers will be relying upon them "in determining the tax treatment of their own transactions" and to avoid the need to "request specific rulings applying the principles of a published revenue ruling to the facts of their particular cases."²³⁶ With this endorsement of the application of the step transaction doctrine to a two-step acquisition, it seems reasonable to conclude that the *Kimbell-Diamond* Doctrine lives with respect to non-corporate purchasers, and may be invoked in those situations where it historically has been available.

IV. CONCLUSION

While the non-corporate KD Doctrine remains viable, the practical effect of its viability is shrouded in ambiguity. There are considerable tax policy reasons why taxpayers should not be able to circumvent corporate-level taxation, especially where similarly situated taxpayers, i.e., corporate purchasers are unable to do so

234. See, e.g., *Nestle Holdings v. Comm'r*, 152 F.3d 83, 87 (2d Cir. 1998) (citing *Comm'r v. Nat'l Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 149 (1974) (holding "taxpayer is free to organize his affairs as he chooses, [but] once having done so, . . . he must accept the tax consequences of his choice, whether contemplated or not.")).

235. BORIS I. BITTKER AND LAWRENCE LOKKEN, *FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS* ¶4.4.6 (2d ed. 1999 supp.) (citing Rev. Rul. 55-540, 1955-2 C.B. 39).

236. Rev. Proc. 89-14, 1989-1 C.B. 814, § 7.01(5).

without inheriting a tax liability. But taxpayers are not always so circumspect about tax policy when a substantial body of law (unamended by legislative, judicial, or administrative action) gives apparent imprimatur to treating a two-step acquisition as a direct purchase. Thus, the government should not be surprised if non-corporate taxpayers invoke the KD Doctrine in circumstances where it historically has been applied. And taxpayers should not be surprised if the government asserts that form controls and that the taxpayer must live with the federal income tax consequences that attend a corporate liquidation event.