CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 221

June 27, 1958

BASIS: KIMBELL-DIAMOND PRINCIPLE

Syllabus:

On the particular facts herein the Kimbell-Diamond principle is applicable and it is determined that the assets were acquired by purchase and the basis is the purchase price.

A Corp. was indebted to B, a bank, for approximately $37,000,000, however B Co.'s basis was only $180,000 the balance having been written off as bad debts for tax purposes. In November, 1949, A Corp. dissolved and all its assets were transferred to B in partial satisfaction of the indebtedness. Among these assets was 90% of the outstanding stock of C Co., and immediately thereafter B acquired the remaining outstanding shares in order to facilitate the liquidation of C Co. B thereupon proceeded to liquidate C Co., and received its assets in complete cancellation of the stock. Shortly thereafter B sold a portion of these assets, which had a basis of $288,000 on C Co.'s books, for $31,000. B claims a $257,000 loss on the theory that the liquidation of C Co. met all the requirements of section 25031(f) of the 1954 Bank and Corporation Tax Law and accordingly no gain or loss was recognized upon the receipt of the assets and under the provisions of section 23071(1) of the 1954 Bank and Corporation Tax Law its basis of the assets was the same as the basis to C Co. Advice is requested as to whether the transaction should be controlled by the Kimbell-Diamond principle and be considered in its entirety as the purchase of assets or should effect by given to the liquidation.

Although the liquidation of C Co. followed the literal requirements of section 25031(f), the facts in this case warrant the application of the principle discussed in Kimball-Diamond Milling Co., 14 TC 74, aff'd 187 F2d 718, cert. den. 324 US 827. In that case the court held that where the essential nature of a transaction is the acquisition of property it will be viewed as a whole and closely related steps will not be separated either at the insistence of the taxpayer or the taxing authority.

Thus where to fulfill its intention of acquiring assets a taxpayer purchases the stock of a corporation and within a short time after purchase the corporation is liquidated, the incidental step of liquidation will be ignored in computing the tax effect of the entire transaction.

The instant case follows this general pattern. A Co. was heavily indebted to B. B's obligation to its shareholders was to liquidate this indebtedness.

In order to do so it must look to the properties of A Co. in order to affect payment of the amounts due. One of the assets owned by that corporation was the stock of the C Co., which itself owned some readily resalable properties. Since B Co. could not, under the banking laws, operate the C Co. itself, its only recourse was to liquidate that company, acquire its assets and sell them for as good a price as it could obtain.

In accordance with this intention stock of C Co. was acquired in November of 1949. Its acquisition was by "purchase" just as surely as if it had purchased the stock for cash. Before liquidating C Co., B Co. acquired the balance of the outstanding stock in order to eliminate any problems which would be connected with a minority interest. Almost immediately after acquiring the additional stock C Co. was liquidated and the assets acquired. After acquiring the assets taxpayer then entered into an advertising campaign to sell the assets. Apparently this campaign was very successful since on June 3, 1950, the major portion of the assets were disposed of to the former manager of the C Co.

The sequence of events in this case compels the conclusion that it was the B Co.'s intention at all times to acquire the property indirectly owned by A Co. and apply the proceeds from their sale to the liquidation of the indebtedness owned by A Co. Under the circumstances the Kimbell-Diamond principle applies and the intervening step of the liquidation of C Co. must be ignored. By ignoring the liquidation the essential nature of this transaction was an acquisition of the C Co. properties and their sale.

The fact that B Co. acquired the assets for purposes of sale rather than for use in their business, does not prevent the application of the Kimbell-Diamond rule. This rule was founded upon the principle that a purchase of assets was intended and the use of the assets should have no effect upon this theory. Accord. Distributors Finance 20 TC 768. This reasoning is supported also by section 24505(b)(2) of the 1955 Law where the judicial Kimbell-Diamond rule was codified and where the intention of the purchaser has been entirely eliminated as a factor in applying the section.