KIMBELL-DIAMOND MILLING CO. v. COMMISSIONER, 14 TC 74 (1950)

Black, *Judge*:

This proceeding involves deficiencies in income, declared value excess profits, and excess profits taxes for the fiscal years ended May 31, 1945 and 1946, in the following amounts:

Year ended--	Income tax	Declared value excess profits tax	Excess profits tax
May 31, 1945	$5,679.25		$7,055.55
May 31, 1946		$2,352.23	26,128.02

The deficiencies are primarily due to respondent's reduction of petitioner's basis in assets acquired by it in December, 1942, through the liquidation of another corporation known as Whaley Mill & Elevator Co. (sometimes hereinafter referred to as Whaley). By reason of this reduction respondent has adjusted petitioner's allowable depreciation and its excess profits tax credit based on equity invested capital. By appropriate assignments of error petitioner contests these adjustments. Other adjustments which respondent made have been conceded.

This leaves for our consideration the determination of petitioner's basis in the assets acquired from Whaley.

The facts have been stipulated and are adopted as our findings of fact. They may be summarized as follows:

Petitioner is a Texas corporation, engaged primarily in the business of milling, processing, and selling grain products, and has its principal office in Fort Worth, Texas. Petitioner maintained its books and records and filed its corporation tax returns on an accrual basis for fiscal years ended May 31 of each year. For the years ended May 31, 1945 and 1946, its returns were filed with the collector of internal revenue for the second collection district of Texas.

On or about August 13, 1942, petitioner sustained a fire casualty at its Wolfe City, Texas, plant which resulted in the destruction of its mill property at that location. The assets so destroyed, and the adjusted basis thereof, were as follows:

	Cost	Depreciation allowed or allowable	Adjusted basis
Mill building	$6,106.96	$2,967.50	$3,139.46
Elevator building	7,007.77	6,024.15	983.62
Machinery	24,785.70	16,840.85	7,944.85
Warehouse	13,984.79	9,076.52	4,908.27
Steel tank	4,886.48	2,940.78	1,945.70
Total	56,771.70	37,849.80	18,921.90

This property was covered by insurance, and on or about November 14, 1942, petitioner collected insurance in the amount of $124,551.10 ($118,200.16 as a reimbursement for the loss sustained by the fire and $6,350.94 as a premium refund). On December 26, 1942, petitioner's directors approved the transaction set forth in the minutes below:

That, Whereas, on or about August 1, 1942, the flour mill and milling plant of Kimbell Diamond Milling Company located at Wolfe City, Texas was destroyed by fire; and

Whereas, Kimbell-Diamond Milling Company collected from the insurance companies carrying the insurance on the said destroyed properties the sum of $125,000.00 as indemnification for the loss sustained, which said insurance proceeds were by the proper officers of this corporation promptly deposited in a special account in the Fort Worth National Bank of Fort Worth, Texas, where they have since been kept intact in order to have the same available for replacing, as nearly as might be, the destroyed properties; and

Whereas, it has at all times been the intention and desire of Kimbell-Diamond Milling Company to replace its burned mill either by constructing a new mill or by purchasing facilities of substantially similar kind and use; and

Whereas, due to existing building restrictions and other causes, it has been found impractical and impossible to replace the destroyed facilities by new construction, but it has come to the attention of the officers of this corporation that the stock of Whaley Mill & Elevator Company, a Texas corporation, which, among its other assets, owns physical properties substantially comparable to the destroyed Wolfe City Milling plant, can be purchased;

Now, Therefore, Be It Resolved:

1. That the proper officers of Kimbell-Diamond Milling Company be, and they are hereby, authorized, empowered and directed to purchase the entire authorized, issued and outstanding capital stock of Whaley Mill & Elevator Company, a Texas corporation, consisting of 4,000 shares of the face or par value of $100.00 per share, for a sum not in excess of $210,000.00; that payment for the said stock of Whaley Mill & Elevator Company be made, to the extent possible, from the insurance proceeds deposited in a special account in the Fort Worth National Bank, and that the balance of the agreed consideration for the stock of Whaley Mill & Elevator Company be paid out of the general funds of Kimbell-Diamond Milling Company.

2. That as soon as practicable after the purchase of the Whaley Mill & Elevator Company stock hereby authorized has been consummated, 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, and that the charter of said corporation be forthwith surrendered and cancelled.

On December 26, 1942, petitioner acquired 100 per cent of the stock of Whaley Mill & Elevator Co. of Gainesville, Texas, paying therefor $210,000 in cash which payment, to the extent of $118,200.16, was made with the insurance proceeds received by petitioner as a result of the fire on or about August 13, 1942.

On December 29, 1942, the stockholders of Whaley assented to the dissolution and distribution of assets thereof. On the same date an "Agreement and Program of Complete Liquidation" was entered into between petitioner and Whaley, which provided, *inter alia:*

That, Whereas, Kimbell-Diamond owns the entire authorized issued and outstanding capital stock of Whaley, consisting of 4000 shares of a par value of $100.00 per share, which said stock was acquired by Kimbell-Diamond primarily for the purpose of enabling it to secure possession and ownership of the flour mill and milling plant owned by Whaley, the parties herewith agree that the said mill and milling plant shall forthwith be conveyed to Kimbell-Diamond by Whaley under the following program for the complete liquidation of Whaley viz:

(1) Kimbell-Diamond shall cause the 4000 shares of the capital stock of Whaley owned by it to be surrendered to Whaley for cancellation and retirement, whereupon Whaley shall forthwith convey, transfer and assign unto Kimbell-Diamond all property of every kind and character owned or claimed by it, particularly its flour mill and milling plant, located at Gainesville, Texas, and all machinery and equipment appurtenant thereto, or used in connection therewith, in full and complete liquidation of all of the outstanding stock of Whaley. The aforesaid distribution in complete liquidation shall be fully consummated by not later than midnight, December 31, 1942.

(2) When the entire assets of every kind and character, owned by Whaley, have been transferred to Kimbell-Diamond in full and complete liquidation of the capital stock of Whaley, owned by Kimbell-Diamond, Whaley shall forthwith make application to the Secretary of State of the State of Texas for its dissolution as a corporation and surrender its corporate charter.

On December 31, 1942, the Secretary of State of State of Texas certified that the Whaley Mill & Elevator Co. was dissolved as of that date.

* * *

Having decided the issue of *res judicata* against petitioner, we must now determine the question of petitioner's basis in Whaley's assets on the merits. Petitioner argues that the acquisition of Whaley's assets and the subsequent liquidation of Whaley brings petitioner within the provisions of section 112 (b) (6) and, therefore, by reason of section 113 (a) (15), petitioner's basis in these assets is the same as the basis in Whaley's hands. In so contending, petitioner asks that we treat the acquisition of Whaley's stock and the subsequent liquidation of Whaley as separate transactions. It is well settled that the incidence of taxation depends upon the substance of a transaction. *Commissioner* v. *Court Holding Co.*, 324 U. S. 331. It is inescapable from petitioner's minutes set out above and from the "Agreement and Program of Complete Liquidation" entered into between petitioner and Whaley, that the only intention petitioner ever had was to acquire Whaley's assets.

We think that this proceeding is governed by the principles of *Commissioner* v. *Ashland Oil & Refining Co.*, 99 Fed. (2d) 588, certiorari denied, 306 U. S. 661. In that case the stock was retained for almost a year before liquidation. Ruling on the question of whether the stock or the assets of the corporation were purchased, the court stated:

The question remains, however, whether if the entire transaction, whatever its form, was essentially in intent, purpose and result, a purchase by Swiss 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. *** And without regard to whether the result is imposition or relief from taxation, the courts have recognized 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 instance of the taxpayer or the taxing authority. *Prairie Oil & Gas Co.* v.*Motter* , 10 Cir., 66 F. 2d 309; *Tulsa Tribune Co.* v.*Commissioner* , 10 Cir., 58 F. 2d 937, 940; *Ahles Realty Corp.* v. *Commissioner*, 2 Cir., 71 F. 2d 150; *Helvering* v. *Security Savings Bank*, 4 Cir., 72 F. 2d 874. ***

See also *Koppers Coal Co.*, 6 T. C. 1209 and cases there cited.

We hold 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. This was not a reorganization within section 112 (b) (6), and

petitioner's basis in these assets, both depreciable and nondepreciable, is, therefore, its cost, or $110,721.74 ($18,921.90, the basis of petitioner's assets destroyed by fire, plus $91,799.84, the amount expended over the insurance proceeds). Since petitioner does not controvert respondent's allocation of cost to the individual assets acquired from Whaley, both depreciable and nondepreciable, respondent's allocation is sustained.

* * *

Decision will be entered for the respondent.

Reviewed by the Court.

[1] SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) Basis (Unadjusted) of Property.-The basis of property shall be the cost of such property; except that- ***

(9) Involuntary conversion.-If the property was acquired, after February 28, 1913, as the result of a compulsory or involuntary conversion described in section 112 (f), the basis shall be the same as in the case of the property so converted, decreased in the amount of any money received by the taxpayer which was not expended in accordance with the provisions of law (applicable to the year in which such conversion was made) determining the taxable status of the gain or loss upon such conversion, and increased in the amount of gain or decreased in the amount of loss to the taxpayer recognized upon such conversion under the law applicable to the year in which such conversion was made.

[2] SEC. 112. RECOGNITION OF GAIN OR LOSS. ***

(b) Exchanges Solely in Kind.- ***

(6) Property received by corporation on complete liquidation of another.-No gain or loss shall be recognized upon the receipt by a corporation of property distributed in complete liquidation of another corporation. ***

[3] SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) Basis (Unadjusted) of Property.-The basis of property shall be the cost of such property; except that- ***

(15) Property received by a corporation on complete liquidation of another.-If the property was received by a corporation upon a distribution in complete liquidation of another corporation within the meaning of section 112 (b) (6), then the basis shall be the same as it would be in the hands of the transferor. The basis of property with respect to which election has been made in pursuance of the last sentence of section 113 (a) (15) of the Revenue Act of 1936, as amended, shall in the hands of the corporation making such election, be the basis prescribed in the Revenue Act of 1934, as amended.