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Asset Deal's Purchase Price Allocation Binds Buyer

by Robert W. Wood • San Francisco

The allocation of purchase price in an asset acquisition may make a big difference to the buyer's anticipated tax benefits after the acquisition. The allocation may affect the seller, too. In *North American Rayon Corp.*, CA-6, 12/21/93, the Sixth Circuit affirmed the Tax Court's holding that an agreement as to the allocation of purchase price in a contract was binding.

In 1978, North American Rayon Corp. ("NARCO") purchased a manufacturing facility from an entity that was commonly controlled with it. The purchase agreement allocated \$4 million of the price to inventory, and \$1 million to fixed assets. On its return, NARCO allocated the total sales price based on an appraisal of assets that had been prepared for the seller of the plant in 1977. The goal, of course, was a higher basis for depreciation purposes.

The Service determined a deficiency against NARCO on the basis of the excess depreciation deductions claimed in 1980, 1982, 1984, and 1985. The Service's position was that NARCO was bound by the allocation in the agreement. NARCO filed a Tax Court petition, claiming that the agreement regarding the allocation of the purchase price was not binding, because there had been undue influence.

NARCO tried to set aside the normal rule that a party to a contract can challenge the tax consequences of the agreement (as construed by the IRS) only with evidence that would be admissible as evidence in an action between the parties to the contract, to alter the construction of the contract, or to show the unenforceability of the agreement because of mistake, undue influence, fraud, or duress. (See *Danielson*, 378 F.2d 771 (CA-3, 1967), *cert. den.*, 389 US 858 (1967), which held that strong proof is required when one party seeks to set aside an agreed allocation.)

Apart from affirming the rule in *Danielson*, the court in *North American Rayon* made the predictable comment in response to NARCO's undue influence argument that there could be no undue influence where the parties were commonly controlled. ■