Grocery company avoids $567M bill

By Jerry Crimmins
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After a federal tax dispute that would have cost The Kroger Co. $567 million if it lost, McDermott, Will & Emery LLP said its lawyers won "a complete victory" for the grocery chain.

Two partners in the firm's Chicago office, Roger J. Jones and Andrew R. Roberson, said they won a decision in this case at the U.S. Tax Court in Washington, D.C., in January 2011. That litigation lasted five years.

The dispute with the IRS dates back to a business transaction in 1992, Jones and Roberson said.

After the IRS lost this case in tax court, the U.S. Department of Justice appealed to the 9th U.S. Circuit Court of Appeals, Jones and Roberson said.

Before the government's opening brief was due, "the government conceded in full," said a statement from the law firm.

Last month, Jones said, "I got a call from the Department of Justice lawyer handling the case telling me they wanted to file a motion with the 9th Circuit to withdraw their appeal with prejudice."

The government did so and the 9th Circuit dismissed the matter.

Charles Miller, spokesman for the Tax Division of the U.S. Department of Justice declined to comment Wednesday.

Roberson praised the judge who handed down the original, 100-page decision in tax court — Judge Carolyn P. Chiechi.

He said he and Jones differed with the IRS only on how the law should be interpreted. "The judge looked at the undisputed facts and held that they did not support the government's legal argument.

"It shows that the tax court decided the issue before it. It didn't go outside the record and try to formulate a new legal test," Roberson said.

Jones said the case involves Ralphs Grocery Co., a California grocery store chain, which is owned by Kroger.
In the 1990s, Ralphs was owned primarily by Federated Department Stores Inc. when Federated Department Stores went into voluntary bankruptcy.

In negotiating a plan to get out of bankruptcy, Federated Department Stores turned over Ralphs Grocery Co. to a group of creditors to satisfy some of their claims. Ralphs was solvent and making money, Jones said.

In that transaction in 1992, an election was made under IRS Code Section 338(h)(10) so that the creditors' acquisition of Ralphs would be deemed a sale to them of all the assets of Ralphs for fair market value, Jones said.

Ralphs' assets had already been depreciated for income tax deduction purposes before that transaction. Thus, the tax basis of those assets had already been reduced, Jones said.

A substantial benefit of turning over Ralphs to the creditors' group under the election made with IRS Code Section 338(h)(10) was that the tax basis of Ralphs' assets was stepped up again, thus gaining millions of dollars in future depreciation tax deductions for the new owners of Ralphs, Jones said.

The IRS later argued that the assets of Ralphs were not eligible for the beneficial tax code election that had been chosen in the 1992 transaction, Jones said.

During this lengthy dispute, Kroger acquired Ralphs in 2000 and acquired the tax dispute too.

Samuel Brunson, assistant professor at Loyola University Chicago School of Law, a tax expert, said in the 2011 tax court decision, 80 pages are devoted to the complicated facts, and only the last few to the law.

"On a quick, quick skim, … it looks like the judge is correct," he said.

Brunson said he could only speculate as to why the government declined to pursue its own appeal.

"Maybe they decided it was a losing proposition after all, or maybe they had a personnel change," Brunson said.

The cases are Ralphs Grocery Co. v. Commissioner, No. 12-72369 and Fred Meyer Inc. v. Commissioner, No. 12-72368. Fred Meyer was an owner of Ralphs before Kroger bought it.