5 T.C. 842 (1945)

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A corporate reorganization can qualify for tax-free treatment under Section 112(g) of the applicable revenue acts, allowing the successor corporation to use the predecessor's basis in assets, even if a small minority of dissenting creditors are paid in cash from the predecessor's retained funds, as long as substantially all of the predecessor's assets are transferred.

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Summary

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Southland Ice Co. acquired assets from its insolvent predecessor in exchange for voting stock and new bonds. The Tax Court addressed whether this acquisition constituted a tax-free reorganization under Section 112(g) of the applicable revenue acts, thereby entitling Southland to use the predecessor's basis in the acquired assets under Section 113(a)(7). The court held that the acquisition did qualify as a tax-free reorganization, despite the fact that a small percentage of non-assenting creditors were paid in cash from the predecessor's retained funds, because substantially all of the predecessor's assets were transferred to Southland.

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Facts

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Southland Ice Company (petitioner) was formed to acquire the assets of its predecessor, an insolvent Texas corporation (the old company). The old company had outstanding first mortgage bonds and unsecured debt. A bondholder filed suit seeking the appointment of a receiver and foreclosure of the bond lien. A receiver was appointed and operated the business until Southland was formed to acquire the old company's assets. A bondholders' committee negotiated a deposit agreement and adopted a plan of reorganization. The plan involved forming a new corporation (Southland), conveying the old company's property to it, issuing common stock to bondholders in lieu of past-due interest, and issuing new income bonds to bondholders. The funds accumulated by the receiver were intended to cover expenses and provide working capital, including cash payments to non-depositing bondholders.

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Procedural History

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A bondholder filed suit in the United States District Court for the Northern District of Texas seeking protection of their security and asking the appointment of a receiver and foreclosure of the lien securing the bonds. The District Court entered judgment for the bondholders and ordered foreclosure. The properties were bid in by the bondholders' committee. The District Court confirmed the sale and approved the plan of reorganization. Southland intervened in the equity proceedings. The Tax Court was presented with deficiencies in income, excess profits, and declared value excess profits taxes for the calendar years 1935 to 1941. Petitioner claimed an overpayment. The central issue was the proper basis for gain or loss and depreciation of property acquired by the petitioner.

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Issue(s)

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1. Whether the acquisition of the old company's assets by Southland constituted a reorganization under Section 112(g) of the applicable revenue acts, despite the cash payment to dissenting creditors.

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2. Whether Southland was entitled to use the predecessor's basis in the acquired assets under Section 113(a)(7).

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Holding

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1. Yes, because the acquisition met the requirements of a tax-free reorganization under Section 112(g), as substantially all of the old company’s assets were transferred to Southland, and the cash payment to dissenting creditors was made from retained funds.

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2. Yes, because Section 113(a)(7) entitles Southland to use the predecessor’s basis in the acquired assets as the acquisition qualifies as a reorganization.

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Court’s Reasoning

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The court reasoned that the transaction qualified as a reorganization, emphasizing that nearly 94% of the old bondholders participated in the plan, and the non-assenting bondholders were paid in cash from operating income accumulated during the receivership, which was considered part of the old corporation’s assets. The court distinguished this case from *Helvering v. Southwest Consolidated Corporation*, 315 U.S. 194 (1942), where the new company assumed a loan to pay off security holders, treating it as if the new company had directly paid cash for the properties. Here, the cash payment was made from the old company’s assets and only a small minority interest was paid off in cash. The court emphasized that the

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