8 T.C. 467 (1947)

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For a transfer of assets from an insolvent corporation to a new corporation to qualify as a tax-free reorganization under Section 112(b)(5) of the Revenue Act of 1932, the transfer must be solely in exchange for stock or securities, and the transferors must maintain proportionate control and interests in the new entity.

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Summary

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Seiberling Rubber Co., a major creditor of the insolvent Kemitex Products Co., sought to treat the transfer of Kemitex's assets to a newly formed corporation (Kemitex Products, Inc.) as a tax-free reorganization. Seiberling received the majority of the new corporation's stock in exchange for its claims. The Tax Court held that the transaction did not qualify as a tax-free reorganization because the transfer was not solely for stock or securities, and the creditors of the old company did not maintain proportionate control in the new entity. Additionally, the court addressed the issue of bad debt deduction disallowance and its impact on accumulated earnings and profits for excess profits tax purposes.

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Facts

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Kemitex Products Co. was indebted to Seiberling Rubber Co. for $323,993.73 in unsecured debt and $23,035 secured by cotton sheeting.r
Seiberling also owned 3,772 shares of Kemitex's common stock and 250 shares of its preferred stock.r
Kemitex was insolvent with total assets of $255,102.06 and current liabilities of $440,416.31.r
Seiberling proposed the creation of a new corporation, Kemitex Products, Inc., to acquire all assets of Kemitex Products Co.r
In exchange, Seiberling would receive all 5,000 shares of the new corporation's stock and a note for $23,993.73, settling $300,000 of its unsecured claim.r
The new corporation assumed Kemitex Products Co.'s other debts, issuing short-term notes to creditors with claims over $250. Seiberling transferred some of its shares in the new company to the preferred shareholders of the old company.

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Procedural History

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Seiberling claimed a loss on the sale of its Kemitex Products, Inc. stock which the Commissioner disallowed.r
Seiberling also sought to include a portion of a previously disallowed bad debt deduction in its accumulated earnings and profits for excess profits tax purposes.r
The Commissioner determined deficiencies in Seiberling's income, excess profits, and declared value excess profits tax liabilities for the fiscal years ended October 31, 1941 and 1942. The Tax Court reviewed the Commissioner's determination.

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Issue(s)

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1. Whether the transactions conducted in 1934, whereby Seiberling acquired the Kemitex Products, Inc., stock, amounted to a nontaxable reorganization within the meaning of Section 112(b)(3), (4), or (5) of the Revenue Act of 1932.r
2. Whether Seiberling, in computing its equity invested capital for excess profits tax purposes, is entitled to include in its accumulated earnings and profits the portion of a partial bad debt deduction disallowed by the Commissioner in 1939.

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Holding

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1. No, because the transfer was not solely in exchange for stock or securities, and the transferors (creditors of the old company) did not maintain proportionate control in the new entity.

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2. No, because the disallowed portion of the partial bad debt deduction cannot be restored to accumulated earnings and profits for computing equity invested capital.

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Court’s Reasoning

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Regarding the reorganization issue, the court relied on *Bunker Hill & Sullivan Mining & Concentrating Co.*, emphasizing that the creditors did not invoke legal processes to enforce their rights of full priority, thus failing to

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