9 T.C. 215 (1947)

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For purposes of calculating excess profits tax credit using the invested capital method, “outstanding indebtedness” does not include debts that have been assumed by a purchaser of the taxpayer’s property, even if the taxpayer remains secondarily liable.

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Summary

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Player Realty Co. sought to include mortgage amounts assumed by purchasers of its properties in its “borrowed invested capital” for excess profits tax purposes. The Tax Court ruled against Player Realty, holding that once a purchaser assumes a mortgage on property sold by the taxpayer, the debt is no longer considered an “outstanding indebtedness” of the taxpayer for purposes of calculating borrowed invested capital, even if the taxpayer remains secondarily liable under the original mortgage agreement. The court reasoned that the capital represented by the debt is no longer invested in the taxpayer’s business but in the purchaser’s asset.

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Facts

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Player Realty Co. constructed and sold houses. To finance construction, it borrowed money from mortgage companies, securing the loans with deeds of trust on the properties. When the houses were sold, the purchasers assumed the existing mortgages as part of the purchase price. The deeds of trust contained provisions stating that the original liability of Player Realty would not be affected by the sale of the premises. However, the deeds conveying the properties to the purchasers included clauses where the purchasers assumed and agreed to pay the mortgages.

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Procedural History

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The Commissioner of Internal Revenue determined a deficiency in Player Realty's excess profits tax for 1942. Player Realty challenged the Commissioner's computation, arguing that the mortgage amounts assumed by purchasers should be included in its borrowed invested capital. The Tax Court heard the case to determine whether the Commissioner's exclusion of these amounts was correct.

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Issue(s)

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Whether, for the purpose of computing excess profits credit under the invested capital method, the amounts of mortgages on real property executed by the taxpayer, but assumed by purchasers of the mortgaged real property, can be included in the taxpayer's borrowed invested capital under Section 719(a)(1) of the Internal Revenue Code.

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Holding

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No, because once the purchasers assumed the mortgages, the borrowed money was no longer invested as capital in the taxpayer's business, and therefore, the debt no longer qualified as an "outstanding indebtedness" for the purpose of calculating borrowed invested capital.

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Court's Reasoning

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The court reasoned that the term

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