14 T.C. 1428 (1950)

For purposes of calculating equity invested capital under the Internal Revenue Code, property transferred to a corporation by its stockholders as paid-in surplus is included at its cost to the transferors, less any liabilities, such as a purchase money mortgage, assumed by the corporation.

Summary

Lansdale Structural Steel acquired a steel fabricating plant from its stockholders, assuming a mortgage on the property. The company sought to include the full cost of the property in its equity invested capital for excess profits tax purposes, without reducing it by the amount of the mortgage. The Tax Court held that the property should be included at its cost to the transferors less the mortgage assumed by the corporation. The court reasoned that the corporation only received the equity in the property as paid-in surplus, not the unencumbered asset. The mortgage was properly included in borrowed invested capital.

Facts

Joseph Roberts and Norman Farrar formed Lansdale Structural Steel in 1933, each contributing cash for stock.

Roberts and Farrar transferred a steel fabricating plant they owned to the corporation as paid-in surplus, subject to a purchase money mortgage, which the corporation assumed.

The corporation recorded the property on its books at a value exceeding its cost to Roberts and Farrar.

For depreciation, the IRS allowed the corporation a cost basis equal to Roberts and Farrar's original cost.

In its excess profits tax returns, the corporation included the mortgage in borrowed invested capital and the original cost of the property in equity invested capital.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the corporation's income, declared value excess profits, and excess profits taxes for the years 1941-1943.

The corporation petitioned the Tax Court, contesting the Commissioner's calculation of invested capital.

The Tax Court ruled in favor of the Commissioner, determining the correct amount to be included in equity invested capital.

Issue(s)

Whether property transferred to a corporation by its stockholders as paid-in surplus, subject to a mortgage assumed by the corporation, should be included in equity invested capital at its full cost to the transferors, or at that cost less the amount of the mortgage.

Whether the respondent erred in failing to include certain postwar refund credits in equity invested capital.

Holding

No, because the corporation only received the equity in the property as paid-in surplus, not the full unencumbered value; assuming the mortgage created an offsetting obligation. The mortgage was properly classified as borrowed invested capital.

No, because the petitioner failed to provide sufficient evidence to support the claim that the postwar refund credits should have been included.

Court's Reasoning

The court reasoned that the term "paid in," as used in reference to invested capital, means property transferred to a corporation free and clear of any obligation, except as may be represented by capital stock. The court cited *La Belle Iron Works v. United States, 256 U.S. 377*, stating that invested capital excludes borrowed money or property against which there is an offsetting obligation affecting the corporation's surplus.

The court stated, "What Roberts and Farrar actually paid in to petitioner was not the whole property, free and unencumbered, but only their interest, or equity, in it. The petitioner was itself a purchaser of the property to the extent that it assumed liability for the purchase money mortgage."

Regarding the postwar refund credits, the court found that the petitioner failed to present sufficient evidence to support its claim. The court noted that the stipulated facts did not contain any reference to postwar refund credits, and the petitioner did not produce any evidence on the issue.

Practical Implications

This case clarifies the meaning of "paid-in surplus" for purposes of calculating equity invested capital. It establishes that when property is transferred to a corporation subject to a liability, the corporation only receives the equity in the property as paid-in surplus. This means the asset's value for equity invested capital calculations is reduced by the amount of the assumed liability.

The ruling impacts how businesses calculate their excess profits tax liability. By clarifying which assets qualify as equity versus borrowed invested capital, it provides a clearer framework for tax planning and compliance.

This case highlights the importance of providing sufficient evidence to support claims made in tax court. A taxpayer must present adequate documentation and factual support to substantiate any deductions or credits claimed.

