15 T.C. 148 (1950)

A corporation purchasing property at a mortgage foreclosure sale generally cannot use the original mortgagor's basis for depreciation if the mortgagor lost its interest in the property before the foreclosure proceedings.

Summary

Adwood Corporation acquired hotel property at a foreclosure sale and sought to use the original lessee's (Savoy Hotel Co.) basis for depreciation. The Tax Court held that Adwood could not use Savoy's basis because Savoy had lost its leasehold interest prior to the foreclosure. The court reasoned that the foreclosure was not a tax-free reorganization under Section 112 of the Internal Revenue Code, as the property was not acquired directly from Savoy, and the requirements for a tax-free exchange were not met. Adwood's basis was determined to be its cost, i.e., the foreclosure sale price. This case clarifies the circumstances under which a new corporation can claim the prior owner's basis after a foreclosure and purported reorganization.

Facts

The Piersons leased property to Spitzley and Kamper, who assigned the lease to Savoy Hotel Co. Savoy and the Piersons executed a trust indenture for first mortgage bonds. Savoy defaulted on rent, and the Piersons served a notice to quit in June 1929. They later took possession of the premises in January 1930, after further defaults. A Michigan court briefly restored Savoy's right to possession subject to curing defaults. A bondholders committee was formed and foreclosure proceedings began in June 1930. Adwood Corporation was later formed to purchase the property at the foreclosure sale in 1941.

Procedural History

Adwood Corporation petitioned the Tax Court contesting the Commissioner's determination of deficiencies. The Commissioner argued Adwood was not entitled to use Savoy Hotel Co.'s basis. The Tax Court ruled in favor of the Commissioner, determining that Adwood's basis was its cost of acquiring the property at the foreclosure sale.

Issue(s)

1. Whether the transaction whereby Adwood acquired the hotel property qualified as a tax-free reorganization under Internal Revenue Code Sections 112(b)(3), 112(g)(1)(C), or 112(b)(5), thus allowing Adwood to use Savoy Hotel Co.'s basis for depreciation.
2. Whether the cost basis of the property to Adwood was $400,000, as determined by the Commissioner, or a higher amount.

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Holding

1. No, because Savoy Hotel Co. had lost its interest in the property prior to the foreclosure sale, and the acquisition did not meet the requirements of a tax-free reorganization.
2. The cost basis was $400,000, because the additional amounts paid to the Detroit Trust Co. and the Piersons were part of the foreclosure sale price, not additional costs.

Court’s Reasoning

The court reasoned that Section 112(g)(1)(C) requires the acquisition of properties

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