## ***Camp Wolters Land Co. v. Commissioner*, 23 T.C. 757 (1955)**

When determining the basis of assets acquired by a corporation, the court must determine whether notes issued in exchange for those assets qualify as "securities" under Internal Revenue Code § 112(b)(5), which affects the corporation's basis calculation.

### Summary

The case involved a dispute over the correct basis for Camp Wolters Land Company's (petitioner) assets acquired from the government and the Dennis Group. The court considered whether notes issued by the petitioner to the Dennis Group in exchange for a contract and restoration rights qualified as "securities" under Internal Revenue Code § 112(b)(5), thereby impacting the petitioner's basis in the acquired assets. The Tax Court determined that the notes were indeed "securities" due to their long-term nature and the degree of risk borne by the noteholders, thus affecting the basis calculation for depreciation and other tax purposes. The court also addressed depreciation deductions for the buildings, determining that they were held primarily for sale, with depreciation allowed only on the buildings actually rented.

### Facts

The U.S. Government leased land for Camp Wolters. The Dennis Group acquired the land and restoration rights. They then contracted with the government to acquire the buildings and improvements. The Dennis Group formed the petitioner, Camp Wolters Land Co., and transferred the contract and land to it. In exchange, the petitioner issued land notes and building notes to members of the Dennis Group. The petitioner paid the government for the buildings and improvements, releasing the restoration rights. The IRS and petitioner disagreed on the basis of the assets for tax purposes, particularly concerning the building notes.

### Procedural History

The case was heard by the Tax Court. The Commissioner disallowed depreciation deductions and questioned the property's basis. The Tax Court had to determine the correct basis for the acquired buildings and improvements for depreciation purposes.

### Issue(s)

1. Whether the building notes issued by petitioner to the Dennis Group constituted "securities" within the meaning of IRC § 112(b)(5)?
2. If the building notes were securities, what was the proper basis of the acquired assets?
3. Whether the petitioner could claim depreciation deductions for buildings it held?
4. Whether the petitioner could deduct interest paid on the land notes and building

 

notes?

**Holding**

1. Yes, the building notes constituted “securities” because they met the test of long-term nature of the debt, and the degree of participation and continuing interest in the business of the note holders.
2. The basis of the assets was determined to include the value of the “securities.” The Court determined that petitioner’s basis for the buildings and improvements was $466,274.
3. Yes, the petitioner could claim depreciation deductions for buildings that were rented but not for those held for sale.
4. Yes, the petitioner was entitled to deduct the interest payments on both the land and building notes.

**Court’s Reasoning**

The court focused on whether the building notes qualified as “securities” under IRC § 112(b)(5). The court examined the nature of the notes, considering their terms and the relationship between the noteholders and the corporation. The court analyzed whether the exchange of the contract and restoration rights for cash and notes met the provisions of sections 112(b)(5) and 112(c)(1) of the Code, determining that they did. “The test as to whether notes are securities is not a mechanical determination of the time period of the note. Though time is an important factor, the controlling consideration is an over-all evaluation of the nature of the debt, degree of participation and continuing interest in the business, the extent of proprietary interest compared with the similarity of the note to a cash payment, the purpose of the advances, etc.” The court determined that the 89 notes constituted “securities” under section 112 (b) (5) and that, consequently, the transaction falls within the provisions of that and the other aforementioned sections. The notes were non-negotiable, unsecured, and had a term of five to nine years. They were also subordinate to a bank loan, meaning the noteholders bore a substantial risk. The Court stated, “It seems clear that the note-holders were assuming a substantial risk of petitioner’s enterprise, and on the date of issuance were inextricably and indefinitely tied up with the success of the venture, in some respects similar to stockholders.” The court distinguished the notes from short-term debt instruments, emphasizing that they represented a long-term investment in the corporation. The court determined that the building notes were, therefore, to be included when determining the basis of the assets acquired. Further, the Court also assessed whether the petitioner was allowed to deduct depreciation and interest on both the land and building notes.

**Practical Implications**

This case provides a framework for determining whether a debt instrument qualifies as a “security” in corporate transactions, influencing the tax treatment of such transactions. When advising clients in similar situations, attorneys should carefully analyze the terms and conditions of any debt instruments issued in connection with corporate acquisitions or reorganizations. The classification of a debt instrument as a security will affect the calculation of basis, the recognition of gain or loss, and the availability of certain tax benefits, such as non-recognition of gain or loss under IRC § 351. Furthermore, this case clarifies the distinction between assets held for investment and assets held for sale for depreciation purposes. Attorneys should be prepared to present evidence to substantiate the purpose for which the property is held, and to properly account for gross income.

 