33 T.C. 671 (1960)

A successor corporation cannot deduct the unamortized mortgage discounts and expenses of its predecessor, because these expenses relate to the cost of borrowing money, not to the cost of acquiring the property.

Summary

Anover Realty Corp. (Petitioner) sought to deduct unamortized mortgage discounts and expenses that its predecessor, Condyck Realty Corporation, had incurred. Condyck had purchased real estate, financed in part by mortgages with associated discounts and expenses, and amortized these costs over the loan terms. Condyck then transferred the property to its stockholders, who subsequently transferred it to Anover and two other corporations. The Tax Court ruled that Anover could not deduct the unamortized portion of the discounts and expenses, as these were costs of borrowing money, not property acquisition costs, and the right to deduct them did not transfer with the property.

Facts

Condyck Realty Corporation purchased several properties. To finance the purchase, Condyck executed multiple mortgages with associated discounts (the difference between the face value of the note and the amount received) and incurred expenses like legal fees and recording taxes. Condyck amortized the discounts and expenses over the life of the mortgages. Condyck was then dissolved and transferred the mortgaged realty to its stockholders. The stockholders, shortly thereafter, transferred the property to three new corporations, including Anover Realty Corp., the petitioner. Anover claimed a deduction for its pro rata share of the unamortized mortgage discounts and expenses on its tax return.

Procedural History

The Commissioner of Internal Revenue disallowed the deduction claimed by Anover Realty Corp. The Tax Court heard the case and ruled in favor of the Commissioner, determining that the deduction was not permissible for the transferee corporation.

Issue(s)

1. Whether the petitioner, as the transferee of mortgaged realty, is entitled to amortize and deduct a pro rata share of the remaining unamortized portion of mortgage discount and expenses incurred by its predecessor corporation?

Holding

1. No, because the unamortized mortgage discount and expenses represent the cost of borrowing money, and the right to deduct the remaining balance does not transfer to the transferee of the mortgaged property.

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Court’s Reasoning

The court recognized that it was proper for Condyck to amortize the mortgage discounts and expenses over the loan’s life. This is because, as the court stated, “it is because such an expenditure is an expenditure made for the purpose of securing the use of money, throughout the loan period, as the basis for deriving income.” The court emphasized that these expenditures relate to securing the use of money, not to the cost of acquiring an asset, even if the loan proceeds were used to purchase an asset. The court cited prior cases where the borrower was permitted to deduct the unamortized balance of the mortgage discounts and expenses upon selling the property or dissolution. The court distinguished between the cost of using money, which is amortized over the loan term, and the cost of an asset, which can be included in its basis.

The court quoted: “Mortgage fees paid to secure loans such as those involved in this proceeding do not represent cost of property, but represent cost of the use of money borrowed.”

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