Bolger v. Commissioner, 59 T. C. 760 (1973)

The unpaid balance of a mortgage on transferred property can be included in the transferee's basis for depreciation purposes, even if the transferee does not assume personal liability for the mortgage.

Summary

Bolger used financing corporations to purchase properties, secure them with mortgages, and then transfer them to individuals without personal liability for the debt. The Tax Court ruled that these corporations were separate taxable entities, and the transferees could claim depreciation deductions based on the full mortgage value, even though they did not assume personal liability. This decision upheld the Crane doctrine, allowing transferees to include the mortgage balance in their property basis for depreciation.

Facts

David Bolger formed financing corporations to acquire properties, which were then leased to commercial users. These corporations issued promissory notes secured by mortgages on the properties. Immediately after these transactions, the properties were transferred to Bolger and associates for nominal consideration, subject to the existing mortgages and leases but without any personal liability assumed by the transferees. The corporations were required to remain in existence until the mortgage debts were paid off.

Procedural History

The IRS challenged Bolger's depreciation deductions, leading to a trial before the U. S. Tax Court. The court issued a majority opinion affirming Bolger's right to the deductions, with dissenting opinions by Judges Scott, Quealy, and Goffe.

Issue(s)

1. Whether the financing corporations should be recognized as separate viable entities for tax purposes after transferring the properties?
2. Whether Bolger, as a transferee of the properties, is entitled to depreciation deductions, and if so, what is the measure of his basis?

Holding

1. Yes, because the corporations continued to be liable on their obligations and were required to maintain their existence, they remained separate viable entities for tax purposes.
2. Yes, because Bolger acquired a depreciable interest in the properties upon transfer, and the unpaid mortgage balance should be included in his basis for depreciation, even without personal liability.

Court's Reasoning

The court applied the Moline Properties doctrine to affirm the corporations' status as separate taxable entities, noting their ongoing obligations and existence requirements. For the depreciation issue, the court relied on the Crane doctrine, which allows the inclusion of mortgage debt in the basis of property for depreciation purposes. The court rejected the IRS's arguments that the lack of personal liability or minimal cash flow negated Bolger's basis in the property, emphasizing that the rental income increased Bolger's equity and potential for gain upon sale or refinancing. The court distinguished cases where the underlying obligations were contingent by nature, affirming that the mortgage obligations here were fixed and thus part of Bolger's basis.

Practical Implications

This decision has significant implications for real estate transactions involving financing corporations and property transfers. It affirms that transferees can claim depreciation based on the full mortgage amount without assuming personal liability, potentially encouraging similar financing structures. The ruling reinforces the Crane doctrine, impacting how tax practitioners calculate basis and depreciation for properties acquired under similar circumstances. It may also lead to increased scrutiny of such transactions by the IRS to ensure compliance with tax laws and prevent abuse. Subsequent cases have cited Bolger in discussions about the treatment of mortgage debt in property basis calculations.

