Determining the Form of the Acquiring Entity, the Method of Acquisition, and the Type of Financing

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The use of real estate in an enterprise raises many tax problems unique to this type of asset. This article deals with some of the tax aspects incident to the acquisition of real estate held as an investment or used in, or connected with, a business; it does not cover the personal use of real estate, either as a residence or otherwise.

THE ACQUIRING ENTITY: WHO SHOULD OWN THE PROPERTY

A major question confronting the purchaser of real estate is who should own the property. Tax aspects must be considered in answering this question, but they will not necessarily be controlling. Non-tax factors must always be studied, and their importance may sometimes force the acceptance of unwanted tax implications. Among these non-tax factors are the problems of financing the transaction, limiting liability, and fulfilling the practical business needs of the purchaser.

In considering the tax aspects of the form of acquisition, the problem is narrowed to a choice between the corporate form and some form of "single tax ownership." The latter includes ownership by an individual or individuals, partners, and trusts. Earnings resulting from this form of ownership will incur only one tax, while corporate earnings will be doubly taxed, to the corporation and again to the shareholders if distributed to them.

If the particular real estate project is relatively small in scale and the number of participants is limited, individual ownership or variations of it, such as joint tenancy and tenancy-in-common, may be the form in which the property should be acquired. Where, however, there are a number of people involved, individual ownership and its variations can create serious problems of management and control.
Single Tax Ownership

Tenancy-in-Common

A common form of "single tax ownership" is a tenancy-in-common. In Ohio, any conveyance to two or more persons, even as "joint tenants," without any express provision for survivorship, will be construed as a tenancy-in-common. If a tenancy-in-common is not actively engaged in business, it will not be required to file a tax return as a partnership and there is little danger of its being an association taxable as a corporation, especially if the owners share the control. Each tenant-in-common will be subject to taxation only on that fraction of the income, and conversely may deduct only that fraction of expenses, equivalent to his interest in the total ownership.

Joint Tenancy

A joint tenancy with right of survivorship is another variation of "single tax ownership," although it is perhaps not as frequently encountered as tenancy-in-common. Income from property so owned, and gain or loss from its disposition, are divided equally among the joint tenants, but the expenses are deductible by the joint tenant who pays them.

Partnership

A partnership is a further variation of "single tax ownership." This form of organization is relatively simple and allows the inclusion of other types of entities as partners. The term "partnership" includes syndicates, joint ventures, pools, and other unincorporated

3. A tenant-in-common who furnishes the consideration for the acquiring of an interest in the property by others is regarded as making a taxable gift. Treas. Reg. § 25.2511-1(e) (1958); cf. Treas. Reg. § 25.2511-1(f) (1958). Upon the death of a tenant-in-common, only his interest in the property is included in his gross estate for federal estate tax purposes, even if he furnished all the consideration for the acquiring of the entire interest in the property. Harvey v. United States, 185 F.2d 463, 469 (7th Cir. 1950).
5. I.T. 3754, 1945 CUM. BULL. 143, 144.
6. I.T. 3785, 1946-1 CUM. BULL. 98; see G.C.M. 15530, XIV-2 CUM. BULL. 107 (1935). A joint tenant who furnishes the consideration for the acquiring of an interest in the property by others is regarded as making a taxable gift, except that if a husband and wife are the parties, no gift is involved at that time unless the donor elects to treat the transaction as an immediate gift; if no such election is made, there is a gift when the joint ownership is severed other than by death, unless the proceeds are divided proportionately to the original contributions. INT. REV. CODE OF 1954, §2515. Upon the death of a joint tenant, the value of the entire property will be included in his gross estate for federal estate tax purposes unless contribution to the purchase price by the survivor is proved. INT. REV. CODE OF 1954, § 2040. Note the constitutionally questionable Ohio inheritance tax rule regarding spouses. OHIO REV. CODE § 5731.02(E).
organizations by means of which any business or venture is carried on, which is not a trust, corporation, or association taxable as a corporation.\(^7\) There is no legal objection to the holding of title to real estate in the name of a partnership.\(^8\)

A partnership is not a taxable entity; it merely files an information return. Accordingly, there is no double tax on the cash withdrawals of the partnership earnings and excess mortgage proceeds (except to the extent that these exceed the partner's basis for his partnership interest), and depreciation and other deductions attributable to the partnership property are directly available to the partners, thus affording them a means of reducing their other income.\(^9\) Furthermore, the "collapsible corporation" problems attendant upon the disposition of certain corporations are not usually present with the sale of a partnership interest; only capital gain results from such a sale.\(^10\)

One of the main disadvantages of a partnership is that it lacks both continuity of existence and centralized management in a representative capacity. Any efforts to avoid these shortcomings may lead the partnership into being classified as an association taxable as a corporation.\(^11\) The current position of the Internal Revenue Service is apparently that a partnership will be taxable as an association if it has continuity of existence and centralized management in a representative capacity. Thus, if the partnership terminates upon the death of a partner or the transfer of his interest during his lifetime, or if its continuation is dependent upon the consent of the surviving or remaining partners,\(^12\) obviously there is no continuity of existence; therefore, it probably will not be taxable as an association even if it should have centralized management. Conversely, if the partnership agreement provides for continuity of existence, it may still avoid the association classification if it does not have centralized management, \textit{i.e.}, if managerial duties are not assigned to less than all the partners. The lack of centralized management destroys any resemblance to a board of directors of a corporation. Another provision which does

\begin{itemize}
\item \texttt{INT. \textit{REV. CODE OF 1954, § 7701(a) (2).}}
\item \texttt{OHIO \textit{REV. CODE § 1775.07(c).}}
\item \texttt{INT. \textit{REV. CODE OF 1954, §§ 702, 731.}}
\item \texttt{INT. \textit{REV. CODE OF 1954, § 741.}} But cf. \texttt{INT. \textit{REV. CODE OF 1954, § 751.}} While situations exist where such a sale can be pigeon-holed into the collapsible partnership rules and thus cause the gain to be taxed as ordinary income, it is significant to note that in real estate partnerships depreciable property and property used in the trade or business and held for more than six months can never be classified as "substantially appreciated inventory." The only type of real estate partnership which may have substantially appreciated inventory resulting in ordinary income on disposition of a partnership interest is a dealer partnership, \textit{i.e.}, one that deals in real estate or one in which the selling partner is a dealer in real estate. \texttt{INT. \textit{REV. CODE OF 1954, § 751(d) (2).}}
\item \texttt{Bloomfield Ranch v. Commissioner, 167 F.2d 586 (9th Cir. 1948); Poplar Bluff Printing Co. v. Commissioner, 149 F.2d 1016 (8th Cir. 1945); Treas. Reg. 118, § 39.3797-4 (1953).}
\item \texttt{Rev. Rul. 484, 1954-2 \textit{CUM. BULL. 242.}}
\end{itemize}
not endanger the non-taxable status of the partnership is one which gives the partnership the first right to purchase the interest of a selling partner, and which provides for the termination of the partnership if the right is not exercised, with the right in the remaining partners to continue the business.\(^\text{13}\)

However, where limited liability for the investors is a desired feature of the venture, a general partnership is not feasible, since all partners are fully liable. A limited partnership may be the solution: the limited partners have the protection of limited liability, management is centralized in the general partners, and the limited interests ordinarily are transferable. Such partnerships do not have to terminate when a limited partner dies. The Internal Revenue Service has ruled that a limited partnership is not taxable as a corporation where the partnership can continue without interruption on the death or withdrawal of even a general partner, if all the general partners consent to the continuation.\(^\text{14}\) However, it is desirable that the general partners have a substantial investment in the partnership; they must be financially responsible and not mere dummies or agents of the limited partners.\(^\text{15}\) Furthermore, the limited partners must not take any part in the management of the property. If these rules are observed, there is a strong likelihood that the Service will not attempt to treat the partnership as an association taxable as a corporation.

**Real Estate Trust**

Another form of single tax ownership that may be employed is a real estate trust. Trusts are, in general, taxed on a conduit theory, i.e., the beneficiaries are taxed on income of the trust distributed to them, and the trust is taxed only on undistributed income. Trusts generally resemble a corporation in that there is centralized control in the trustee, transferability of the beneficial interests, and continuance of the trust on the death of a beneficiary participant. Ordinarily, these factors alone are not sufficient to cause a trust to be taxed as a corporation — to be so taxed it must also be formed for profit and be engaged in a business.\(^\text{16}\) If a trust is employed merely as a means to hold title and to perform ministerial duties at the direction of all the beneficiaries, and if the trustee has no power to bind the beneficiaries without their consent, the trust probably is not taxable as a corporation since the element of centralized management in

13. Ibid.
a representative capacity is lacking. Conversely, if less than all the beneficiaries can act for the others, and if the trustee can act without the consent of all the beneficiaries, even a trust holding property under a net, long-term lease may find itself taxable as a corporation.

One thing is certain in this area of taxing unincorporated entities as corporations, and that is the uncertainty which arises from the multifold factual variations that may be found. The risk of being taxed as a corporation is great when a partnership or a trust is employed if centralized management in a representative capacity and continuity of existence are present.

As indicated above, the principal disadvantages of the various forms of "single tax ownership," where the owners are numerous, are that: management problems may be created, there may be difficulty in transferring title, and continuity of existence is not easily attainable. Another major disadvantage is the risk of personal liability, which, however, may be minimized by liability insurance in the case of torts and by the use of covenants not to sue in the case of mortgages.

**Corporate Ownership**

Ownership of real estate by a corporation easily overcomes the problems of "single tax ownership" in so far as the factors of centralized management, continuity of legal title, and continuity of the enterprise uninterrupted by the deaths of any of the participants are concerned. From these standpoints, the corporate form is superior to any other, and it may have other advantages also. Corporate income is taxed at 30% on the first $25,000 and at 52% on amounts in excess of $25,000. These rates may be lower than the continuously progressive rates applicable to individuals, and hence, it may be more advantageous to use the corporate form. In addition, if the shareholders lend funds to the corporation, as distinguished from a capital structure consisting solely of stock, a large portion of the investment in the real estate project may be returned tax-free to the investors. Funds to repay the loans may be generated both from income and from the depreciation account. If the debt qualifies as a bona fide indebtedness, the moneys paid to the investors, being a return of capital, will be tax-free to them. In addition, of course, the corporation would have the benefit of an interest deduction.

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20. *INT. REV. CODE OF 1954*, § 163. But see *INT. REV. CODE OF 1954*, § 267, disallowing a deduction by an accrual basis corporation for interest paid or accrued where the interest is not paid to a more-than-50%, cash-basis shareholder within 2½ months after the close of the corporation's taxable year.
Another advantage of using a corporation is the flexibility which may be attained in its capitalization. For example, preferred stock may be issued to inactive investors in order to give the managing group, with their common stock, a larger equity in the corporation. 21

A real estate corporation may also be used as a vehicle for investing in stocks of other domestic corporations. An amount equal to 85% of the dividends received by the real estate corporation from such investments may be deducted by it. 22 Since this is a real estate corporation, it will not be subject to the prohibitive tax rates imposed on a "personal holding company" 23 by reason of such investments, so long as at least 50% of its gross income consists of rents. 24 The corporation can also retain at least $100,000 of accumulated earnings without fear of the accumulated earnings surtax. 25 In addition, employee-shareholders may receive such fringe benefits as: pension and profit-sharing plans, wage continuation plans, and health and accident insurance. These benefits are generally not available to the owners of an unincorporated enterprise. 26

Disadvantages

However, the corporate form does have its disadvantages. One of the major disadvantages is that the earnings of the corporation are not available to the shareholders without their paying an additional tax on the distribution from the corporation, i.e., there is a tax at the corporate level and one at the shareholder level. This additional tax to the shareholders will be at ordinary income rates if the corporation has sufficient earnings and profits from the current year, or prior years, to cover the distribution. 27

Another disadvantage of the corporate form is the ever-present possibility of a penalty tax for unreasonable accumulation of surplus. 28 This danger is less acute where the corporation has substantial mortgages or other indebtedness, because the need to accumulate

21. Such preferred stock, if issued upon incorporation, is not "Section 306" stock. INT. REV. CODE OF 1954, § 306(c) (2).
22. INT. REV. CODE OF 1954, § 243. If the real estate corporation is in the 52% bracket, the effective tax rate on the total amount of dividends received will be 7.8%.
24. INT. REV. CODE OF 1954, § 543 (a) (7).
25. INT. REV. CODE OF 1954, § 535 (c) (3).
27. INT. REV. CODE OF 1954, § 316. The burden of double taxation is alleviated or reduced in certain events. For example, a shareholder receiving dividends is entitled to a credit against his tax equal to an amount not in excess of 4% of such dividends. INT. REV. CODE OF 1954, § 34. Some distributions, such as those in partial or complete liquidation of the corporation, are subject to tax only as capital gain. INT. REV. CODE OF 1954, § 331; see also INT. REV. CODE OF 1954, §§ 301 (c) (2), 301 (c) (3). Regarding the distribution of excess mortgage proceeds by the corporation to its shareholders, see INT. REV. CODE OF 1954, §§ 312 (j), 341, and Rev. Rul. 357, 1957-2 CUM. BULL. 900.
earnings to amortize such obligations will excuse the accumulation of such earnings. Nevertheless, in determining the form in which the property is to be acquired, this penalty tax is a factor to be considered.

Also, depreciation deductions and deductions for carrying charges incurred during construction of improvements on the real estate will not be available to the shareholders, who at that time will probably be in a higher tax bracket than the corporation since the corporation will not yet have realized its full income-producing potential.

On liquidation of a corporation, any gain to the shareholders is taxed at capital gain rates, even though that gain includes accumulated earnings of the corporation. Here, however, as well as in the area of stock sales, the danger of "collapsibility" lurks as a serious disadvantage in the use of the corporate form.

Many of these corporate disadvantages can be overcome if the real estate venture can qualify as a Subchapter S corporation. This avenue of escape is not available to a corporation if its rental income exceeds 20% of its gross receipts. However, income from the operation of hotels, motels, or parking lots is not regarded as rental income for Subchapter S purposes, and hence will not disqualify the corporation.

**Importance of Timing**

Timing is also important in determining the form the acquiring entity is to take. If the corporate form is chosen initially, it is generally difficult to change the form of organization without encountering adverse tax consequences. This suggests the possibility of initially operating in some form of "single tax ownership" and subsequently incorporating. If the partnership form is used initially, the losses created by the fast depreciation methods and carrying charges are available as a direct offset against the partners' other income. When the partnership shows substantial taxable income, it can then be incorporated so that the income will be taxed at the lower corporate rates. This incorporation can be accomplished in either a tax-free or taxable transaction. If only stock or securities are received by the taxpayer in exchange for the transfer of the property to the corporation, the transaction will not generate any tax if certain conditions exist: immediately after the transfer the transferors must own at least 80% of the total combined voting power of all classes of stock entitled to vote, and at least 80% of the total number of shares

29. See INT. REV. CODE OF 1954, § 266.
30. See INT. REV. CODE OF 1954, § 341. See also discussion p. 238.
32. INT. REV. CODE OF 1954, § 1372(e) (5).
34. See discussion p. 238.
35. See discussion pp. 197-99.
The basis of the property to the corporation will be the same as it was to the shareholders. However, if the amount of the mortgage indebtedness and other liabilities assumed by the corporation, or subject to which it takes, exceeds the basis of the property transferred at the time of incorporation, that excess will be taxable to the shareholders; the rate of such tax will depend on whether or not the property was a capital asset.

If a taxable incorporation is desired in order to step up the basis of the property to the corporation for depreciation, a bona fide sale to the corporation will accomplish this. The transferors would pay a capital gains tax, assuming they were not real estate dealers, and the corporation would get higher depreciation deductions as an offset against its ordinary income. However, if depreciable property is transferred to a corporation more than 80% in value of the outstanding stock of which is owned by an individual, his wife, his minor children, and his minor grandchildren, then the gain on the sale is taxable as ordinary income to the transferors and not as capital gain.

**Multiple Corporations**

The advantages of the corporate form have led to the use of multiple corporations in real estate transactions. The benefits obtained from using multiple entities are substantial. Each corporation has a $25,000 surtax exemption. This means that the first $25,000 of income of each corporation is taxable at the 30% rate, resulting in a savings of $5,500 per year for each corporation in the 52% bracket. Each corporation can accumulate $100,000 of earnings without fear of the penalty tax on accumulated earnings. Where it is contemplated that a part of the business may be liquidated or sold, the liquidation or the sale can be accomplished with a single capital gain tax (assuming there is no "collapsible corporation" problem), whereas if there were only one corporation, such liquidation or sale might be subject to taxation both at the corporate and at the shareholder levels. The disposal of a part of the total business may be accomplished without disturbing what remains by disposing of the particular entity carrying on that part of the business. The multiple corporation approach also permits the use of different taxable years

36. **Int. Rev. Code of 1954, § 351.**
37. **Int. Rev. Code of 1954, § 362(a).**
38. **Int. Rev. Code of 1954, § 357(c).**
39. See discussion pp. 252-53.
40. **Int. Rev. Code of 1954, § 1239.**
41. **Int. Rev. Code of 1954, § 11(c).**
42. **Int. Rev. Code of 1954, § 535(c).**
43. See **Int. Rev. Code of 1954, §§ 332-33.**
44. See discussion p. 238.
for the corporations and different accounting methods of reporting income.\textsuperscript{46}

However, there are also disadvantages in the use of multiple entities. The losses of one corporation cannot be offset against profits of the others. There may be serious problems, arising from the duplication of operations, such as the allocation of income and expenses among the several entities, and perhaps additional costs, such as legal and accounting expenses and franchise taxes.

Multiple corporations can be set up on a horizontal basis. For example, a builder who has acquired a tract of land on which he is going to build homes may organize separate corporations for acquiring the land, grading it, installing streets, constructing the homes, and selling them. Multiple corporations can also be set up on a vertical basis. Each corporation will do a complete job, from the acquisition of its particular lots in a development to the building of the houses and their sale.

There are, however, serious tax problems in the use of multiple entities. Until recently, it had been generally thought that where multiple entities had been set up initially (as distinguished from the division of an existing corporation),\textsuperscript{46} the Internal Revenue Service had little chance of upsetting the plan; that is, except perhaps by reallocating income and deductions realistically when the multiple corporations were under common control and dealings between them were not equivalent to the results obtained from arm’s-length transactions.\textsuperscript{47} However, this situation was changed by a recent case which involved the formation by an individual of nine real estate development corporations, by conveying land to each. The court applied section 269 to deny the surtax exemption to the one of these nine corporations which was involved in the tax litigation, on the principle that the acquisition of control by the individual shareholder secured to him a tax advantage, in the form of a surtax exemption, which he would not have enjoyed but for the incorporation. In other words, the court held that except for the tax implications, there was no business purpose in separately incorporating the various projects; the corporation’s only function was to contract with a construction company to build houses and with a sales company to sell them, all of which companies were owned by the same individual.

Where separate corporations have undivided interests in property

\textsuperscript{45} See \textit{Int. Rev. Code of 1954}, §§ 441, 446.

\textsuperscript{46} \textit{Int. Rev. Code of 1954}, § 1551; Coastal Oil Storage Co. v. Commissioner, 242 F.2d 396 (4th Cir. 1957).

\textsuperscript{47} See \textit{Int. Rev. Code of 1954}, § 482. The Service may also argue that if income is diverted from one corporation to another solely to keep each corporation’s income out of the 52% bracket, such income should be attributed to the former corporation under § 61(a).

which is subject to common management, the Internal Revenue Service may attempt to treat the entire group of corporations as a single association which is itself taxable as a corporation. Income received by the constituent corporations would then be treated as dividends to them, and, in effect, a system of triple, rather than double, taxation would be imposed.

The factor of overriding importance in the use of multiple entities is the ability to prove a business purpose for their use. The existence of a business purpose is the best defense to any attack upon the separateness of the multiple corporations.

If such a business purpose exists, the further question arises whether the multiple entities should be brother-sister or parent-subsidiary corporations. The principal objection to brother-sister corporations is that the losses of one may not be offset against the profits of the others. Such an objective may be attained with parent-subsidiary corporations through the filing of consolidated returns. Furthermore, the use of consolidated returns eliminates the recognition of gains, otherwise taxable, in transactions between the members of the parent-subsidiary group. However, the use of consolidated returns involves the loss of the multiple exemptions, the desire for which may have been the reason for using multiple entities in the first place, and a 2% surtax on consolidated income. In addition, the creation of subsidiaries by a parent, if done for tax-avoidance purposes, may not result in obtaining the multiple exemptions desired. The decision on what form the multiple entities shall take obviously involves a balancing and weighing of the various factors in the particular case.

Determining the Method of Acquisition

Another problem facing the acquirer of real estate is the method by which the acquisition is to be made and his resulting basis for the property. For various business reasons the acquisition may be made by the exercise of an option. The basis of real estate acquired by exercise of an option is the cost of the option plus the amount paid pursuant to its exercise. If the option was inherited from a decedent, its basis will be its fair market value at the date of death of the decedent. However, if a taxpayer is given, by a decedent's will,
the right to purchase property of the decedent for less than its fair market value and he subsequently exercises this right, his basis for the property will be his actual cost in acquiring it; the value of the right is not added to his actual cost.\textsuperscript{55}

Where a lump sum is paid for more than one asset, without segregation, the cost generally must be allocated among the assets in proportion to their fair market value.\textsuperscript{56} This rule does not apply where land and the building on it are purchased separately.\textsuperscript{57} Accordingly, no part of the cost of an option to purchase the land can be allocated to the basis of the building for depreciation or for other purposes.\textsuperscript{58}

When real estate is acquired for cash, the basis of the property to the purchaser is its cost to him.\textsuperscript{59} However, if the property is acquired in a taxable exchange for other property, its basis is not the fair market value of the property given; it is the fair market value of the property received.\textsuperscript{60} The basis of the property will include the amount of any indebtedness assumed or subject to which the purchaser takes the property.\textsuperscript{61}

If real estate is acquired by gift, its basis to the donee is the same as it was in the hands of the donor,\textsuperscript{62} increased by the amount of gift tax paid with respect to the gift if the gift was made on or after September 2, 1958, or even if the gift was made before that date if the property was not sold, exchanged, or otherwise disposed of before such date.\textsuperscript{63} For purposes of determining the loss, if any, on the subsequent sale of donated property, its basis cannot exceed its fair market value at the date of the gift.\textsuperscript{64} Accordingly, if property has declined in value to less than its adjusted basis, the donor should sell it, thereby obtaining a loss deduction, and give the proceeds to his donee. If he gives the property to the donee, who then sells it, the donee’s loss will be limited to any decline in value occurring after the gift is made.

Real estate acquired from a decedent in a manner that results in its inclusion in his gross estate for federal estate tax purposes will have as its basis the fair market value on the date of death or on the

\textsuperscript{55} Valleskey v. Nelson, 59-2 U.S. Tax Cas. § 9721 (7th Cir. 1959); Mack v. Commissioner, 148 F.2d 62 (3d Cir. 1945).

\textsuperscript{56} See discussion p. 164.

\textsuperscript{57} Carnegie Center Co., 22 T.C. 1189 (1954).

\textsuperscript{58} For holding purposes, the date of acquisition of property by virtue of exercise of an option is the date the option is exercised and the property conveyed, not the date on which the option is granted. Helvering v. San Joaquin Fruit & Investment Co., 297 U.S. 496 (1936).

\textsuperscript{59} INT. REV. CODE OF 1954, § 1012.

\textsuperscript{60} Philadelphia Park Amusement Co. v. United States, 126 F. Supp. 184 (Ct. Cl. 1954). But see Estate of Isadore Myers, 1 T.C. 100 (1942).

\textsuperscript{61} Crane v. Commissioner, 331 U.S. 1 (1947).

\textsuperscript{62} INT. REV. CODE OF 1954, § 1015 (a).

\textsuperscript{63} INT. REV. CODE OF 1954, § 1015 (d). This section contains several limitations.

\textsuperscript{64} INT. REV. CODE OF 1954, § 1015 (a).
optional valuation date.\textsuperscript{65} If real estate is acquired as compensation for services, its fair market value will be included in the recipient's gross income,\textsuperscript{66} and that value will be its basis.\textsuperscript{67}

Real estate received by a creditor in partial or full discharge of the debt has a basis to the creditor equal to its fair market value.\textsuperscript{68} If the property has no fair market value, the creditor's basis for it is the amount of the debt discharged.\textsuperscript{69}

Another method of acquiring real estate is by leasing it. The tax problems incident to this method, including those associated with leases with options to purchase, are treated elsewhere in this Symposium.\textsuperscript{70}

FINANCING THE ACQUISITION

Investors in real estate are seldom in a position to purchase the property entirely with cash. In fact, most investors probably do not want to expend large sums of cash for the property. They prefer mortgage financing because it can give them definite tax benefits. It is through mortgage financing that investors obtain leverage, by purchasing the property with as small a cash outlay as possible. The balance may be paid in various manners: by a purchase money mortgage, by an obligation to make further payments under an installment contract, by borrowing on the security of the property, or by taking subject to or assuming an existing mortgage obligation. In this way all increase in the value of the property goes to the owner, even though his equity may be comparatively small. Furthermore, since depreciation deductions are based on the entire cost, \textit{i.e.}, both cash outlay and the amount of the mortgage debt,\textsuperscript{71} tax deductions are increased without any additional outlay of cash. Of course, the property must generate enough income to pay the principal of the mortgage, or the property may be lost. Also, if the property depreciates in value, then the equity owner's loss will be greater where the mortgage debt is high, because the debt remains the same and the loss in value comes out of the cash investment.

Another possible means of financing is through a sale and leaseback, which is discussed in greater detail elsewhere.\textsuperscript{72} This is an increasingly popular method of financing, since the purchaser usually can obtain more money this way than by conventional mortgage financing. Also, the capital that otherwise would be tied up if he

\textsuperscript{65} \textsc{Int. Rev. Code of 1954}, \S\ 1014.
\textsuperscript{66} \textsc{Int. Rev. Code of 1954}, \S\ 61(a).
\textsuperscript{67} William T. Bivin, 21 B.T.A. 1051 (1930).
\textsuperscript{68} Herbert N. Fell, 18 B.T.A. 81 (1929).
\textsuperscript{69} Society Brand Clothes, Inc., 18 T.C. 304, 317 (1952).
\textsuperscript{70} See discussion p. 178.
\textsuperscript{71} Crane v. Commissioner, 331 U.S. 1 (1947).
\textsuperscript{72} See discussion pp. 249-51.
owned the property is free, and his balance sheet looks better even though, as a practical matter, long-term lease rentals are as fixed an obligation as are mortgage payments. There are also disadvantages to this type of financing. The most important one is that, in a sale and lease-back arrangement, the seller-tenant is locked in, i.e., he cannot freely move out if a better opportunity or better location is available. Also, if the real estate increases in value, that increase obviously accrues to the benefit of the purchaser-lessee, and not to the seller-tenant. Therefore, as in all other situations, the various tax and non-tax factors must be carefully weighed before a decision is made.