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# Crane's Basis: A Reappraisal of the Crane Decision and Its Effect on the Concept of Basis

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# CRANE'S BASIS: A REAPPRAISAL OF THE *CRANE* DECISION AND ITS EFFECT ON THE CONCEPT OF BASIS*

## I.

## INTRODUCTION

Possibly one of the most fundamental and, at the same time, one of the most complex concepts of taxation is that of "basis." This broad term describes the capital investment in property and serves as the departure point for determining the gain or loss on a sale or other exchange, as well as for computing depreciation and depletion. The function of "basis" is to provide a tax-free recovery of investment.[1] The taxpayer is permitted to recover his cost, or what can be construed as his cost, without tax consequences and prior to a determination of gain or loss on the transaction.[2]

The Code provides simply that the basis of property shall be the cost thereof.[3] The basis is determined immediately upon acquisition by the taxpayer, and need not represent a cash outlay only. Cost, like basis, is a concept that the tax field has derived from the accountants and economists. It signifies any sacrifice in money, or the equivalent thereof, that is made toward the acquisition of the property.[4]

The basis of property, whether it be cost or some other valuation, is rarely used without change for tax purposes, but must be adjusted for such items as depreciation, depletion, capital recoveries and capital expenditures. The resultant figure gives the working unit of "adjusted basis."[5] The same approach is utilized in computing the "basis" used for determining depreciation or depletion. Adjustments are made at the beginning of the taxable year, and the depreciation or depletion is computed on that basis with reference to the remaining useful life of the property. As a general rule, adjusted basis is used in computing gain or loss from the sale or other disposition of property.[6] It is fundamental that the gain or loss is

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1. Rubin, *How Mortgages Affect Basis; the Rules are in Accord With Economic Reality*, 13 J. TAXATION 38 (1960).
2. Detroit Edison Co. v. Comm'r, 319 U.S. 98 (1943).
3. INT. REV. CODE OF 1954, § 1012 — Basis of Property-Cost.

   § 1012 — The basis of property shall be the cost of such property, except as otherwise provided in this subchapter and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses). The cost of real property shall not include any amount in respect of real property taxes which are treated under section 164(d) as imposed on the taxpayer.

The 1939 Code, § 113(a), similarly provided that the basis of property was its cost, subject to certain adjustments.

4. Wurzel, *The Tax Basis for Assorted Bargain Purchases or: The Inordinate Cost of "Ersatz" Legislation*, 20 TAX L. REV. 165 (1964).
5. INT. REV. CODE OF 1954, § 1011; Treas. Reg. § 1.1011-1.
6. *Ibid.*

always determined by the difference between the "tax basis or cost,"[7] and the proceeds or "amount realized."[8] The amount realized for the property is generally the total consideration received by the taxpayer for its transfer, less his expenses, that is, the monetary equivalent of the total economic benefit derived by the taxpayer.[9]

## II.

## BASIS OF PROPERTY ENCUMBERED BY MORTGAGES

The complexities of the tax problems attendant a sale, transfer or other disposition of real property are aggravated by the existence of mortgages.[10] Placing a mortgage on the property, in and of itself, has no tax consequences, in the sense that it is neither a sale nor an exchange of the property. The mortgagor remains the owner of the property after execution of the mortgage as he was before.[11] While, practically speaking, the mortgage may exhaust the value of the property, for tax purposes the mortgagor has merely pledged the property as security. Irrespective of the basis, neither gain nor loss accrues to the mortgagor by virtue of the mortgage transaction.[12] Thus, if a taxpayer bought property for $50,000 and subsequently mortgaged it for $75,000 he has realized no gain.[13] Mere receipt of the mortgage proceeds produces no taxable income. Taxation must await a subsequent sale or exchange of the property; only then is the transaction completed.[14]

However, upon a subsequent disposition, such as a sale, foreclosure, or voluntary surrender of the property, the mortgage is taken into account in determining the mortgagor's gain or loss, and the buyer's basis. The inclusion of mortgages in the basis rests partially on an assumption that the mortgage will eventually be paid.[15] Thus, where the purchaser assumes the seller's mortgage liability, the amount of the indebtedness is includable in the amount realized by the seller.[16] Likewise, the amount must be included in the buyer's basis for future computations. Where the purchaser, rather than assuming the indebtedness, merely takes the

7. The term "tax basis" has been applied to the *Crane* situation and its successors, discussed in Sections II and III *infra*. In its use the term has become almost synonymous with "adjusted basis" for that type situation. See, Lurie, *Mortgagor's Gain on Mortgaging Property for More Than Cost Without Personal Liability (Contentions of Taxpayer's Counsel in a Pending Case)*, 6 TAX L. REV. 319, 326 (1951).

8. Meyer, *Disposition of Real Estate Where Mortgage Indebtedness Exceeds "Tax Basis,"* N.Y.U. 7TH INST. ON FED. TAX. 338 (1949).

9. PH STAND. FED. LAW OF TAX SERV., Vol. 2 (1965), ¶ 10,031, ¶ 10,036.

10. 3A MERTENS, FEDERAL INCOME TAXATION § 21.11 (Zimet & Weiss Ed. 1958).

11. See Judge Hand's opinion in Comm'r v. Crane, 153 F.2d 504, 506 (2d Cir. 1945).

12. For a general discussion of the area see, Rusoff, *The Federal Income Tax Consequences of Transactions Relating to Mortgages on Land*, 4 BUFFALO L. REV. 181 (1955).

13. Woodsam Associates, Inc. v. Comm'r, 198 F.2d 357 (2d Cir. 1952), *aff'g*, 16 T.C. 649 (1951); Lutz & Schramm Co., 1 T.C. 682 (1943).

14. Lutz & Schramm Co., 1 T.C. 682 (1943).

15. B. F. Avery & Sons, 26 B.T.A. 1393 (1932), *appeal dismissed*, 67 F.2d 985 (6th Cir. 1933).

16. U.S. v. Hendler, 303 U.S. 564 (1938).

property subject to it, different consequences may ensue. The question arises whether the purchaser has acquired anything more than an equity in the property, thereby excluding the amount of the unassumed indebtedness from his basis.[17]

## III.

## THE *Crane* DECISION

This latter problem confronted the Supreme Court in the leading case of *Crane v. Commissioner*.[18] The question arose in determining the amount of taxable gain arising from the acquisition of an apartment house and the land on which it stood through devise. The amount of the unassumed mortgage which encumbered the property was found to equal the fair market value of the property at the date of death for Federal Estate Tax purposes. Depreciation deductions subsequently allowed were based on the full, undiminished value of the property.[19] To avoid foreclosure, this property was later transferred by the taxpayer to a third party, still subject to the indebtedness, for a small amount of cash (the net cash receipt to the taxpayer was $2,500). The taxpayer claimed that the outstanding balance of the encumbrance should not be added to the cash received in determining the amount realized on the transfer, since the mortgage had never been personally assumed. The Tax Court,[20] accepting the taxpayer's claim, found that her realized gain was only the money or "boot" received since her basis was only her equity in the property at the date of her husband's death, which was zero.[21]

The Commissioner contended that since the tranaction was a sale, the gain should be determined by adding the net cash receipt to the amount of the unassumed mortgage and deducting the taxpayer's basis from that sum. He further asserted that this was the value of the property, as determined for estate tax purposes (which, as pointed out, was equal to the encumbrance), less the depreciation allowance due the taxpayer. The Circuit Court reversed the Tax Court and upheld the Commissioner's contentions.[22] The Supreme Court, in affirming, stated:

> . . . we think that a mortgagor, not personally liable on the debt, who sells the property subject to the mortgage and for additional consideration, realizes a benefit in the amount of the mortgage as well as the boot. If a purchaser pays boot, it is immaterial as to our problem whether the mortgagor is also to receive money from the

17. 3A MERTENS, *op. cit. supra* note 10, § 21.11.
18. 331 U.S. 1 (1947).
19. The taking of depreciation by the taxpayer and utilizing the fair market value unadjusted for the mortgage was unquestionably detrimental to the taxpayer's position. See Rusoff, *supra* note 12, at 184; See also Note, 49 COL. L. REV. 845 (1949).
20. Beulah B. Crane, 3 T.C. 585 (1944).
21. The basis was determined to be zero because as pointed out above the property was acquired through devise, and the adjusted basis thereof was its fair market value at the time of the decedent's death-taken as equal to the amount of the mortgage as determined for estate tax purposes in accord with INT. REV. CODE OF 1939, § 113(a)(5).
22. 153 F.2d 504 (2d Cir. 1945).

> puchaser to discharge the mortgage prior to sale, or whether he is merely to transfer subject to the mortgage — it may make a difference to the puchaser and to the mortgagee, but not to the mortgagor. Or put in another way, we are no more concerned with whether the mortgagor is, strictly speaking, a debtor on the mortgage, than we are with whether the benefit to him is, strictly speaking, a receipt of money or property. We are rather concerned with the reality that any owner of property, mortgaged at a figure less than that at which the property will sell, must and will treat the conditions of the mortgage exactly as if they were his personal obligations. If he transfers subject to the mortgage, the benefit to him is as real and substantial as if the mortgage were discharged, or as if a personal debt in an equal amount had been assumed by another.[23]

This language, so heavily relied on by the majority, has been subjected to much criticism. As one observer noted: "The Court, with doubtful justification, took the buyer's willingness to pay cash over the mortgage as proof that the value of the property in this case was greater than the mortgage. The opinion thus invites the speculation that Mrs. Crane might have been better off to give the property away without taking any 'boot'."[24] It seems somewhat ironic that a taxpayer can be charged with a gain from a sale or other disposition of property where he receives nothing of any real value. He has surrendered a possibly valuable asset, received nothing (or only a nominal amount) in return, and may yet face substantial capital gains tax. The possibility thus arises that one could lose his property by foreclosure and, although having suffered an economic loss, be subject to taxation to the extent that the discharged liability exceeded the basis of the property foreclosed.[25]

Application of the rule, enunciated in *Crane,* that a transferor "realizes" an economic benefit on the disposition of mortgaged property, regardless of personal responsibility, can be illustrated by the following hypothetical:

A taxpayer purchases a depreciable property for \$15,000, subject to a mortgage of \$10,000 (the taxpayer does not assume the indebtedness), giving him a total cost basis, under the *Crane* rationale, of \$25,000. While the property is held by the taxpayer, depreciation deductions aggregate \$16,000, thus the adjusted basis becomes \$9,000. The property is then transferred by the taxpayer still subject to the mortgage, but for no additional consideration. Applying the *Crane* rule, the transferor would realize a gain of \$1,000, the difference between the amount realized (no cash, but the full \$10,000 unassumed mortgage indebtedness) and the adjusted basis of \$9,000.

*Crane* itself involved property acquired by devise and found additional justification in certain administrative practices and rulings related

23. 331 U.S. 1, 14 (1947).
24. Lurie, *Mortgagors with "Negative Equities" and "Negative Bases,"* N.Y.U. 10TH INST. ON FED. TAX. 71, 73 (1952).
25. Schlesinger, *Disposition of Property Having a Negative Basis,* N.Y.U. 15TH INST. ON FED. TAX. 339, 340 (1957).

to inherited property.[26] Additionally, broad interpretation was given to the term "property" as used in Section 113(a)(5) of the 1939 Internal Revenue Code.[27] The regulations[28] apparently required that a quite broad definition be given to the concept of "property," and that its value be set at the fair market value utilized for estate tax purposes, unaffected by encumbrances. An interesting possibility for a different result from the decision could be postulated if the estate from which the property descended had itself been free from the indebtedness. Section 81.38 of Regulation 105[29] provides for inclusion of only the equity value in the gross estate, where the estate is not liable on the debt. It thus appears that the "equity" interpretation advocated by the taxpayer was not necessarily excluded from Section 113(a)(5) of the Internal Revenue Code of 1939.[30] Regardless of speculation, *Crane* established that unassumed mortgages should be included in the basis of inherited property. Extension of the doctrine, enunciated in *Crane,* to "purchase" situations was left for subsequent decisions.[31]

## IV.

## EXTENSION OF THE RULE

In *Blackstone Theatres Co.,*[32] inclusion of the full amount of an encumbrance in the depreciation basis for the property was upheld, although the taxpayer had no personal liability thereunder. The Tax Court, relying chiefly on the *Crane* case for its decision, stated:

> . . . [W]hatever vitality respondent's present position, or a sterner one he asserts he may have taken, may have had before the Supreme Court spoke in *Crane v. Commissioner,* [Citation omitted], it can not now be said to have survived the broad sweep of that decision. From *Crane* we can deduce the following applicable principles: (a) The basis for given property includes liens thereon, even though not personally assumed by the taxpayer; and (b) the depreciation allowance should be computed on the full amount of this basis. These principles, we believe, are controlling in this proceeding, and should be dispositive of the one litigated issue presented.[33]

26. Greenbaum, *The Basis of Property Shall Be The Cost of Such Property: How is Cost Defined?,* 3 TAX. L. REV. 351, 355 (1948).
27. Now § 1014(a) of the INT. REV. CODE OF 1954.
28. Treas. Reg. 101, art. 113(a)(5)-1(c) (1938); Treas. Reg. 105, § 81.70 (1944); Treas. Reg. 105, § 81.38 (1942).
29. Treas. Reg. 105, § 81.38 (1942).
30. See Note, 21 So. CAL. L. REV. 112, 115-16 (1947).
31. In a "purchase" situation, the question is not so much a meaning of "property" as it is of "cost" — § 113(a) of INT. REV. CODE OF 1939, and § 1012 of INT. REV. CODE OF 1954. This distinction as between amount included in cost basis, or basis of property acquired some other way, as in *Crane,* through devise, has been raised in subsequent cases, as a major point of distinction. See Respondent's brief, p. 12, in Columbus and Greenville Railway Co. v. Comm'r, on appeal to the 5th Circuit, from the Tax Court decision, 42 T.C. 834 (1964).
32. 12 T.C. 801 (1949).
33. *Id.* at 804.

This case directly presented the question of inclusion of an unassumed debt in a purchase basis, and involved, to an extent, the meaning of "cost."[34] Exclusion of this debt from the "cost" could have found justification in the cases on modification or cancellation of debts, that held the owner of the encumbered property (who was not personally liable thereon) did not realize taxable income to the extent the debt was cancelled.[35]

In *Parker v. Delaney*,[36] the transferor disposed of his interest in property which was again subject to an unassumed encumbrance. Neither cash nor any other property was tendered by the transferee, who was also the mortgagee. The transferor had taken annual depreciation deductions. The First Circuit held that a gain had been realized on the transfer and deemed *Crane* applicable even though there had been no receipt of cash or other "boot."[37] In a concurring opinion, Judge Magruder criticized such extension of the *Crane* rule and proposed an alternative approach to determine the basis.[38] Some criticism has been leveled at this approach:

> Judge Magruder's approach had the theoretical advantage of permitting a less strained construction of the phrase, 'amount realized,' and using it retroactively in *Parker v. Delaney* would have done no harm, since the result would have been the same. Used prospectively, however, it would add complexity to the calculation of deductions for depreciation without preventing the tax avoidance and hardship which may result from the *Crane* case.[39]

The Second Circuit further extended the Supreme Court's decision, involving a voluntary conversion, to the forced sale of mortgaged property.[40] In *Commissioner v. Fortee Properties, Inc.*, the view was adopted that a separate condemnation award, paid to a mortgagee on an unassumed mortgage, was taxable as gain to the owner of the property. The property had been taken by eminent domain, the mortgage value being paid directly to the mortgagee and the remainder to the owner. The Circuit Court reversed the Tax Court, finding that the "property" converted included the unassumed mortgage. The Court observed:

> In practical terms, for the purpose of protecting his property from foreclosure, where the value of the property is greater than the amount of the mortgage, the taxpayer-mortgagor has to treat the obligations of a non-assumed mortgage as if they were his personal obligations. Payment to the mortgagee relieved the owner of this necessity.[41]

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34. See text relating to notes 26 to 30. See also, note 31.
35. Ernst Kern Co., 1 T.C. 249 (1942), *appeal dismissed* (6th Cir. 1944); P. J. Hiatt, 35 B.T.A. 292 (1937). This point may be moot under the 1954 Code, but it was still relevant at the time of the *Blackstone* decision. See Rusoff, *supra* note 12, at 192.
36. 186 F.2d 455 (1st Cir. 1950).
37. This would seem to answer the question raised by the commentator quoted in the text, at note 24, although the question as to the effect on *Crane* itself is still open to speculation.
38. 186 F.2d 455, 459; 3 MERTENS, *op. cit. supra* note 10, § 20.02.
39. Rusoff, *supra* note 12, at 187.
40. Comm'r v. Fortee Properties, Inc., 211 F.2d 915 (2d Cir. 1954), *rev'g.* 19 T.C. 99 (1952), *cert. denied*, 348 U.S. 826 (1954).
41. 211 F.2d 915, 916 (1954).

The Tax Court, through Judge Murdock (who was the lone dissenter in *Blackstone*), had held *Crane* inapplicable because it defined "amount realized" only for purposes of computing "gain or loss" and "basis" on a voluntary disposition or sale.[42] It had further found the non-recognition requirements of Section 1033 satisfied by the reinvestment of an amount equal to the proceeds received by the taxpayer for his "equity" interest in the property.[43]

Although the Tax Court had been reversed in *Fortee Properties, Inc.*, it followed its own opinion in that case to decide *Frank W. Babcock*.[44] There, the part of a condemnation award paid by the state to the holder of a purchase money mortgage, which had not been assumed, was held not includable in the taxpayer's basis for determining recognition of gain. The Tax Court, reviewing the Court of Appeals decision in *Commissioner v. Fortee Properties, Inc.*, concluded:

> The Court of Appeals in holding in effect that the taxpayer had not complied with the requirements of Section 112(f), took the view that, within the meaning of that section, the property sold was the full property and not merely the owner's rights over and above encumbrances, and that the payment to the mortgagee, even though liability had not been assumed by the taxpayer, benefited it. In so holding, the Court of Appeals relied heavily on *Crane v. Commissioner*, 331 U.S. 1 (1947).
>
> In our consideration of the *Fortee* case we gave thorough consideration to the *Crane* case and held that it had no application since it did not involve Section 112(f) of the Code. In the *Crane* case the question presented was how a taxpayer, who acquired depreciable property subject to an unassumed mortgage, held it for a period, and finally sold it, still so encumbered, must compute the taxable gain. . . . We have given careful consideration to the holding of the Court of Appeals for the Second Circuit in the *Fortee* case, but with all due respect to that Court we adhere to the position taken by us in that case.[45]

On appeal, the Ninth Circuit affirmed the Tax Court decision.[46] The Court of Claims, though in an involuntary conversion situation, has followed *Commissioner v. Fortee Properties, Inc.*, in determining how much the owner might reinvest tax free by adding, out of his own funds, an amount equal to that awarded to the mortgagee.[47] The controversy over extending the *Crane* rationale to the area of involuntary conversion still remains unsettled. But, as one observer has noted:

> The preferable view seems to be that amounts realized paid in liquidation of a non-assumed mortgage should be included in the amount realized on the disposition. If not included, the effect is

42. Fortee Properties, Inc., 19 T.C. 99 (1952).
43. *Id.* at 103.
44. 28 T.C. 781 (1957).
45. *Id.* at 785.
46. 259 F.2d 689 (9th Cir. 1958).
47. Wala Garage, Inc. v. U.S., 163 F. Supp. 378 (Ct. Cl. 1958).

that "amount realized" has one meaning for purposes of § 1033 and another for § 1001.

> Moreover, unless the amount of the encumbrance is includable a taxpayer receives more favorable treatment upon involuntary conversions than he does upon a voluntary exchange of his encumbered property for like kind property under § 1031. Under that section, the transfer of a non-assumed mortgage is specifically treated as a receipt of money by the transferor. [I.R.C. § 1031(d)].[48]

It has been established that, if an obligation existed and formed part of the taxpayer's acquisition cost, the fact that the obligation was extinguished,[49] became unenforceable,[50] or was settled for a lesser amount,[51] did not affect the cost basis.

Considerable theorizing stems from the possibility, presented by the *Crane* decision, that property may have a "negative basis." Such a situation would arise where "property is subject to debt in excess of its basis."[52] The thought of a negative or sub-zero basis has been viewed by the Tax Court as incompatible with a "fundamental concept of income taxation."[53] The Supreme Court was apparently aware of this, and concerned with it, in *Crane,* but left it open and reserved the question.[54]

Until the *Easson* decision,[55] no clear authority existed in the area of negative basis. That case involved the allowance of a postponement of income realization where property was transferred from a controlling shareholder to the controlled corporation. *Easson* was governed by the pre-1954 Code, § 112(b)(5) of the 1939 Code; similar transactions arising under the 1954 Code would be governed by § 357(c) which provides for a recognition of gain in such a transaction to the extent that the mortgage exceeds the basis.[56] Although the factual problem presented in *Easson* is now resolved for post 1954 transactions under § 357(c) in favor of the Tax Court decision, the Circuit Court's reversal establishes an important precedent for acknowledging that in the proper circumstances a negative basis may be appropriate.[57] Yet, although a negative basis may be permitted in the proper situation, the long-standing rule prohibiting depreciation deductions below a zero basis remains intact.[58]

48. Fouts, *Gain Upon Involuntary Conversions,* N.Y.U. 19TH INST. ON FED. TAX. 993, 1000–01 (1960). Treas. Reg. § 1.1033(a)-2(c)(11), incorporates the *Crane* rationale into § 1033.
49. Edward W. Edwards, 19 T.C. 275 (1952).
50. Amphitrite Corporation, 16 T.C. 1140 (1951).
51. Marion A. Blake, 8 T.C. 546 (1947).
52. Peavy, *Corporate Organizations and Reorganizations,* 102 J. ACCOUNTANCY 36, 39 (Aug. 1956).
53. Jack L. Easson, 33 T.C. 963, 970 (1960).
54. 331 U.S. 1, 11, 14, n.37.
55. Easson v. Comm'r, 294 F.2d 653 (9th Cir. 1961), *rev'g* 33 T.C. 963 (1960).
56. Schlesinger, *Negative Basis, Recognized in Easson as Possible, Will Arise Only Rarely,* 16 J. TAXATION 212, 214 (April 1962).
57. For an excellent discussion of the case and the general area of negative basis, see Cooper, *Negative Basis,* 75 HARV. L. REV. 1352 (1962); see also Lurie, *Taxing Transfers of Mortgaged Property,* 39 CORNELL L.Q. 611 (1954); Spears, *Mortgages in Excess of Basis,* 11 So. CAL. TAX INST. 883 (1959).
58. Treas. Reg. § 1.167(a)-1(a) (1956), as amended T.D. 6507, 1960-2 CUM. BULL. 91.

In *Albany Car Wheel Co.*,[59] the amount of the obligation was so contingent and indeterminate that no part of the indebtedness was found includable in the basis of the property. The taxpayer had purchased the assets of a predecessor corporation and carried on its business. By the purchase agreement between the successor corporation and its predecessor, the purchaser-taxpayer became obligated to procure a release of the predecessor's liability for severance pay under a union contract. The taxpayer obtained such a release by substituting itself for its predecessor. However, the taxpayer was liable only where it failed to give notice of termination of operations to the employees. The Court of Appeals affirmed the Tax Court's decision that the obligation was too contingent or speculative to be included in the cost basis, observing:

> The new contract, however, differed from the old contract in a crucial respect, since it provided for the payment of severance pay only if petitioner could not give the required notice. If, as actually happened, petitioner was able to make its decision to terminate operations far enough in advance to give notice, it could discharge its obligation without incurring any expenses for severance pay. We agree with the conclusion of the Tax Court that petitioner's obligation under the union contract was therefore too speculative to be includable in the cost basis of the acquired assets.[60]

In *Columbus and Greenville Railway Co.*,[61] the Tax Court ruled that an unassumed mortgage could not be included in the taxpayer's basis for computing depreciation deductions. The taxpayer was the successor corporation to a defunct railroad company and all the properties acquired were taken subject to prior mortgages. By an agreement, entered into three years after acquisition of the properties, the mortgage obligations were cancelled. Prior to that time, no entries had been made on the taxpayer's books to reflect the indebtedness. Since the taxpayer's first entries, reflecting the liabilities, were made subsequent to the release, he achieved a stepped-up basis, which permitted a greater yearly depreciation deduction. No portion of the indebtedness had been paid by the taxpayer nor did he include any of it as income to him subsequent to the release. The Commission disallowed depreciation deductions based on the stepped-up basis. The Tax Court upheld the Commissioner, and further denied petitioner's inclusion of the released-unassumed mortgages in his cost. The Tax Court took the position that the indebtedness in question was, like the obligation in *Albany Car Wheel Co.*,[62] too speculative in nature, ". . . and that this fact precluded the inclusion of any of this contingent amount in petitioner's original cost basis in the property."[63]

59. 333 F.2d 653 (2d Cir. 1964), *affirming per curiam* 40 T.C. 831 (1963).
60. *Id.* at 653–54.
61. 42 T.C. 834 (1964), *appeal pending* in the 5th Circuit Court of Appeals.
62. 40 T.C. 831 (1963), *aff'd. per curiam*, 333 F.2d 653 (2d Cir. 1964).
63. 42 T.C. 834, 849.

The Tax Court's opinion does concede that "Petitioner's principal theory finds some support in *Crane v. Commissioner* . . . ,"[64] but continues:

> . . . whether the theory of the *Crane* case means that in a 'purchase' situation the cost of the property acquired includes the liens thereon, even though not personally assumed by the purchaser, . . . we need not decide here, because we do not think the theory of the *Crane* case is applicable here in any event.[65]

The Tax Court went on:

> Assuming for purposes of discussion, but without deciding that the theory of the *Crane* case may be applied in the ordinary purchase situation, we do not think it can be applied under the circumstances of this case because to do so would be to negate the basic concept of depreciation deductions, which is to permit a taxpayer to recover through depreciation allowances only his cost or other basis in the property. In the cases cited by petitioner, the amounts in question had been a part of the taxpayer's purchase price of the property or had been a part of the cost of constructing the property. And in *Crane* the value of the property was admittedly equal to the face amount of the mortgage subject to which the property was received. In each of those cases the obligation to which the property was subject at the time it was acquired was fixed in amount and was a part of the original cost of the property to taxpayer or, in the *Crane* case, was the value of the property inherited. Such is not the situation in the present case.[66]

It would appear that the extension of the *Crane* rationale in the *Columbus and Greenville* case presented the court with some difficulties and misgivings. This might indicate the Tax Court's view of the desirability of extending the *Crane* rule into the "purchase" situation. The Tax Court has disputed the validity of such extension in other cases,[67] and objection has come from commentators on the topic.[68] Such a trend would reject *Crane*'s application in cases which involve a determination of "whether the amount of the mortgage debt was included in the *cost*."[69]

## V.

## CONCLUSION

Although it could be argued, as an original proposition, that where the buyer assumes no personal liability, the existence of a mortgage is

64. *Id.* at 847.
65. *Ibid.*
66. *Ibid.*
67. Frank W. Babcock, 28 T.C. 781 (1957); Fortee Properties, Inc., 19 T.C. 99 (1952); Woodsam Associates, Inc., 16 T.C. 649 (1951).
68. For a criticism of the extension of the *Crane* rule see Engel, *Effects of the Crane Case,* N.Y.U. 6TH INST. ON FED. TAX. 379 (1947); Note, 49 COL. L. REV. 845 (1949); Note, 33 IOWA L. REV. 143 (1947).
69. Respondent's brief p. 12, in the Columbus and Greenville Railway Co. appeal to the 5th Circuit, attempts to distinguish the *Crane* case from the *Columbus and Greenville* case on that basis. This is similar to the discussion in the text, *supra* notes 26 to 35.

not a sufficient investment to warrant an inclusion in basis, the Supreme Court decision in *Crane v. Commissioner* has settled the issue.[70] A mortgage, even though not assumed by the mortgagor as his personal debt, is includable in the "amount realized" as "property" received.[71]

The rule enunciated by the Supreme Court has been extended from the inherited property situation presented in *Crane* to what has been called the "purchase" situation. The existing limits on the extended rule appear to be that the obligation must be neither too contingent,[72] nor so speculative as to be illusory.[73]

The *Crane* rule, basically, is in accord with proper accounting and tax procedures. Yet it is subject to certain criticisms which may be best cured legislatively. Under *Crane,* the amount recovered by the Government is less than the amount saved by the mortgagor through depreciation deductions, since the latter are offset against ordinary income and the gains are capitally treated. This aspect of the decision offers those in the higher income brackets a tax avoidance method.[74] Conversely, the situation might be presented where the amount recovered by the Government will exceed the amount of the depreciation deductions. This can occur either where the taxpayer has so small an income as not to benefit from the deductions, or where his tax rate in the years prior to the sale was less than the applicable capital gains rate.[75] *Crane* itself is an example of such a hardship.[76]

Numerous remedies have been suggested,[77] most of which would be best effected through legislation. One problem which has plagued the Tax Court and commentators,[78] and which could be judicially settled, is the advisability of the continued extension of the *Crane* doctrine into the "purchase" area. The Tax Court has again indicated its disapproval of the extension in the *Columbus and Greenville* case, which is now before the Fifth Circuit on Appeal. A pronouncement from the appellate level would seem most desirable.

*Kenneth L. Gross*

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70. See concurring opinion of Judge Magruder in Parker v. Delaney, 186 F.2d 455 (1st Cir. 1950) ; see also Rubin, *supra* note 1.

71. Crane v. Comm'r, 331 U.S. 1 (1947) ; R. O'Dell & Sons Co., 8 T.C. 1165 (1947), *aff'd,* 169 F.2d 247 (3d Cir. 1948).

72. Albany Car Wheel Co., 333 F.2d 653 (2d Cir. 1964).

73. Columbus and Greenville Railway Co., 42 T.C. 834 (1964).

74. Note, 33 IOWA L. REV. 143, 147 n.26 (1947) ; Note, 49 COL. L. REV. 845, 849 (1949).

75. Note, 49 COL. L. REV. 845, 848–51 (1949).

76. *Ibid.*

77. Note, 13 U. CHI. L. REV. 510, 514 (1946) ; Comment, 26 TEXAS L. REV. 796, 799 (1948) ; Rusoff, *supra* note 12, at 197.

78. *Supra* notes 67 and 68.