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DOUBLE DEDUCTIONS, OR NOTHING: WHY THE VINDICATION OF BEULAH CRANE POSTER CHILD OF GREEDY TAXPAYERS SHOULD INSPIRE CLOSING THE TAX TRAP LEFT OPEN AFTER TAX SHELTERS WERE SHUT DOWN: AND OTHER CRANE FOOTNOTES REVEALED

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I. Jay Katz

The question here is how a taxpayer who acquires depreciable property subject to an unassumed mortgage, holds it for a period, and finally sells it still so encumbered, must compute her taxable gain.\(^1\) (the “Crane Case Scenario”).

Obviously, if the value of the property is less than the amount of the mortgage, a mortgagor who is not personally liable cannot realize a benefit equal to the mortgagor. Consequently, a different problem might be encountered where a mortgagor abandoned the property or transferred it subject to the mortgage without receiving boot. That is not this case.\(^2\) (the “Footnote 37 Tax Shelter Scenario”).

The crux of this case, really, is whether the law permits her to exclude allowable deductions from consideration in computing gain. We have already showed that, if it does, the taxpayer can enjoy a double deduction, in effect, on the same loss of assets.\(^3\) (the “Vilifying Double Deduction Rationale”).

Of the $28,000 of allowable deductions on the apartment building devised to Beulah Crane, only $3,307 actually produced tax benefits for Beulah Crane and her husband’s estate. Upon the subsequent sale of the apartment building, the section 1016(a)(2) basis reduction caused those mostly useless depreciation deductions to be transformed into taxable gain.\(^4\) (the “Basis Reduction Tax Trap”).

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\(^1\) *Crane v. Commissioner*, 331 U.S 1, 2 (1947) (quote).
\(^2\) *Id.* at 14, n. 37 (quote).
\(^3\) *Id.* at 15-16 (footnote omitted) (quote).
\(^4\) *See infra* notes 40-46 and accompanying text.
PROLOGUE

THE AFTERMATH OF CRANE: TAX SHELTERS COME AND GO AS A THREAT TO THE TREASURY; BEULAH CRANE IS VILIFIED AS A TAX VILLAINNESS; AND THE BASIS REDUCTION TAX TRAP SHE FELL INTO REMAINS OPEN

During the six decades since Crane v. Commissioner,\(^5\) perhaps the most famous tax law vocabulary cases was decided, a plethora of articles, including one written by this author in 1993,\(^6\) have been penned about the case.\(^7\) As the following prologue explains, the Article is intended to fill a void in the scholarship with a spin different from most conventional Crane articles.

As the Crane case initially unfolded, the relatively straightforward Crane Case Scenario involving the sale of apartment building devised to Beulah Crane (“Beulah”) by her husband’s will was complicated by the presence of a nonrecourse mortgage securing the building. In exchange for the apartment building (transferred to the buyer subject to the nonrecourse liability), Beulah received net monetary consideration of $2,500.\(^8\) In determining the amount realized, the first step in the computation of gain, the Supreme Court faced a problematic dilemma of deciding whether the relief of a nonrecourse liability Beulah had no personal obligation to repay provided her with an economic benefit in addition to the monetary consideration she received.\(^9\) If the Supreme Court were unable to justify the relief of a nonrecourse liability as being the receipt of an economic benefit; and, thus, included in the amount realized, it would have been faced with “the absurdity that [Beulah] sold a quarter-of-a-million dollar property for roughly one percent of its value.”\(^10\)

The Supreme Court avoided what it perceived to be an “absurdity” by determining the fair market value of the apartment building ($257,500) exceeded the outstanding balance of the nonrecourse mortgage ($255,000).\(^11\) Consequently, the

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\(^5\) 331 U.S. 1 (1947).
\(^8\) Crane, 331 U.S. at 3.
\(^9\) Id. at 13.
\(^10\) Id.
\(^11\) Id.
Supreme Court concluded the economic benefits Beulah received in the exchange included both the net monetary consideration plus the nonrecourse debt relief.\(^\text{12}\) Simply stated, the Supreme Court reasoned both elements of the consideration constituted economic benefits to Beulah because she would not have received the monetary consideration unless the buyer had also agreed to take the apartment building subject to the nonrecourse liability.\(^\text{13}\)

In the process of reaching its decision, in Footnote 37, the Supreme Court pondered whether it might have reached a different conclusion regarding the economic benefit of nonrecourse debt relief in a Footnote 37 Tax Shelter Scenario. Unlike the *Crane* Case Scenario, in a Footnote 37 Tax Shelter Scenario, the seller/obligor obviously receives no monetary consideration since the amount of the nonrecourse debt relief is greater than the property is worth. Accordingly, with that distinction, the economic bootstrapping of the nonrecourse debt relief with the monetary consideration present in the *Crane* Case Scenario would be lacking in a Footnote 37 Tax Shelter Scenario. Although the Supreme Court did not directly answer the question, there was certainly the implication that if presented with a Footnote 37 Tax Shelter Scenario, it would have likely excluded from the amount realized the nonrecourse liability in excess of the property’s fair market value.

For the next thirty plus years following the decision, whether the Supreme Court’s apparent response to its hypothetical query would be the precursor for subsequent judicial decisions blessing Footnote 37 Tax Shelters remained an open question. If the Supreme Court’s reasoning were followed, Footnote 37 Tax Shelters would have potentially devastating consequences to the Treasury.\(^\text{14}\) If the amount realized were limited to the fair market value of the underlying depreciable property, the relief of the nonrecourse liability in excess of fair market value that without any economic outlay by the taxpayer had produced substantial tax benefits would be eliminated from the taxable gain consideration.

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\(^{12}\) *Id.*  
\(^{13}\) *Id.*  
To illustrate this point, consider the typical Footnote 37 Tax Shelter Scenario: A taxpayer acquires depreciable property with nonrecourse financing receives basis in the property of a like amount.\textsuperscript{15} Over the ownership period of the property, the taxpayer enjoys the tax benefits of the declining value of the property by claiming depreciation deductions. Over this same time period, the taxpayer makes minimal principal payments and/or interest only payments so that the outstanding balance of the liability remains constant. Subsequently, at a time when the fair market value of the property has fallen well below the outstanding balance of the nonrecourse liability, the taxpayer disposes of the property, through foreclosure or otherwise.\textsuperscript{16} By limiting the amount realized to the fair market value of the property (i.e., the property’s original value as reduced by economic depreciation that occurred during the ownership period), the lesser amount of recognized taxable gain (if there even was such a gain) would afford the taxpayer with the tax benefit of the same loss a second time. Moreover, the taxpayer would have accomplished this result without ever expending after tax dollars commensurate with the tax benefit – either by repaying the loan in an amount equivalent to the depreciation deductions taken against the nonrecourse liability created basis; or by being compelled to account for those deductions in the recognition of taxable gain equivalent to the tax benefit they had produced for the taxpayer.

Finally, approximately thirty years after the Supreme Court’s Crane decision, two courts were confronted with Footnote 37 Tax Shelter Scenarios, which if resolved consistent with the Supreme Court’s reasoning would had likely led to a proliferation of Footnote 37 Tax Shelters.\textsuperscript{17} Conversely, a decision in favor of the Government striking down Footnote 37 Tax Shelters might have been construed as a lower court overruling the Supreme Court, albeit, on a matter of dictum.

The two lower courts resolved the Footnote 37 dilemma in favor of the Government by finding a way to rationalize the inclusion of the full outstanding balance of the nonrecourse liability in the amount realized without appearing to overrule Footnote 37. The courts did so by embracing the Supreme Court’s Vilifying Double Deduction

\textsuperscript{16} Obviously, because the nonrecourse debt exceeds the value of the property, the taxpayer would receive no monetary consideration.
Rationale as “the rationale of the Supreme Court’s principal reasoning, analysis and holding.”¹⁸ In essence, the courts proclaimed the Supreme Court’s purpose in deciding the *Crane* Case Scenario the way it did was to prevent taxpayers from receiving double deductions as Beulah had attempted to do.¹⁹ Thus, the courts invoked the Vilifying Double Deduction Rationale to justify the same holding in a Footnote 37 Tax Shelter Scenario as the Supreme Court’s holding in the *Crane* Case Scenario.²⁰

Although the lower courts invoking of the Vilifying Double Deduction Rationale was an effective first strike against Footnote 37 Tax Shelters,²¹ its portrayal of Beulah as a tax villainess was a distortion of the real facts of *Crane*. Implicit in the Vilifying Double Deduction Rationale is the presumption the depreciation deductions Beulah claimed on the apartment building produced substantial tax benefits for her and her husband’s estate. Then, in reporting her gain upon the sale of the apartment building, Beulah concocted a computational formula calculated to eliminate any accountability for the previously claimed depreciation deductions in order to enjoy the tax benefits of those deductions a second time. Thus, had the Supreme Court not compelled Beulah to report taxable gain to account for the previously claimed depreciation deductions, Beulah would have succeeded in her quest for the unwarranted tax benefits of double depreciation deductions.

Ironically, the Vilifying Double Deduction Rationale “spin” of the *Crane* facts made it appear as it were a classic tax shelter case. In reality, the *Crane* case was the antithesis of a tax shelter, i.e., a Basis Reduction Tax Trap²² because unlike a tax shelter, the front end tax benefits Beulah and her husband’s estate received from the depreciation deductions on the apartment building were minimal. Of the $28,000 of allowable

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¹⁸ Miller, 577 F.2d at 215; Tufts, 70 T.C. at 765.
²⁰ In doing so, the courts created the impression they were carrying out the true intent of the Supreme Court to prevent taxpayers from enjoying the unwarranted tax benefits of double depreciation deductions. Moreover, it allowed the courts to de-emphasize the importance of Footnote 37 in the Supreme Court’s holding; and, in a much more judicially correct way dispense of it as being mere dictum.
²¹ Subsequently, the Fifth Circuit reversed the Tax Court’s *Tufts* decision. Tufts v. Commissioner, 651 F. 2d 1058 (5th Cir. 1981). Thereafter, the Supreme Court reversed the Fifth Circuit and replaced the Vilifying Double Deduction Rationale with the loan proceeds theory as the rationale for including the full outstanding balance of nonrecourse debt relief in the amount realized regardless of the underlying property’s fair market value. Commissioner v. Tufts, 461 U.S. 300 (1983). See Katz at 295-297, *supra* note 6.
²² See *supra* note 4.
depreciation deductions\textsuperscript{23} Beulah and her husband’s estate were entitled to claim over the seven year ownership period of the apartment building, only $3,307 actually produced a tax benefit.\textsuperscript{24} Consequently, the balance of the allowable depreciation deductions, $24,693 provided zero tax benefits.

Then, on the back end sale of the apartment building, rather than triggering correlative taxable gain to cancel out the tax benefits of the prior depreciation deductions, mostly useless depreciation deductions that reduced the basis of the apartment building pursuant to 1016(a)(2)\textsuperscript{25} were transformed into taxable gain. For that reason, Beulah’s resulting gain from the Basis Reduction Tax Trap was punitive.

Moreover, since Beulah’s day, with one exception,\textsuperscript{26} section 1016(a)(2) has not been amended. Thus, the Basis Reduction Tax Trap Beulah fell into remains a potential tax hazard for unwary taxpayers. In other words, the gain triggered by a basis reduction of useless depreciation deductions cannot possibly offset a nonexistent tax benefit. Because the basis reduction is mandatory, however, the taxpayer is compelled to reduce basis regardless of the lack of tax benefits. Thus, upon the subsequent disposition of the underlying property, the taxpayer is trapped into the recognition of essentially phantom taxable gain.

\textbf{INTRODUCTION}

As fiscally devastating as judicial approval of Footnote 37 Tax Shelters would have been to the Treasury, the continuing presence of the Basis Reduction Tax Trap is equally devastating to taxpayers. Although the Vilifying Double Deduction Rationale provided the courts with the rationale to squelch tax shelters, it unjustly portrays Beulah as the poster child of greedy taxpayers who was unwilling to pay her fair share of tax. Moreover, the falsity of Beulah’s portrayal has obscured the punitive tax consequences of the Basis Reduction Tax Trap that persist to this day.

The purpose of this Article is to expose the real facts of Beulah’s untold story so as to vindicate her unjust depiction as a tax villainess; and, at the same time inspire

\textsuperscript{23} See infra note 40-46 and accompanying text.
\textsuperscript{24} Id.
\textsuperscript{25} For purposes of this Article, all references to sections are to the Internal Revenue Code of 1986, as amended and unless otherwise indicated are substantially the same as the earlier version of the referenced sections.
\textsuperscript{26} See infra notes 134-135. In 1954, Congress amended section 1016(a)(2) to its current version by not requiring a basis adjustment for excessive depreciation that did not reduce the taxpayer’s taxes.
Congress to put an end to the Basis Reduction Tax Trap. As a means of eliminating the Basis Reduction Tax Trap, the Article advocates the implementation of tax benefit principles as the way to end the inequity.

Part I of the Article exposes the truth concerning the minimal tax benefits the depreciation deductions on the apartment building produced for Beulah and her husband’s estate during the seven year ownership period. Part II explains how Beulah fell victim to the Basis Reduction Tax Trap as those most useless depreciation deductions were ultimately transformed into taxable gain upon its subsequent sale.

As an aside to the Beulah storyline, considering the general widespread fascination with the *Crane* case, it is mystifying why in the over sixty years since the case was decided, there remains a void in the scholarship regarding the myth of Beulah’s double depreciation deductions and the irony of her being compelled to report gain attributable to useless depreciation deductions. Part III of the Article attempts to explain this enigma by offering two possible reasons as to why the plethora of *Crane* articles has not addressed these aspects of the case. Both reasons suggest the likelihood the *Crane* scholars are simply unaware of the underlying facts of the case. In Part III.A, the Article notes the absence of any discussion in the Supreme Court’s opinion relating to the minimal tax benefits produced by the depreciation deductions and their resulting transformation into taxable gain. The Article attributes their lack of discussion as being due to Beulah not raising these points in the defense of her reporting position. In the absence of any judicial consideration of these matters, the Article concludes there is no reason why *Crane* scholars would be aware of, much less write about that aspect of the case. As a second reason for the lack of meaningful writing, Part III.B attributes the misperception of Beulah’s quest for the unwarranted tax benefits of double deductions emanating from the Vilifying Double Deduction Rationale as further validated by two subsequent court decisions as why many *Crane* scholars might have no reason to suspect the opposite was true.

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27 Admittedly, the comment is a bit of an overgeneralization as some scholars have discussed the minimal tax benefits Beulah and her husband’s estate actually received from the depreciation deductions on the apartment building. *See infra* note 56. However, to this author’s knowledge, no article has focused on the Beulah’s harsh tax consequences caused by the transformation of those useless deductions into taxable gain.
Then, in an exercise of second guessing, Part IV of the Article ponders whether Beulah might have prevailed in the decision had she framed her case as a direct challenge to the inequity of the section 1016(a)(2) basis reduction of useless depreciation deductions transformed into taxable gain. Because of the state of judicial precedent at that time, however, the Article concludes Beulah would have fared no better even had she argued her case in that way.

Next, Part V of the Article advocates the implementation of tax benefit principles as a means of ending the Basis Reduction Tax Trap. In doing so, it points out that the other applications of the section 1016(a)(2) basis reduction achieve the intended purpose of preventing taxpayer abuse of depreciation deductions. Thus, the tax benefit remedy advocated by the Article is limited to taxable gain attributable to depreciation deductions that produced no tax benefits for the taxpayer without tampering with the other applications of section 1016(a)(2) that operate properly.

As additional support for the implementation of tax principles to eliminate the Basis Reduction Tax Trap, Part VI discusses two existing Code sections involving depreciation deductions in which tax benefit principles have been prudently incorporated into their application.

Finally, *Crane* may be the most celebrated case in any area of law in which a footnote of dictum is more relevant than the actual holding. Part VII of the Article explores other unknown *Crane* “footnotes,” though not relevant to the ultimate disposition of the case, may nonetheless be of interest to those fascinated with all that is related to *Crane*. Part VII.A explains why contrary to common belief, the actual fair market value of the apartment building as well as the amount realized at the time of the sale was $273,500 rather than $257,500. Part VII.B offers a musing of other hypothetical tax relief Beulah and her husband’s estate might have received from other provisions of tax law that were simply not in force during the Great Depression years in which the *Crane* transactions took place. Part VII.C details several unknown personal tidbits concerning Beulah, her husband and family.
I. THE SEVEN YEAR ITCH: UNTOLD STORY OF THE MINIMAL TAX BENEFITS THE ALLOWABLE DEPRECIATION DEDUCTIONS ON THE APARTMENT BUILDING PRODUCED FOR BEULAH AND HER HUSBAND’S ESTATE

As alluded to in the Introduction and as discussed in more detail below, there is the misconception that Beulah sought the unwarranted tax benefits of double depreciation deductions. In reality, the opposite is true as the allowable deductions on the apartment building produced minimal tax benefits for Beulah and her husband’s estate. The facts relevant to this discussion are as follows: On January 11, 1932, William M. Crane (“William”) died. 28 His will named Beulah as the executrix of his estate 29 (the “Crane Estate”) and devised the residuary estate to her, including an apartment building located at 345 Clinton Avenue in Brooklyn, New York (the “Brooklyn Apartment Building”). 30 Upon William’s death, the unencumbered fair market value of the Brooklyn Apartment Building was $262,000. 31 It was secured, however, by an equal amount of nonrecourse liability, including a nonrecourse mortgage in the principal amount of $255,000 plus interest arrears of approximately $7,000. These amounts appeared on Schedule A and J of the Federal estate tax return, respectively. 32

Also, at the time of William’s death, the nonrecourse mortgage was in default and the mortgagee, Bowery Bank (“Bowery”) was seriously considering foreclosure. 33 Beulah, however, wanted to retain the Brooklyn Apartment Building in the Crane Estate, and, ultimately, to pass to her. Taking swift action the day after William’s will was admitted to probate, 34 Beulah persuaded Bowery to allow the Crane Estate to retain the Brooklyn Apartment Building subject to the outstanding debt with the additional promise

28 Crane, 331 U.S. at 3.
29 Id.
30 Transcript of Record, Supreme Court of the United States, Oct. Term, 1946, No. 68 at 5, Tax Court Petition, VI (2).
31 Although the unencumbered fair market value of the Brooklyn Apartment Building was appraised at $55,000.00 for the land and $207,042.00 for the building, for purposes of this Article, the apportionment of the fair market value to the land is ignored. Thus, it is always assumed that the fair market value of the building was the full $262,000. Tax Court Stipulation of Facts (6).
32 Tax Court Stipulation of Facts (5).
33 Tax Court Stipulation of Facts (15).
34 William’s will was probated on January 31, 1932. Tax Court Petition, VI (4).
to pay all the net rental income (computed without taking into account the depreciation deduction) to Bowery, all of which was to be applied to the delinquent loan.35

On December 31, 1936, the Crane Estate terminated and the Brooklyn Apartment Building was transferred to Beulah.36 After the transfer, until November 29, 1938,37 Beulah continued to operate the Brooklyn Apartment Building in her individual capacity. Moreover, true to Beulah’s prior promise, she continued to pay the net rental income to Bowery.

Throughout the entire ownership period of the Brooklyn Apartment Building (between 1932 and 1938), Beulah appropriately claimed depreciation deductions in the aggregate amount of $25,20038 on the Crane Estate’s and her own Federal income tax returns. Apparently, in claiming those depreciation deductions on the Brooklyn Apartment Building, Beulah utilized the date of death unencumbered fair market value as her original section 1014(a) basis.39

An examination of the Record40 reveals that the Crane Estate and Beulah received minimal tax benefits from the claimed depreciation deductions. For example, 1932 and 1933 were the only two years of the Crane Estate’s ownership of the Brooklyn Apartment Building in which positive net rental income was generated of approximately $3,439 and $1,570 of net rental income, respectively,41 prior to taking the depreciation deduction. From 1934 through 1936, the net rental income was zero or negative, prior to taking the depreciation deduction.42 Over the entire five year ownership period of the Crane Estate, Beulah, as the executrix, claimed the aggregate amount of $18,500 of depreciation deductions on the Crane Estate’s income tax returns. From the minimal amount of net rental income the Crane Estate generated, only approximately $3,113 of the claimed

35 Crane, 331 U.S., at 3.
36 Tax Court Petition VI (8).
37 Crane, 331 U.S. at 3.
38 Tax Court, Stipulation (9) and (11). For some unexplained reason, the Supreme Court stated the depreciation deductions claimed by the Crane Estate and Beulah was $25,500. Crane, 331 U.S. at 3, n. 2.
39 Although the Record is silent on the point, considering the large amount of the depreciation deductions claimed by Beulah, it would appear that she utilized the unencumbered date of death fair market value of the Brooklyn Apartment Building as the original basis.
40 Supra note 30.
41 Tax Court Petition VI (10).
42 Id.
depreciation deductions was needed to eliminate all the Crane Estate’s tax liability.\textsuperscript{43}
Thus, the balance of the depreciation deductions, $15,387 produced zero tax benefits.

Similarly, for tax years 1937 and 1938, the two years in which Beulah operated the Brooklyn Apartment Building in her individual capacity, she claimed the aggregate amount of $6,700 of depreciation deductions. Over that two year period, the Brooklyn Apartment Building generated net rental income of $1,294 and $1,036,\textsuperscript{44} respectively prior to taking the depreciation deduction. Only approximately $194 in depreciation deductions was needed to reduce the net rental income to achieve a zero tax liability.\textsuperscript{45}
The balance of the depreciation deductions, $6,506 produced no tax benefits.

In summary, due to the limited amount of net rental income, of the $25,200 of depreciation deductions on the Brooklyn Apartment Building claimed by the Crane Estate and Beulah, only approximately $3,307 of those deductions was needed to reduce net rental income to eliminate all tax liability.\textsuperscript{46} Consequently, the balance of the depreciation deductions, $21,893, produced no tax benefits. With the addition of $2,800 of allowable depreciation deductions Beulah did not claim,\textsuperscript{47} a total of $24,693 of allowable depreciation deductions produced no tax benefits. None of these facts revealing the minimal tax benefits enjoyed by Beulah and the Crane Estate contained in the Record were addressed or even mentioned in the Supreme Court’s decision.

II. BEULAH FALLS INTO THE BASIS REDUCTION TAX TRAP

Although Beulah and the Crane Estate received minimal tax benefits from the claimed depreciation deductions, that in of itself did not cause Beulah’s harsh tax consequences. Because the Crane Estate had no income other than the rental income and it was unlikely that Beulah had any significant income of her own during this period, the wasted depreciation deductions had no tax significance. It was the second part of the equation, the sale of the Brooklyn Apartment Building, however, that caused Beulah to fall into the Basis Reduction Tax Trap.

\textsuperscript{43} See Patricia A. Cain, \textit{From Crane to Tufts: In Search Of A Rationale For The Taxation of Nonrecourse Mortgagors}, 11 Hofstra L. Rev. 1, 15-16, n. 79.
\textsuperscript{44} Tax Court Petition VI (10).
\textsuperscript{45} See supra note 43.
\textsuperscript{46} This would be the sum of the Crane Estate’s $3,113 of tax beneficial depreciation deductions plus Beulah’s $194 of tax beneficial depreciation deductions.
\textsuperscript{47} See Crane, 331 U.S. at 4.
Shortly after Bowery notified Beulah of its intention to bring a foreclosure action against the Brooklyn Apartment Building in October 1938, Beulah offered to execute a deed in lieu of foreclosure. Bowery, however, refused.\textsuperscript{48} In order to avoid the imminent foreclosure, Beulah and Avenue C Realty entered into a “Contract of Sale”\textsuperscript{49} by which title of the Brooklyn Apartment Building passed from Beulah to Avenue C Realty subject to the outstanding balance of the nonrecourse mortgage and the interest arrears in exchange for net monetary consideration of $2,500. On the eve of the sale, the principal balance of the nonrecourse mortgage was $255,000 and the interest arrears had increased to approximately $16,000.\textsuperscript{50}

In the computation of Beulah’s gain upon the sale of the Brooklyn Apartment Building, the Supreme Court (agreeing with the Commissioner) determined the amount realized to be the sum of the principal balance of the nonrecourse mortgage ($255,000) plus the net monetary consideration ($2,500), or $257,500. As to the Brooklyn Apartment Building’s adjusted basis, the Supreme Court applied section 1016(a)(2) and reduced the original 1014(a) basis of $262,000 by the $28,000 of allowable deductions, arriving at a final adjusted basis of $234,000. Thus, the difference between the amount realized and the adjusted basis resulted in a taxable gain of $23,500.\textsuperscript{51}

Assuming the amount realized was also the fair market value of the Brooklyn Apartment Building,\textsuperscript{52} over the seven year ownership period, the property lost $4,500 of its date of death value ($262,000 to $257,500). Consequently, of the $28,000 of allowable deductions on the Brooklyn Apartment Building, Beulah received the tax benefit of the $4,500 economic decline in value reflected in the reduced amount realized (the difference between the original value and the selling price) plus the $3,307 of depreciation deductions claimed during the ownership period that reduced tax liability to zero. Thus, of Beulah’s taxable gain of $23,500, $20,193 ($28,000 allowable deductions

\textsuperscript{48} Tax Court Petition (14).
\textsuperscript{49} Tax Court, Stipulation of Facts, Exhibit K.
\textsuperscript{50} Tax Court, Stipulation of Facts (14).
\textsuperscript{51} The selling price was allocated between the building and the land. With respect to the building, there was a taxable gain of approximately $24,000. As to the land, there was a capital loss of approximately $264. The net effect was a taxable gain of approximately $23,500. Crane, 331 U.S. at 5. For purposes of this Article, however, the allocation between the building and the land is ignored and a taxable gain of $23,500 is deemed to be the taxable gain from the sale of the Brooklyn Apartment Building.
\textsuperscript{52} See infra Part VII.A of this Article (demonstrating the actual fair market value of the Brooklyn Apartment Building and amount realized at the time of the sale was actually $273,500).
less $7,807 of actual tax benefits) represented useless depreciation deductions that were transformed into gain.

The following charts set forth a year by year breakdown of the amount of depreciation deductions claimed by the Crane Estate and Beulah, the amount of unclaimed allowable deductions, the section 1016(a)(2) basis reductions, the tax benefits the depreciation deductions produced and the amount of the useless depreciation deductions transformed into taxable gain upon the sale of the Brooklyn Apartment Building.\textsuperscript{53}

\textsuperscript{53} For purposes of the illustrations, below, it is assumed that the taxable rental income generated each year by the Brooklyn Apartment Building was either zero or a negative number.
THE SEVEN YEAR OWNERSHIP PERIOD OF THE BROOKLYN APARTMENT BUILDING (1932-1938)\textsuperscript{54}

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Rental Income Excluding Depreciation Deduction</th>
<th>Claimed Depreciation Deduction</th>
<th>Net Income With Depreciation Deduction</th>
<th>Section 1016(a)(2) Brooklyn Apartment Building Basis Reduction</th>
<th>Tax Benefit Received From Deduction</th>
<th>Wasted Depreciation Deductions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1932</td>
<td>$3,439</td>
<td>$3,500</td>
<td>($61)</td>
<td>$3,500</td>
<td>$2,243</td>
<td>$1,257</td>
</tr>
<tr>
<td>1933</td>
<td>$1,570</td>
<td>$3,500</td>
<td>($1,930)</td>
<td>$3,500</td>
<td>$870</td>
<td>$2,630</td>
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<td>1934</td>
<td>-0-</td>
<td>$3,800</td>
<td>At least ($3,800)</td>
<td>$3,800</td>
<td>-0-</td>
<td>$3,800</td>
</tr>
<tr>
<td>1935</td>
<td>-0-</td>
<td>$3,800</td>
<td>At least ($3,800)</td>
<td>$3,800</td>
<td>-0-</td>
<td>$3,800</td>
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<td>1936</td>
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<td>At least ($3,900)</td>
<td>$3,900</td>
<td>-0-</td>
<td>$3,900</td>
</tr>
<tr>
<td>1937</td>
<td>$1,294</td>
<td>$3,500</td>
<td>($2,206)</td>
<td>$3,500</td>
<td>$194</td>
<td>$3,306</td>
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<tr>
<td>1938</td>
<td>$1,026</td>
<td>$3,200</td>
<td>($2,464)</td>
<td>$3,200</td>
<td>-0-</td>
<td>$3,200</td>
</tr>
<tr>
<td>Plus Unclaimed Allowable Depreciation Deductions All Years</td>
<td>N/A</td>
<td>$2,800</td>
<td>N/A</td>
<td>$2,800</td>
<td>-0-</td>
<td>$2,800</td>
</tr>
<tr>
<td>Total</td>
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<td>$28,000</td>
<td>$28,000</td>
<td>$28,000</td>
<td>$3,307</td>
<td>$24,693</td>
</tr>
</tbody>
</table>

\textsuperscript{54} This chart is based upon the information set forth in Tax Court Petition VI (9) – (13).
COMPUTATION OF TAXABLE GAIN UPON SALE OF BROOKLYN APARTMENT BUILDING

<table>
<thead>
<tr>
<th>Amount Realized</th>
<th>Allowable Depreciation Deductions</th>
<th>Economic Depreciation That Produced Tax Benefits</th>
<th>Adjusted Basis As Reduced By All Allowable Depreciation Deductions</th>
<th>Taxable Gain</th>
<th>Depreciation Deductions That Produced Tax Benefits</th>
<th>Useless Depreciation Deductions Transformed Into Taxable Gain</th>
</tr>
</thead>
<tbody>
<tr>
<td>$257,500</td>
<td>$28,000</td>
<td>$4,500</td>
<td>$234,000</td>
<td>$23,500</td>
<td>$3,307</td>
<td>$20,193</td>
</tr>
</tbody>
</table>

As evidenced by the foregoing charts, during the seven year ownership period of the Brooklyn Apartment Building, $24,693 of the $28,000 of allowable depreciation deductions were wasted as they provided no tax benefits for Beulah and the Crane Estate. Due to the lack of any other taxable income, however, the minimal tax benefits were of no real loss to Beulah and the Crane Estate. On the other hand, to the extent the Supreme Court’s Crane decision stands for the proposition of tax symmetry, i.e., the offsetting of the tax benefits of depreciation deductions by the tax detriments of taxable gain attributable to those deductions; it clearly missed the mark. Instead, Beulah was a victim of the Basis Reduction Tax Trap as approximately 86% of her taxable gain ($20,193/$23,500) was attributable to useless depreciation deductions transformed into taxable gain.55

III. WHY HAVE THE PLETHORA OF CRANE ARTICLES NOT ADDRESSED BEULAH’S MINIMAL TAX BENEFITS AND HARSH TAX CONSEQUENCES?

It is certainly understandable that by virtue of its importance to tax law, Footnote 37 type issues have animated most Crane articles. Considering the general fascination with Crane, however, it is puzzling the Crane writings have not addressed the myth of Beulah’s double depreciation deductions and the irony of her being compelled to report

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55 The difference between the $24,693 of useless depreciation deductions and $20,193 is attributable to the $4,500 actual economic decline in value of the Brooklyn Apartment Building. By virtue of reducing the amount realized upon the disposition of the Brooklyn Apartment Building, Beulah did receive the tax benefit of that loss.
gain attributable to useless depreciation deductions. 56 The short answer to this question is many Crane commentators may simply be unaware of the underlying facts relating to these aspects of the case. This part of the Article explores two possible reasons explaining this phenomenon.

A. THE MINIMAL TAX BENEFITS PRODUCED BY DEPRECIATION DEDUCTIONS AND THE SECTION 1016(a)(2) BASIS REDUCTION THAT LED TO THEIR TRANSFORMATION INTO TAXABLE GAIN PLAYED NO PART IN BEULAH’S REPORTING POSITION OR HER DEFENSE OF IT

The dispute between Beulah and the Commissioner involved the computation; and, thus, the amount of taxable gain to be reported by Beulah on the transfer of the Brooklyn Apartment Building to Avenue C Realty subject to the nonrecourse mortgage for net monetary consideration of $2,500. As discussed in more detail below, Beulah’s computation resulted in a relatively modest taxable gain of $2,500 so those minimal tax benefits from the previous years were probably not much of a concern to her. In addition, Beulah reported the sale of a non-depreciable equity interest in the Brooklyn Apartment Building with a zero basis meaning none of Beulah’s gain was attributable to a section 1016(a)(2) basis reduction of useless depreciation deductions. Therefore, because Beulah did not raise these points in her case in chief or in defending her position against the Commissioner’s challenge, the Supreme Court had no reason to address these them; and, thus, it is unlikely a Crane commentator whose understanding of Crane is based upon the Supreme Court’s decision would be aware of this aspect of the case.

1. BEULAH REPORTED THE SALE AS AN EQUITY INTEREST IN THE BROOKLYN APARTMENT BUILDING

In determining Beulah’s taxable gain from the sale of the Brooklyn Apartment Building to Avenue C Realty, the three sub-issues to be resolved were: (1) whether the property sold was depreciable; (2) the adjusted basis of the property; and (3) the amount realized. The way Beulah ultimately resolved these sub-issues in reporting her taxable

56 Not all Crane commentators are unaware of the minimal tax benefits Beulah and the Crane Estate actually received. See, e.g., George K. Yin, The Story of Crane: How a Widow's Misfortune Led to Tax Shelters, in Tax Stories 251, 273 (Paul L. Caron 2d ed., 2009); Patricia A. Cain, From Crane to Tufts: In Search Of A Rationale For The Taxation of Nonrecourse Mortgagors, 11 Hofstra L. Rev. 1, 14 (1982).
gain for the 1938 tax year was predicated on how she viewed the sale of the Brooklyn Apartment Building to Avenue C Realty.

In October 1938, one month prior to the transfer of the Brooklyn Apartment Building to Avenue C Realty, it was clear that Beulah’s nearly seven year effort to save the Brooklyn Apartment Building from foreclosure had failed. In spite of paying the entire net rental generated to Bowery,\(^{57}\) the nonrecourse mortgage remained in default and the interest arrears had increased from $7,000 to approximately $16,000.\(^{58}\) No longer able to forestall the foreclosure, Beulah’s only possibility of receiving any monetary consideration from her inevitable loss of the Brooklyn Apartment Building was to sell it to Avenue C Realty subject to the encumbering debt in exchange for $3,000. After paying $500 of selling expenses, Beulah netted $2,500.\(^{59}\)

Beulah, however, did not consider the “property” she was selling to Avenue C Realty as being the physical structure of the Brooklyn Apartment Building. Instead, Beulah conceived the devised Brooklyn Apartment Building fully encumbered by a nonrecourse mortgage as an interest in a property with no equity.\(^{60}\) So, Beulah reported the sale of an equity interest rather than the actual Brooklyn Apartment Building.\(^{61}\) The following language from the Contract of Sale between Beulah and Avenue C Realty is consistent with Beulah’s perception of the sale:

\[
\text{The purchase price is Three thousand Dollars ($3,000.) for the equity conveyed by the seller . . .} \\
\text{[emphasis added]} \quad {62}
\]

Thus, Beulah reached the following determinations regarding the equity interest’s original basis and the impropriety of reducing that basis by depreciation deductions: Beulah utilized zero as the original section 1014(a) date of death fair market value basis of the equity interest because at her husband’s death it was worthless. Consequently, since a non-depreciable equity interest with a zero basis could not be depreciated, Beulah

\(^{57}\) See supra notes 38-44 and accompanying text. In only four of the seven years in which Beulah and the Crane Estate held the Brooklyn Apartment was there any net rental income. In the other three years, the Brooklyn Apartment Building did no better than perhaps break even.

\(^{58}\) Crane, 331 U.S. at 3.

\(^{59}\) Id.

\(^{60}\) Id. at 11-12.

\(^{61}\) Id.

\(^{62}\) Tax Court Stipulation of Facts, Exhibit K.
concluded there were no section 1016(a)(2) basis reductions to be made. Accordingly, Beulah reasoned the adjusted basis of her equity interest in the Brooklyn Apartment Building at the time of the sale was also zero.\textsuperscript{63}

As to the economic consideration she received, it is highly unlikely when Beulah reported the sale on her 1938 income tax return long before the Commissioner’s challenge, she ever conceived the nonrecourse liability that would remain an encumbrance on the Brooklyn Apartment Building after she transferred it to Avenue C Realty as being debt relief, much less an economic benefit she received.\textsuperscript{64} Instead, Beulah more probably viewed the liability as a burden since over the seven year ownership period, the loan remained in default and the interest arrears continued to increase.

So, in arriving at the amount realized, Beulah counted the money in hand, i.e., the net monetary consideration of $2,500 as the only economic benefit she received from the sale of her equity interest to Avenue C Realty. Accordingly, Beulah reported her taxable gain as the difference between the amount realized ($2,500) minus the adjusted basis of the equity interest ($0), or $2,500.\textsuperscript{65} From an economically simplistic perspective, Beulah believed the $2,500 of taxable gain was the true measure of her profit from the sale of the initially valueless equity interest in the Brooklyn Apartment Building. Moreover, considering the modest gain from a non-depreciable equity interest with a zero adjusted basis from which there could be no basis reduction, the minimal tax benefits Beulah received from the depreciation deductions as well as any adverse tax consequences caused by what she would have considered an inappropriate section 1016(a)(2) basis reduction by useless depreciation deductions were of no relevance to her case.

\textsuperscript{63} Crane, 331 U.S. at 3.

\textsuperscript{64} In response to the Commissioner’s challenge to her exclusion of the nonrecourse liability in the amount realized, Beulah stated in \textit{Brief for The Petitioner}, p. 24 as follows:

\begin{quote}
Nothing could be clearer than that [Beulah] was not obligated to pay interest on the mortgage. The sale of her interest in the real estate did not relieve her of any obligation arising under the mortgage or the mortgage bond because she was never under any obligation. \[emphasis in the original\]
\end{quote}

\textsuperscript{65} Crane, 331 U.S. at 3.
2. **Beulah’s Defense to the Commissioner’s Challenge of Her Reporting Position Did Not Question the Propriety of the Section 1016(a)(2) Basis Reduction by Useless Depreciation Deductions**

Not surprisingly, the Commissioner disputed Beulah’s reporting position as to the nature of the property sold, adjusted basis, the amount realized; and, thus, the amount of her taxable gain. The Commissioner treated the depreciable physical structure of the Brooklyn Apartment Building as the property Beulah sold to Avenue C Realty. In determining its adjusted basis, the Commissioner applied section 1016(a)(2) to reduce the original section 1014(a) basis (the date of death unencumbered fair market value of $262,000) by all allowable depreciation deductions ($28,000). Finally, as to the amount realized, the Commissioner included the two economic benefits he believed Beulah received in the transaction – the nonrecourse principal debt relief ($255,000) in addition to the net monetary consideration ($2,500). The resulting taxable gain was $23,500.66

Mathematically, the Commissioner’s amount realized was nearly 100 times greater than Beulah’s amount realized. Although the Commissioner’s adjusted basis was obviously much higher than Beulah’s, the differential between the Commissioner’s amount realized ($257,500) and his adjusted basis ($234,000) far exceeded the differential between Beulah’s amount realized ($2,500) and her adjusted basis ($0). Because of the wide disparity between the amount of taxable gain she and the Commissioner had computed ($23,500 compared to $2,500), Beulah was compelled to mount a defense against the Commissioner’s position.

Although the adjusted basis of the Brooklyn Apartment Building as reduced by useless depreciation deductions was a contributing factor to the Commissioner’s large taxable gain, Beulah’s defense focused on the inclusion of the nonrecourse liability in the amount realized. Beulah’s view of the nonrecourse liability as a burden rather than a benefit probably led her to perceive the Commissioner’s inclusion of it as debt relief in the amount realized as the most incomprehensible aspect of his position. Perhaps Beulah’s strategy was to persuade the Tax Court that the nonrecourse liability was not an economic benefit to be included in the amount realized and the property sold was an equity interest in the Brooklyn Apartment Building with an adjusted basis of zero. If the

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66 *Id.* at 4.
Tax Court were to agree with Beulah’s position, there would be no need to question the Commissioner’s section 1016(a)(2) basis reductions.67

Beulah’s “equitable” attack of the Commissioner’s inclusion of the nonrecourse liability in the amount realized was to challenge its constitutionality. Beulah argued the imposition of approximately $24,000 of taxable gain68 (when she had only received net monetary consideration of $2,500) resulting from the inclusion of the nonrecourse liability was not income within the meaning of the 16th Amendment and; thus, violated Article I, Section 9, and the 5th Amendment to the U.S. Constitution.69 In making this argument in her Supreme Court briefs, Beulah equated the concept of income in the constitutional sense with the receipt of an economic benefit and contended she could not receive an economic benefit from the relief of a nonrecourse liability she had no obligation to repay.70 Beulah reasoned the inclusion of phantom debt relief in the amount realized effectively created a fictitious gain. Because such a gain was not income within the meaning of the 16th Amendment, the levying of tax on such income was unconstitutional.71 Significantly, Beulah’s constitutional attack did not extend to the Commissioner’s section 1016(a)(2) basis reduction in arriving at the Brooklyn Apartment Building’s adjusted basis. Consequently, she did not attempt to link the transformation of useless depreciation deductions into taxable gain to the “fictitious” income.72

As to the minimal tax benefits Beulah and the Crane Estate received from the previously claimed depreciation deductions, Beulah raised this point for two defensive reasons having nothing to do with their transformation into taxable gain. First, Beulah’s reporting the sale of a non-depreciable equity interest was inconsistent with having

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67 In fact, Beulah did prevail in Tax Court. See Crane v. Commissioner, 3 T.C. 585 (1944).
68 See Brief for the Petitioner at 50.
69 See Petition for Writ of Certiorari and Brief in Support Thereof at 8; Brief in Behalf of Petitioner at 26-28; Brief for the Petitioner at p. 50-52; Petitioner’s Reply Brief at p. 4.
70 See supra note 64.
71 See supra note 69.
72 However, Beulah apparently raised the possibility of challenging the propriety of the transformation of useless depreciation deductions into taxable gain. On page 6, of the Brief of Petitioner, Paragraph (5) of the Assignment of Errors, Beulah indicated she intended to urge the Supreme Court to consider as an alternate argument, “whether depreciation on the building should be included in the ‘amount realized’ upon the sale in 1938, and if so, whether the amount to be included was depreciation ‘allowed or allowable’, or only the depreciation which resulted in tax benefit for [Beulah].” For some unexplained reason, the Supreme Court never considered this argument.
previously claimed depreciation deductions on the Brooklyn Apartment Building.\textsuperscript{73} Moreover, except for one tax year,\textsuperscript{74} the statute of limitations for the disallowance of those depreciation deductions had expired.\textsuperscript{75} Accordingly, even had the Commissioner acquiesced to her position and disavowal of the previously claimed depreciation deductions, he would have been powerless to make any correlative adjustments for the closed tax years 1932-1937. Thus, Beulah’s “eleventh hour” renunciation of her right to claim depreciation deductions could be viewed as being disingenuous.

In addition, the Second Circuit’s decision and the Commissioner’s briefs noted Beulah had claimed depreciation deductions for each tax year of the Brooklyn Apartment Building ownership period.\textsuperscript{76} By implication, it was a challenge to the integrity of Beulah’s reporting position, i.e., taking depreciation deductions during the ownership period of the Brooklyn Apartment Building; and, then concocting a gain formula that eliminated any accountability for those deductions upon its subsequent sale.

In a defensive response, Beulah discounted the inconsistency and possible impropriety of her reporting position by noting how miniscule the tax benefits were as compared to the claimed depreciation deductions. Thus, in spite of Beulah disavowing the right to depreciation deductions she had originally claimed; and, the Commissioner’s inability to disallow them, Beulah attempted to demonstrate the Government had not really been harmed by the small amount of tax she had saved.\textsuperscript{77} Interestingly, in her reference to the minimal tax benefits produced by the depreciation deductions, Beulah

\textsuperscript{73} This includes the $3,200 depreciation deduction Beulah claimed in the year of the sale. See Tax Court Petition VI (11).

\textsuperscript{74} Apparently, 1938, the tax year of the sale, was the only tax year open for examination by the Commissioner. Based upon its agreement with Beulah that the equity interest in the Brooklyn Apartment Building was non-depreciable, In the Tax Court disallowed the $3,200 depreciation deduction Beulah claimed in 1938. As to the prior tax years’ depreciation deductions, the Tax Court declined to address the question since those tax years were not before it. Crane, 3 T.C. at 591.

\textsuperscript{75} See Brief for Petitioner, p. 42.

\textsuperscript{76} Crane v. Commissioner, 153 F.2d 504, 505 (2d Cir. 1945) (“In the years 1932-1936, inclusive, she had filed income tax returns as executrix of the devisor, in each of which she had claimed and had been allowed deductions for depreciation upon the building; and in the years 1937 and 1938 she had claimed and been allowed similar deductions in her individual income tax return.”); Brief for the Respondent, p. 6 (“She claimed and was allowed depreciation on the basis of the full value of the apartment building with any reduction on account of the mortgage.”).

\textsuperscript{77} See supra note 75 at p. 46 (“The double deduction in [Beulah’s] case, if it exists at all; was due only to the error of [Beulah] in claiming depreciation she was not entitled to and the error of the Commissioner in failing to disallow it. The evidence showed that the actual amount of tax loss to the Treasury was between $150 and $200.”)
made no attempt to compare them with the much higher taxable gain they had morphed into.

B. THE DOUBLE DEDUCTION MISPERCEPTION BECOMES THE REALITY

Another explanation of why many Crane commentators may not be aware of the myth of Beulah’s double deductions and harsh tax consequences of the transformation of her useless depreciation deductions into taxable gain is the misperception of Beulah’s quest of the unwarranted tax benefits of double depreciation deductions emanating from the Vilifying Double Deduction Rationale. Sequentially, the Vilifying Double Deduction Rationale appears towards the end of the decision after the Supreme Court had essentially decided the case against Beulah. Specifically, it was a response to Beulah’s argument in her Supreme Court briefs challenging the constitutionality of being compelled to report $24,000 of taxable gain when she had only received $2,500. As discussed above, Beulah argued that point in opposition to the Commissioner’s inclusion of the nonrecourse debt relief in the amount realized. Asserting she could not receive an economic benefit for the relief of a debt she was not obligated to repay, she contended the fictitious taxable income created by its inclusion in the amount realized was unconstitutional.

The Supreme Court’s initial response was to reject Beulah’s concept of “income in the constitutional sense” as being too narrow. Then, the Supreme Court followed that response with the Vilifying Double Deduction Rationale:

She was entitled to depreciation deductions for a period of nearly seven years, and actually took them in almost the allowable amount. The crux of this case, really, is whether the law permits her to exclude allowable deductions from consideration in computing gain. We have already showed that, if it does, the taxpayer can enjoy a double deduction, in effect, on the same loss of assets.

From the text of the entire opinion, it is difficult to discern where in the opinion the Supreme Court had “already showed” how Beulah would have enjoyed a double deduction on the same loss of assets. Although the first sentence accurately recounted

78 See supra note 2 and infra note 82.
79 Crane, 331 U.S. at 15.
80 See supra notes 68-71 and accompanying text.
81 Crane, 331 U.S. at 15.
82 Id. at 15-16 (footnote omitted).
Beulah’s claiming of depreciation deductions over the seven year ownership period of the Brooklyn Apartment Building, it was also conclusory by implying Beulah had actually enjoyed tax benefits commensurate to the depreciation deductions she claimed. Such an implication, however, seemed to presume facts that were not clearly established in the opinion; and, in fact, contradicted by the Record. 83

Moreover, there is but a single comment in the entire opinion made in a footnote that by innuendo could possibly support the Supreme Court’s conclusion. The comment was an apparent stab at Beulah’s assertion that an equity interest in the Brooklyn Apartment Building with a zero basis barred her right to take depreciation deductions. Perhaps viewing Beulah’s position as being disingenuous and not credible, the Supreme Court remarked Beulah’s disavowal of depreciation deductions was “inconsistent with her practice in claiming such deductions in each of the years the property was held. The deductions so claimed and allowed by the Commissioner were in the total amount of $25,500." 84

So, if that single comment reflected what the Supreme Court “already showed” with regard to Beulah’s apparent ability to secure the tax benefit of double deductions, it would be necessary to read the following presumption and conclusion into that comment: During the ownership period of the Brooklyn Apartment Building, Beulah enjoyed the tax benefits from the significant amount of depreciation loss deductions she claimed against a section 1014(a) basis of $262,000. Then, when Beulah sold the Brooklyn Apartment Building, she manipulated the amount realized and the adjusted basis so that the limited amount of gain she recognized would enable her to enjoy the tax benefit of the same loss a second time.

Yet, the presumption Beulah enjoyed significant tax benefits from the previously claimed depreciation deductions and the conclusion Beulah would have received double deductions if her reporting position had been upheld was nonsensical. There were numerous references in the Record including the actual income tax returns of Beulah and the Crane Estate clearly indicating the depreciation deductions claimed by Beulah

83 See Petition For Writ of Certiorari and Brief in Support Thereof, p. 4 (noting the Tax Court made no finding with regard to Beulah’s lack of tax benefit); Brief For the Petitioner, p. 46.
84 Crane, 331 U.S. at 3, n.2. Other than this comment, the only reference to Beulah’s depreciation deductions was to the amount of the allowable depreciation deductions on the Brooklyn Apartment Building.
produced minimal tax benefits. Therefore, there was no way the “correlative” taxable gain Beulah was compelled to recognize could have offset non-existent tax benefits. Thus, for some unknown reason, even though the Supreme Court certainly had access to the Record, none of the facts regarding Beulah’s minimal tax benefits were considered or even mentioned in the Supreme Court’s decision.

Ironically, two courts perhaps desperately seeking to find a rationale to deny taxpayers who unlike Beulah were actually attempting to enjoy the unwarranted tax benefit of double deductions further validated the double deduction myth. This occurred approximately thirty years after Crane in a Third Circuit case and the Tax Court case involving Footnote 37 Tax Shelter Scenarios.

In the Third Circuit case, Millar v. Commissioner, the taxpayers contributed the proceeds of a nonrecourse loan to the capital of an S Corporation that increased the basis in their stock from which to take flow through deductions. Similarly, in the Tax Court case, Tufts v. Commissioner, nonrecourse acquisition debt securing rental real estate owned by a partnership provided the taxpayers with basis from which to take flow through depreciation deductions.

In both cases, over a number of tax years, the taxpayers had received the tax benefit of sizeable losses and deductions taken against a basis created with nonrecourse liability. Subsequently, at the time of the disposition of the underlying property, the fair market value of the underlying property had declined far below the outstanding balance of the debt. In computing the potential gain, the taxpayers contended the amount realized was limited to the fair market value of the property. Relying on Footnote 37, the taxpayers argued that they could not receive an economic benefit from the relief of nonrecourse liability in excess of the underlying property’s fair market value; and, for that reason did not include it in the amount realized.

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85 *See supra* notes 40–47 and accompanying text.
86 *Id.* The reason the Supreme Court did not mention Beulah’s minimal tax benefits might be due to the Tax Court making no finding of fact on this point.
89 577 F.2d. 212 (3d Cir. 1978).
90 *Id.*
91 70 T.C. 756 (1978).
92 *Id.*
If the taxpayers had prevailed in these cases, the Government would have been severely whipsawed. In Millar, the $245,000 loan proceeds invested in the capital of the S Corporation had increased the value and bases in the stock by a like amount.\(^\text{93}\) Over a number of tax years preceding the foreclosure, there was a $205,508 decline in value of the S Corporation stock reflected in loss deductions that had flowed from the S Corporation to the taxpayers.\(^\text{94}\) At the outstanding balance of the nonrecourse liability, however, remained $245,000. If consistent with Footnote 37, the amount realized were limited to the fair market value of the stock; and, assuming the value of the stock was equal to its adjusted basis, the taxpayers would have recognized no gain on the foreclosure of their stock.

Stated differently, a taxpayer victory would have resulted in a huge windfall of the unwarranted tax benefit of double deductions. The first deduction was the $205,508 operating losses that had flowed through to the taxpayers-shareholders. The second deduction would have been the loss of the same $205,508 (economically borne by the mortgagee, not the taxpayers) as reflected in the reduced fair market value of the stock; and, thus, in the amount realized.\(^\text{95}\) If the courts had decided these cases in favor of the taxpayers, they would have essentially approved of taxpayers using “Monopoly Money,” (borrowed nonrecourse proceeds never to be repaid with after tax dollars and never taxed when forgiven) to generate deductions to offset other taxable income as a means to reduce or eliminate a substantial amount of tax liability, i.e., Footnote 37 Tax Shelters.

In spite of this potentially devastating result to the Treasury, a literal reading of Footnote 37 appeared to support the taxpayers’ position. On the other hand, in spite of Footnote 37 being dictum, a judicial rejection of the Footnote 37 rationale in these cases could have been construed as the lower courts “overruling” the Supreme Court. Obviously, both courts understood the only way to eliminate the unwarranted tax benefit of double deductions was the inclusion of the full outstanding balance of the nonrecourse liability in the amount realized regardless of the fair market value of the property. By doing so, double deductions would not be possible because its inclusion in the amount

\(^\text{93}\) Millar, 577 F.2d at 215.
\(^\text{94}\) Id.
\(^\text{95}\) The Tufts case involved a similar scenario.
realized would trigger sufficient taxable gain to cancel out, or offset the tax benefits of the previously claimed deductions.

Relying upon the Vilifying Double Deduction Rationale, however, the courts reached the desired result without appearing to overrule the Supreme Court. By portraying Beulah as a tax villainess who sought the unwarranted tax benefit of double deductions, the courts proclaimed preventing Beulah from doing so was “the rationale of the Supreme Court’s principal reasoning, analysis and holding.” In addition, it was a “judicially correct” way to play down Footnote 37 as being dictum and a “postulate or hypothetical observation with respect to a hypothetical set of facts not before the Court.” In the process of two courts seeking a rationale to strike down Footnote 37 Tax Shelters, however, Beulah was vilified as the poster child of greedy taxpayers.

Because perception and misperceptions become reality, a Crane commentator whose view of the facts of the case is based on the Supreme Court’s opinion as well as the Millar and Tufts decisions that followed would have no reason to belief that Beulah was not seeking double deductions, much less actually suffered much harsher tax consequences.

IV. BEULAH WOULD HAVE FARED NO BETTER HAD SHE CHALLENGED THE PROPRIETY OF THE SECTION 1016(A)(2) BASIS REDUCTIONS THAT CAUSED THE TRANSFORMATION OF USELESS DEPRECIATION DEDUCTIONS INTO TAXABLE GAIN

As documented in this Article, Beulah did not challenge the real cause of her harsh tax consequences, i.e., the section 1016(a)(2) basis reduction of her useless depreciation deductions that were ultimately transformed into taxable gain. Yet, she could have done so by computing her taxable gain in the way the Commissioner had computed it with the significant difference of reducing the original section 1014(a) basis of the Brooklyn Apartment Building by only the previously claimed depreciation

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96 Millar, 577 F.2d at 215 (“A finding that the taxpayers did not realize gain as a result of this exchange, after having realized the full economic benefit of this transaction, would entitle them to the type of double deductions of which the Supreme Court so clearly disapproved in Crane.”). In coming to the same conclusion, the Tax Court cited this part of the Millar decision with approval. Tufts, 70 T.C. at 765.
97 Id.
98 Id.
99 This assumes Beulah reported the transaction as the sale of the physical structure and included the nonrecourse debt relief in the amount realized.
deductions that produced tax benefits. Had she done so and prevailed, she would have successfully excluded the transformation of useless depreciation from her taxable gain.  

Unfortunately, even had Beulah made this argument, the outcome would not have been different as it was similar to arguments made by other taxpayers in a variety of cases decided in favor of the Government during that era. In Breckridge Corporation v. Commissioner, over a number of tax years, a taxpayer who did not claim any allowable depreciation deductions nonetheless sustained losses in the rental of an apartment building. So, even had the taxpayer claimed the allowable depreciation deductions, they would have produced no tax benefits. In addition to not claiming the allowable depreciation deductions, the taxpayer made no corresponding basis reductions on the apartment building. Subsequently, upon the sale of the apartment building, the taxpayer reported a loss because the adjusted basis of the apartment building exceeded the amount realized.

Conversely, the Commissioner applied section 1016(a)(2) and reduced the basis by the full amount of the unclaimed allowable depreciation deductions. As a result, the amount realized exceeded the adjusted basis, converting the loss reported by the taxpayer into a taxable gain.

In deciding the basis reduction issue in the Commissioner’s favor, the Second Circuit essentially held that notwithstanding the lack of a tax benefit provided from a depreciation deduction in the tax year in which it was deductible, the taxpayer could not resurrect the unproductive depreciation deduction in reducing the taxable income of another tax year. The Second Circuit reasoned the taxpayer’s failure to reduce the basis of the apartment building by the allowable depreciation deductions that produced no tax benefits preserved the depreciation deduction in the property’s adjusted basis for a future tax benefit. It was that higher basis from which the ensuing loss would have provided the taxpayer a second opportunity to receive the tax benefit of the earlier tax years’ depreciation deductions. The Second Circuit’s opinion disapproved such a result.

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100 See infra notes 147-153 and accompanying text.
101 129 F.2d 318 (2d 1942).
102 Id.
103 Id. at 319.
In Virginian Hotel Corp. v. Commissioner,\textsuperscript{104} the Supreme Court had the last word on the issue. In this case, over a number of years, the taxpayer claimed depreciation deductions in excess of the allowable amount. Similar to the Breckridge case, the excessive depreciation deductions did not produce any tax benefits for the taxpayer. In any event, within the applicable limitations period, the Commissioner did not contest the taxpayer’s excessive depreciation deductions.\textsuperscript{105} In a subsequent examination of other tax years, however, the Commissioner reduced the taxpayer’s basis in the underlying property by the full amount of the taxpayer’s previously claimed depreciation deductions, including the excessive amounts.\textsuperscript{106}

At stake in the case was the amount of depreciation deductions the taxpayer would be entitled to claim over the remaining tax years of the recovery period. If the adjusted basis of the underlying property were “over” reduced by excessive depreciation deductions, there would be a lower resulting adjusted basis remaining from which depreciation deductions could be taken. In other words, the difference between the remaining allowable depreciation deductions (from a basis previously reduced by only allowable depreciation deductions) and the actual depreciation deductions (from a basis reduced the all depreciation deductions including the excessive amounts) would be attributable to excessive depreciation deductions that produced no tax benefits. The resolution of the issue turned on the meaning of the phrase “to the extent allowed (but not less than the amount allowable)” (emphasis added) in the predecessor of section 1016(a)(2) as it applied to a basis reduction of depreciation deductions.

According to the Commissioner’s interpretation of the phrase, an excessive depreciation deduction not successfully challenged during the limitations period was “allowed” within the meaning of the phrase. Therefore, section 1016(a)(2) mandated a basis reduction by the full amount of the depreciation deductions.

In disputing the Commissioner’s interpretation of the phrase, the taxpayer contended the word “allowed” connoted the receipt of a tax benefit.\textsuperscript{107} In other words, the Government could be harmed by an allowed deduction only if it produced a tax

\begin{footnotes}
\item[104] 319 U.S. 523 (1943).
\item[105]  Id. at 524.
\item[106]  Id.
\item[107]  Id. at 526.
\end{footnotes}
benefit for the taxpayer. In that case, if the basis of the underlying property were not reduced, the taxpayer would be in a position to “over” depreciate or otherwise receive an unwarranted tax benefit. In this case, the excessive amount of depreciation deductions taken in the earlier tax years was a tax nullity. Therefore, inconsistent with preventing an unwarranted tax benefit, the taxpayer contended the Commissioner’s basis reduction unfairly limited the depreciation deductions it could take over the remaining tax years of the recovery period. Although the taxpayer’s interpretation had some equitable appeal, it was not supportable by the plain meaning of the words in the statute.

In an opinion written by Justice Douglas, the Supreme Court refused to read a tax benefit concept into the word “allowed.” Citing the Breckridge case, the Supreme Court held the basis reduction of the predecessor of section 1016(a)(2) was mandatory for allowed and allowable depreciation deductions, alike, even if no tax benefit results from the deductions. In the aftermath of the Virginian Hotel decision, it was clear the Supreme Court was not troubled by the inequity of basis reductions by depreciation deductions that produced no tax benefits for the taxpayer.

Immediately following the Virginian Hotel decision, in a number of 1943 and 1944 Tax Court Memorandum decisions, the Tax Court implemented the Supreme Court’s interpretation of the section 1016(a)(2) basis reduction by all depreciation deductions (allowed and allowable). Considering the close proximity in time between the Virginian Hotel and Crane; and, the overwhelming precedent for decreasing the basis of depreciable property by all depreciation deductions including those that produced no

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108 Justice Douglas’ decision was to made a major statutory interpretation of the predecessor of section 1016(a)(2) that had a significant negative tax impact on taxpayers, such as Beulah. Ironically, thirty one years later, in Commissioner v. Idaho Power, 418 U.S. 1, 19 (1974) (Douglas, J. dissenting), a case in which the Supreme Court decided that cost of equipment utilized to construct a capital asset could not be depreciated but was to be capitalized as part of the cost of such capital asset, Justice Douglas stated: “This Court has, to many, seemed particularly ill-equipped to resolve income tax disputes between the Commissioner and the taxpayers. . . Indeed, we are called to resolve conflicts which more providently should go to the standing committee of the Congress for resolution.” Obviously, Justice Douglas had a change of heart late in life regarding the propriety of the Supreme Court resolving tax issues.
109 129 F. 2d 318.
110 Virginian Hotel, 319 U.S. at 528.
tax benefits, it is unlikely a similar challenge mounted by Beulah would have been successful.

V. SEARCHING FOR A TAX BENEFIT PRINCIPLE APPROACH TO ELIMINATE THE BASIS REDUCTION TAX TRAP

A. THE “CURE” SHOULD BE LIMITED TO THE INEQUITY

At this point in the Article, it should be clear that Beulah was victimized by the Basis Reduction Tax Trap in which useless depreciation deductions were ultimately transformed into taxable gain upon the sale of the Brooklyn Apartment Building.\(^\text{112}\) Although too late to be of any benefit to Beulah, the implementation of tax principles would be an equitable way to shut down the trap. When an application of a Code section causes an unintended punitive result, tax benefit principles should be implemented to nullify that result. Since for all purposes other than the Basis Reduction Tax Trap, the section 1016(a)(2) basis reduction achieves the intended result of preventing a taxpayer abuse of the depreciation deduction, the tax principle “cure” should be limited to the aforementioned tax trap with all other applications continuing to operate as they do today.

More specifically, the underlying rationale for requiring the section 1016(a)(2) basis reduction is to assure the integrity of the depreciation deduction and to prevent taxpayers from receiving unwarranted tax benefits from depreciation deductions. In achieving this goal, the section 1016(a)(2) basis reduction facilitates the important purposes of (1) tracking the asset’s declining basis available for depreciation deductions in the remaining years of the recovery period by reducing it by each ensuing tax year’s depreciation deduction,\(^\text{113}\) (2) precluding the taxpayer from having a second opportunity to take a loss deduction for prior years’ depreciation deductions that produced no tax benefits; (3) preventing the taxpayer from enjoying unwarranted double depreciation deductions; and (4) precluding the taxpayer from enjoying the tax benefits of depreciation deductions in excess of the underlying asset’s original basis.

The common theme implicit in the foregoing purposes facilitated by the section 1016(a)(2) basis reduction is the prevention of unwarranted tax benefits. The section

\(^{112}\) Looking at the “numbers,” of the $28,000 of allowable depreciation deductions only $3,307 actually reduced the taxable income of Beulah or the Crane Estate.

\(^{113}\) See section 167(c)(1).
1016(a) basis reduction cannot accomplish that purpose in the Basis Reduction Tax Trap because in that case there is no tax benefit to be offset by the recognition of gain. Instead, it application is punitive because it essentially transforms useless depreciation deduction into unnecessarily taxable gain.

In Crane, Beulah’s fall into the Basis Reduction Tax Trap was the overlooked result. During the ownership period of the Brooklyn Apartment Building, Beulah and the Crane Estate derived no tax benefits from the majority of the allowable depreciation deductions. Yet, in spite of the absence of tax benefits, the basis of the Brooklyn Apartment Building was reduced by those useless deductions. Then, when Beulah sold the Brooklyn Apartment Building, those useless depreciation deductions were morphed into taxable gain.

So the task at hand is to eliminate the punitive tax consequences caused by the Basis Reduction Tax Trap without tampering with the legitimate functions served by the section 1016(a)(2) basis adjustment.

**B. TWO ALTERNATIVE WAYS TO ELIMINATE THE BASIS REDUCTION TAX TRAP**

1. **EXTEND THE TAX BENEFIT RULE TO DEPRECIATION DEDUCTIONS**

The codification of the tax benefit rule, section 111 provides that “gross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent such amount did not reduce the amount of tax imposed by this chapter.” In Beulah’s case, over the seven year ownership period of the Brooklyn Apartment Building, most of the allowable depreciation deductions did not reduce her tax liability. Nevertheless, the adjusted basis was reduced by all allowable depreciation deductions effectively transforming them into phantom taxable gain upon its subsequent sale. Under the tax benefit rule, the portion of her taxable gain attributable to those useless depreciation deductions would haven been excluded from gross income.

Unfortunately, the Regulations state that the tax benefit rule does not apply to depreciation deductions.\(^{114}\) If, however, the tax benefit rule were extended to depreciation deductions, the inequitable tax consequences caused by the Basis Reduction

\(^{114}\) See 26 C.F.R. § 1.111-1(a).
Tax Trap would be eliminated. In other words, section 1016(a)(2) would continue to operate as it currently does. Basis would be reduced by all allowable depreciation deductions whether or not they produced tax benefits. Upon the disposition of the depreciable property, the tax benefit rule would be invoked so that the portion of gain attributable to useless depreciation deductions would be excluded from gross income.

Thus, by a simple amendment to section 111 to include depreciation deductions, the Basis Reduction Tax Trap would be shut down without any change to section 1016(a)(2). Therefore, for all other legitimate tax purposes, the section 1016(a)(2) basis reduction would continue to operate as it does today.

2. CREATE TWO SEPARATE ADJUSTED BASES: ONE SOLELY FOR THE COMPUTATION OF GAIN AND THE OTHER TO TRACK THE DECLINING BASIS AVAILABLE FOR DEPRECIATION DEDUCTIONS AND FOR THE COMPUTATION OF LOSS

Another way to incorporate tax benefit principles to eliminate the Basis Reduction Tax Trap would be to amend section 1016(a)(2) and the determination of adjusted basis so as to preclude the transformation of unbeneficial depreciation deductions into taxable gain upon the disposition of the underlying depreciable property. To accomplish this purpose without affecting all valid tax purposes facilitated by the current law version of adjusted basis and section 1016(a)(2), a new basis regimen would be created with two mutually exclusive bases for depreciable property – a Gain Basis and a Depreciation Deduction/Loss Basis each with appropriately different basis reduction rules.

The new Gain Basis would be utilized solely for purposes of computing taxable gain upon the disposition of depreciable property. Each tax year, unlike the current version of section 1016(a)(2), the Gain Basis would be reduced only by those depreciation deductions that produced tax benefits for the taxpayer. Thus, upon the disposition of depreciable property, utilizing the Gain Basis as the subtrahend in the gain computation formula, no gain attributable to depreciation deductions that produced tax benefits for the taxpayer would be triggered.

Conversely, the Depreciation Deduction/Loss Basis would be identical to the current version of adjusted basis – with the obvious exception of not being utilized as the subtrahend in the computation of gain. Otherwise, it would continue to operate in the same way as the current law adjusted basis operated including being utilized as the
minuend in the loss computation formula on the disposition of depreciable property. As to basis reductions, for each tax year, section 1016(a)(2) would reduce the Depreciation Deduction/Loss Basis in exactly the same way as it reduces adjusted basis under current law.

Thus, the overall purpose of dividing the functions of the adjusted basis between a newly created Gain Basis and a Depreciation Deduction/Loss Basis is to cure the harsh tax consequences of the Basis Reduction Tax Trap while assuring all other intended purposes of the current law adjusted basis as reduced pursuant to section 1016(a)(2) continue to operate as they do today.

Part V.B.2.a. illustrates how the Gain Basis would eliminate the Basis Reduction Tax Trap. Parts V.B.2.b.i.-iv examine how the intended purposes of the current law section 1016(a)(2) basis reduction rules would be continue to be served by utilizing the Depreciation Deduction/Gain Basis. Next, Part V.C.1. discusses how the utilization of the Gain Basis would have prevented Beulah from falling into the Basis Reduction Tax Trap. Finally, Part V.C.2. explains how the utilization of the Depreciation Deduction/Loss Basis would have prevented the transformation of Beulah’s previously allowable useless depreciation deductions into a taxable loss.

a. **Utilizing the Gain Basis as the Subtrahend in the Gain Computation Formula Shuts the Basis Reduction Tax Trap**

When tax depreciation exceeds economic depreciation, some or all of the depreciation deductions taken by the taxpayer are economically unsustain able; and, thus are unwarranted. So to be fair to the taxpayer and the Government, the taxable gain triggered by the disposition of the underlying property should account for economically unsustainable depreciation deductions only to the extent they produced a tax benefit for the taxpayer. Unfortunately, under current law, a taxpayer falls into the Basis Reduction Tax Trap by being compelled to report gain attributable to depreciation deductions that produced no tax benefits. By exclusively utilizing the Gain Basis as reduced by only those depreciation deductions that produced tax benefits, the Basis Reduction Tax Trap would be eliminated.

To illustrate this point, consider the following fact pattern: Assume a taxpayer acquires depreciable property for $1,000. This amount would be the property’s original
Gain Basis as well as the property’s original section 1012 basis under current law. Further assume in the first year, the allowable depreciation deduction of $200 did not produce a tax benefit. Due to the lack of a tax benefit, there would be no basis reduction to the original Gain Basis. Conversely, the current law adjusted basis would be reduced by the full amount of allowable depreciation deductions to $800.

Then, assume in the second year, the allowable depreciation deduction of $200 produced a tax benefit of only $100. Accordingly, the Gain Basis would be reduced by $100 tax beneficial depreciation deduction resulting in an “adjusted” Gain Basis of $900. Similar to the first year, the current law adjusted basis would be reduced by the full amount of allowable depreciation deduction to $600.

Finally, assume, in the third year, the taxpayer sells the property for $1,000 meaning over the ownership period there was no decline in value. In retrospect, none of the $400 allowable tax depreciation deductions were economically sustainable. Of those depreciation deductions, only $100, however, produced a tax benefit for the taxpayer. Thus, from a tax benefit perspective, the $100 unsustainable depreciation deduction that produced a tax benefit should be offset by the recognition of an equivalent amount of taxable gain.

As demonstrated above, under current law, the property’s adjusted basis would be reduced by all allowable depreciation deductions. Moreover, as a consequence of the section 1016(a)(2) basis reduction, in spite of the absence of any tax benefit from $300 of useless depreciation deductions and the underlying asset not appreciating in value, the taxpayer would be compelled to recognize a $300 gain.

Utilizing the Gain Basis reduced by tax beneficial depreciation deductions as the subtrahend in the section 1001(a) gain computation formula, however, would eliminate that punitive result. Computationally, the amount realized of $1,000 less the “adjusted” Gain Basis of $900 would produce a taxable gain of $100. The difference between the two taxable gain computations is the $300 of depreciation deductions that produced no tax benefits for the taxpayer. Thus, because the Gain Basis would be reduced only by depreciation deductions that produced tax benefits, the punitive tax consequences of the Basis Reduction Tax Trap would be eliminated by an exact matching of the tax benefits of useful depreciation deductions with an equivalent amount of taxable gain.
b. **THE DEPRECIATION DEDUCTION/LOSS BASIS WOULD CONTINUE TO SERVE THE SAME LEGITIMATE TAX PURPOSES OF CURRENT LAW ADJUSTED BASIS**

The following subsections describe how the utilization of the Depreciation Deduction/Loss Basis would continue to carry out the various legitimate tax purposes of the current law adjusted basis as reduced pursuant to section 1016(a)(2).

i. **TRACKING THE DECLINING BALANCE OF BASIS AVAILABLE FOR DEPRECIATION DEDUCTIONS OVER THE REMAINING TAX YEARS OF THE RECOVERY PERIOD.**

One of the legitimate tax purposes of the current law adjusted basis is the tracking of the declining balance of basis available for depreciation deductions over the remaining tax years of the recovery period. Because the Depreciation Deduction Loss/Basis would be identical to current law adjusted basis, there would be no change in this tracking.

In a landmark case, the Supreme Court defined depreciation as follows:

Depreciation is an accounting device which recognizes that the physical consumption of a capital asset is a true cost, since the asset is being depleted. As the process of consumption continues, and depreciation is claimed and allowed, the asset’s adjusted income tax basis is reduced to reflect the distribution of its cost over the accounting periods.\(^{115}\)

Simply stated, depreciation is a means of deducting the cost of an asset, utilized to generate taxable income, over the multiple tax years in which the asset is used up or consumed. The initial cost of the depreciable asset – and starting point from which to claim depreciation deductions over the recovery period is the section 1012 cost basis of the asset. The basis reduction of each tax year’s depreciation deduction tracks the declining balance of the original basis available for depreciation deductions over the remaining tax years of the recovery period.\(^{116}\)  Obviously, once the adjusted basis reaches zero, depreciation deductions must cease because the taxpayer has then recovered her entire investment in the asset. This is the way it is under current law and it would remain that way because the Depreciation Deduction Loss/Basis would serve exactly the same function as today’s version of the adjusted basis..

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\(^{116}\) Section 167(c)(1).
ii. **Preclude a Second Opportunity to Receive the Tax Benefit of a Depreciation Deduction That Did Not Produce a Tax Benefit in a Prior Tax Year**

As indicated above, the Depreciation Deduction/Loss Basis would be reduced by each tax year’s allowable depreciation deductions in the same way adjusted basis is reduced under current law. Reducing the “adjusted” Depreciation Deduction/Loss Basis by all allowable depreciation deductions would account for those deductions whether or not they produced a tax benefit for the taxpayer. This is a proper adjustment because the taxpayer’s opportunity to take each tax year’s allowable depreciation deduction is limited to that tax year. So, if a depreciation deduction does not produce a tax benefit in its properly deductible tax year, a taxpayer does not have the option of skipping or deferring the section 1016(a)(2) basis reduction for that year by not claiming the allowable depreciation deduction. Otherwise, the depreciation deduction would essentially become elective and a tax year’s unclaimed depreciation deduction would be preserved in the unreduced adjusted basis. Then, upon the disposition of the depreciable property in a subsequent tax year, the prior tax year’s unproductive depreciation deduction would be transformed into the tax benefit of a deductible loss or a reduction of taxable gain.

In the final analysis, the failure of a depreciation deduction to provide a tax benefit in the tax year it is properly deductible does not justify its deferral into another tax year because the taxpayer is not guaranteed the receipt of tax benefits commensurate to the allowable depreciation deductions. Thus, it would be imprudent to permit the taxpayer to do indirectly what she cannot do directly, i.e. transform unproductive allowable depreciation deductions from one or more tax years into a loss deduction triggered by the sale of the property a subsequent tax year. By exclusively utilizing the Depreciation Deduction/Loss Basis as the minuend in the loss computation formula, however, no such loss would ever be realized.

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117 See Commerce Co. v. United States, 171 F.2d 189, 192 (5th Cir. 1948) (quoting United States v. Ludley, 274 U.S. 274 (1927)). This is not to say a taxpayer may never derive the tax benefit of an unproductive depreciation deduction. An unproductive depreciation deduction may be reflected in whole or in part in a net operating loss deduction available to offset taxable income in prior and/or subsequent tax years. Also, this is not inconsistent with the elimination of gain attributable to useless depreciation deductions. Although the Article advocates no recognition of such gain, it does not advocate any guarantee of tax benefits.
To illustrate this point, consider the following fact pattern. Assume a taxpayer acquires depreciable property for $1,000. This amount would be the property’s original Gain Basis and Depreciation Deduction/Loss Basis. Further assume in the first year, the allowable depreciation deduction of $200 did not produce a tax benefit for the taxpayer. Due to the lack of a tax benefit, the original Gain Basis would be unchanged. On the other hand, the Depreciation Deduction/Loss Basis would be reduced by the full amount of the allowable depreciation deduction to $800.

Similarly, assume in the second year, the allowable depreciation deduction of $200 did not produce a tax benefit for the taxpayer. As in the first year, the Gain Basis of $1,000 would remain unchanged. The Depreciation Deduction/Loss Basis, however, would again be reduced by the full amount of the allowable depreciation deduction to $600.

Finally, assume in the third year, the taxpayer sells the property for $600 – meaning the $400 economic decline in the property’s value was equal to the allowable depreciation deductions. Yet, even though the economic loss in the underlying property was real, the taxpayer derived no tax benefit from the depreciation deductions in the tax years in which they were allowable. If, in this instance, the taxpayer were allowed to limit basis reduction to those depreciation deductions that produced tax benefits, she could resurrect those wasted depreciation deductions in the form of a “loss” deduction. In other words, it would provide her with a second opportunity to enjoy the tax benefit those deductions did not produce in the prior tax years.

As illustrated by the reduction to the Depreciation Deduction/Loss Basis by all allowable depreciation deductions, the second opportunity to enjoy the tax benefit of a loss deduction in a subsequent year of disposition could never materialize. To generate a loss upon the disposition of property, the adjusted basis must exceed the amount realized.\(^{118}\) Because the Depreciation Deduction/Loss Basis would always be inserted as the minuend in the loss computation formula, a second opportunity to enjoy the tax benefit of the depreciation would never materialize.\(^{119}\) In this case, no loss would be

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\(^{118}\) Per section 1001(a), loss is the excess of the adjusted basis over the amount realized. This means a loss is realized only if there is an excess, or a positive result.

\(^{119}\) Although the reduction of the Gain Basis was limited to depreciation deductions that produced tax benefits for the taxpayer, it functions solely and the subtrahend in the computation of gain. Therefore,
realized, as the “adjusted” Depreciation Deduction/Loss Basis would not exceed the amount realized.120

iii. PREVENT DOUBLE DEPRECIATION DEDUCTIONS

When tax depreciation is equal to the economic depreciation of the underlying property, all depreciation deductions that produced tax benefits for the taxpayer are economically sustainable. So, no taxable gain attributable to those previously claimed depreciation deductions should be triggered by the disposition of the underlying property. At the same time, the disposition should not produce the unwarranted tax benefit of a second deductible loss for those same depreciation deductions. The latter result is accomplished under current law because basis is reduced by all such depreciation deductions. Thus, the disposition of such property would not trigger any loss because the basis as reduced by tax depreciation deductions would be equal to the economic value of the property. The same result would continued to be assured vis-a-vis the Depreciation Deduction/Loss Basis.

To illustrate this point, consider the following fact pattern. Assume a taxpayer acquires depreciable property for $1,000. This amount would be the property’s original Depreciation Deduction/Loss Basis. Further assume that as of the beginning of the third tax year, the aggregate amount of allowable depreciation deductions ($400) produced commensurate tax benefits. Consequently, the Depreciation Deduction/Loss Basis would be reduced to $600.121

Assume in the third year, the taxpayer sells the property for $600. This means the $400 economic decline in the property’s value was equal to the allowable depreciation deductions. Moreover, the taxpayer received the tax benefits of the property’s economic depreciation through the allowable depreciation deductions. Accordingly, under no

120 Conceptually, the Gain Basis and Depreciation Deduction/Loss Basis would be similar to the section 1015 gain basis and loss basis. Pursuant to section 1015(a), the donee’s gain basis in the gifted property (the basis to be used in computing the potential gain on the sale or exchange of such property) is the same as the donor’s basis. On the other hand, if at the time of the gift, the donor’s basis exceeded the fair market value of the gifted property, the donee’s loss basis (the basis to be used in computing the potential loss on the sale or exchange of such property) is the date of gift fair market value.

121 Because the $400 of allowable depreciation deductions produced commensurate tax benefits, the Gain Basis and the Depreciation Deduction/Loss Basis would be reduced by the full amount of the allowable depreciation deductions.
circumstances should the disposition of the underlying depreciable property produce a taxable loss equivalent to a second deduction for the same loss. By utilizing the “adjusted” Depreciation Deduction/Loss Basis as the minuend in the loss computation formula, no loss would be realized because the “adjusted” Depreciation Deduction/Loss Basis ($600) would be offset by the amount realized ($600).  

iv. PREVENT THE TAXPAYER FROM TAKING DEPRECIATION DEDUCTIONS IN EXCESS OF THE PROPERTY’S ORIGINAL BASIS

A taxpayer who claims a depreciation deduction in excess of the allowable amount that reduces taxable income receives an unwarranted tax benefit. Any excessive depreciation deduction unchallenged within the applicable limitations period is considered allowed because the Commissioner can no longer question its validity.  

If the taxpayer were not required to reduce the basis of the underlying property by the amount of such excessive allowed depreciation deductions, the total depreciation deductions taken over the recovery period could potentially exceed the underlying property’s original basis. Therefore, as is the case with regard to the current law adjusted basis, the Depreciation Deduction/Loss Basis would be reduced by excessive depreciation deductions that produced tax benefits for the taxpayer.

To illustrate this point, consider the following fact pattern: Assume the taxpayer acquires an asset for $1,000 (the taxpayer’s original Depreciation Deduction/Loss Basis) depreciable over a five year recovery period. Further assume in the first four years of the recovery period, the taxpayer claimed an aggregate amount of $1,000 of depreciation deductions (all of which reduced taxable income by a like amount) even though the allowable amount was only $800. So, if the Depreciation Deduction/Loss Basis reduction of the underlying property were limited to the amount of the allowable depreciation deductions, the adjusted Depreciation Deduction/Loss Basis entering the final year of the recovery period would be $200 – even though the total amount of depreciation deductions taken by the taxpayer to this point had already equaled the asset’s original Depreciation Deduction Loss/Basis ($1,000). Accordingly, there would be sufficient basis from which to take the final tax year’s $200 allowable depreciation

122 Section 1001(a).
deduction. If this were permitted, at the end of the recovery period, the aggregate amount of depreciation deductions ($1,200) claimed by the taxpayer would have exceeded the asset’s original basis ($1,000) by the $200 of excessive depreciation deductions.

To prevent this potential abuse, the Depreciation Deduction/Loss Basis would be reduced by all excessive allowed depreciation deductions that produce tax benefits. Applying this rule to the above illustration, as of the end of the fourth year of the recovery period, the original Depreciation Deduction Loss/Basis of the asset ($1,000) would have been totally depleted. So, entering the fifth year of the recovery period, the adjusted Depreciation Deduction/Loss Basis would be zero. Therefore, even if the Commissioner were barred by the expiration of the limitations period from challenging the excessive depreciation deductions taken in any of the prior four years, he could nonetheless successfully challenge the “allowable” depreciation deduction claimed in the fifth year.\(^\text{124}\)

C. **Utilizing the Gain Basis and the Depreciation Deduction/Loss Basis to the Crane Case**

1. **Utilizing the Gain Basis Would have Saved Beulah from Falling Into the Basis Reduction Tax Trap**

Had the Gain Basis been in effect during the *Crane* years, equity would have been served, as Beulah would not have fallen into the Basis Reduction Tax Trap in which useless depreciation deductions on the Brooklyn Apartment Building were transformed into taxable gain. To illustrate this point, the following charts demonstrate the application of the Depreciation Deduction/Loss Basis and the Gain Basis to the Brooklyn Apartment Building, first as held by the Crane Estate, and, then individually by Beulah.\(^\text{125}\)

\(^{124}\) This assumes, of course, the fifth year was an open year for examination.  
\(^{125}\) This chart is based upon depreciation deductions of $25,200 actually claimed by Beulah and her husband’s estate. The allowable depreciation deductions, however, were $28,045.10, the amount by which the Commissioner reduced Beulah’s Original Section 1014(a) Basis.
CRANE ESTATE 1932-1936

Depreciation Deduction/Loss Basis ($262,000)\textsuperscript{126}

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Rental Income Excluding Depreciation</th>
<th>Allowable Depreciation Deduction</th>
<th>Net Income With Depreciation Deduction</th>
<th>Depreciation Deduction/Loss Basis As Adjusted</th>
</tr>
</thead>
<tbody>
<tr>
<td>1932</td>
<td>$3,439</td>
<td>$3,500</td>
<td>($61)</td>
<td>$258,500</td>
</tr>
<tr>
<td>1933</td>
<td>$1,570</td>
<td>$3,500</td>
<td>($1,930)</td>
<td>$255,000</td>
</tr>
<tr>
<td>1934</td>
<td>-0-</td>
<td>$3,800</td>
<td>At least ($3,800)</td>
<td>$251,200</td>
</tr>
<tr>
<td>1935</td>
<td>-0-</td>
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<td>At least ($3,800)</td>
<td>$247,400</td>
</tr>
<tr>
<td>1936</td>
<td>-0-</td>
<td>$3,900</td>
<td>At least ($3,900)</td>
<td>$243,500</td>
</tr>
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</table>

Gain Basis (262,000)\textsuperscript{127}

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Rental Income Excluding Depreciation</th>
<th>Depreciation Deduction Producing Tax Benefits</th>
<th>Net Income With Depreciation Deduction</th>
<th>Gain Basis As Adjusted</th>
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</thead>
<tbody>
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<td>$3,439</td>
<td>$2,243</td>
<td>($61)</td>
<td>$259,757</td>
</tr>
<tr>
<td>1933</td>
<td>$1,570</td>
<td>$870</td>
<td>($1,930)</td>
<td>$258,887</td>
</tr>
<tr>
<td>1934</td>
<td>-0-</td>
<td>-0-</td>
<td>At least ($3,800)</td>
<td>$258,887</td>
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<tr>
<td>1935</td>
<td>-0-</td>
<td>-0-</td>
<td>At least ($3,800)</td>
<td>$258,887</td>
</tr>
<tr>
<td>1936</td>
<td>-0-</td>
<td>-0-</td>
<td>At least ($3,900)</td>
<td>$258,887</td>
</tr>
</tbody>
</table>

\textsuperscript{126} This amount is the original section 1014(a) date of death fair market value of the Brooklyn Apartment Building.

\textsuperscript{127} Id.
BEULAH CRANE 1937-1938
Depreciation Deduction/Loss Basis ($243,500)\(^{128}\)

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Rental Income Excluding Depreciation</th>
<th>Allowable Depreciation Deduction</th>
<th>Net Income With Depreciation Deduction</th>
<th>Depreciation Deduction/Loss Basis As Adjusted</th>
</tr>
</thead>
<tbody>
<tr>
<td>1937</td>
<td>$1,294</td>
<td>$3,500</td>
<td>($2,206)</td>
<td>$240,000</td>
</tr>
<tr>
<td>1938</td>
<td>$1,036</td>
<td>$3,200</td>
<td>($2,464)</td>
<td>$236,800</td>
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<table>
<thead>
<tr>
<th>Year</th>
<th>N/A</th>
<th>Allowable Deductions in Excess of Amount Claimed by Estate and Beulah</th>
<th>N/A</th>
<th>Depreciation Deduction/Loss Basis As Adjusted</th>
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<tbody>
<tr>
<td>1932-1938</td>
<td>N/A</td>
<td>$2,800</td>
<td>$234,000</td>
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</tr>
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</table>

Gain Basis ($258,887)\(^{129}\)

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Income Excluding Depreciation</th>
<th>Depreciation Deduction Producing Tax Benefit</th>
<th>Net Income With Depreciation Deduction</th>
<th>Disposition Basis As Adjusted</th>
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<tr>
<td>1937</td>
<td>$1,294</td>
<td>$194</td>
<td>($2,206)</td>
<td>$258,693</td>
</tr>
<tr>
<td>1938</td>
<td>$1,036</td>
<td>-0-</td>
<td>($2,464)</td>
<td>$258,693</td>
</tr>
</tbody>
</table>

As illustrated by the preceding charts, on the eve of sale of the Brooklyn Apartment Building in November 1938, there would have been a vast difference between its Depreciation Deduction/Loss Basis ($234,000) and Gain Basis ($258,693). Beginning with the Crane Estate, the section 1014(a) date of death fair market value of

\(^{128}\) This amount is the “carryover” Depreciation Deduction/Loss Basis from the estate. See C.F.R. § 1.1014-4(a)(1).

\(^{129}\) This amount is the “carryover” Gain Basis from the estate. See 26 C.F.R. § 1.1014-4(a)(1).
the Brooklyn Apartment Building ($262,000) would have been the initial Depreciation Deduction/Loss Basis and Gain Basis of the Brooklyn Apartment Building. Over the Crane Estate’s five tax year ownership period, the Brooklyn Apartment Building’s Depreciation Deduction/Loss Basis would have been reduced dollar for dollar by the allowable depreciation deductions. Conversely, the Gain Basis would have been reduced only by the depreciation deductions that produced tax benefits for the Crane Estate. When the Crane Estate terminated at the end of 1936 and the Brooklyn Apartment Building was transferred to Beulah, she would have taken a carryover Depreciation Deduction/Loss Basis of $243,500 and a carryover Gain Basis of $258,887 in the property.

Thereafter, the depreciation deductions and bases reductions with respect to the Brooklyn Apartment Building would have continued as they had during the Crane Estate’s ownership period. The Depreciation Deduction/Loss Basis would have been reduced by the full amount of allowable depreciation deductions; whereas, the Gain Basis would have been reduced only by the depreciation deductions that produced tax benefits. In 1938, when Beulah sold the Brooklyn Apartment Building to Avenue C Realty, the Gain Basis would have been $258,693 as compared to the Depreciation Deduction/Loss Basis of $234,000.

Assuming the fair market value of the Brooklyn Apartment Building was the $257,500 purchase price, the economic depreciation of $4,500 ($262,000 date of death fair market value less the date of sale fair market value of $257,500) exceeded the $3,307 of depreciation deductions that actually produced tax benefits for Beulah and the Crane Estate. Therefore, all depreciation deductions that produced tax benefits were economically sustainable; and, thus should not have been transformed into taxable gain.

By utilizing the Gain Basis (as reduced only by depreciation deductions that produced tax benefits for the Crane Estate and Beulah) rather than the adjusted basis as computed under current law (reduced by all allowable depreciation deductions), Beulah would not have recognized any taxable gain because the amount realized $257,500 would

130 If Beulah were to hold on to the Brooklyn Property, rather than sell it, she could continue to claim depreciation deductions until the Depreciation Deduction Basis reached zero.
131 These two bases numbers take into account the additional $2,800 of allowable depreciation deductions not claimed by Beulah or the estate.
not have exceeded the “adjusted” Gain Basis of $258,693. In other words, because the economic depreciation of the Brooklyn Apartment Building was greater than the amount of the allowable depreciation deductions that produced tax benefits for Beulah and the Crane Estate, the latter depreciation deductions were economically sustainable. So, there was no tax justification to have compelled Beulah to recognize taxable gain attributable to those economically sustainable depreciation deductions that produced no tax benefits.

2. **The Utilization of the Depreciation Deduction/Loss Basis in Crane Would Have Prevented the Transformation of Unbeneficial Depreciation Deductions Into a Taxable Loss**

Of equal importance in preventing the transformation of Beulah’s useless depreciation deductions into taxable gain from the sale of the Brooklyn Apartment Building would be preventing their transformation into a deductible loss. In this case, the difference between the economic decline in value of the Brooklyn Apartment Building ($4,500) and Beulah’s tax beneficial depreciation deductions ($3,307), or $1,193 was the amount of economically sustainable depreciation that produced no tax benefits for Beulah and the Crane Estate.

By utilizing the Depreciation Deduction/Loss Basis as the minuend in the loss computation formula, Beulah would not have realized that $1,193 loss. This is because unlike the Gain Basis, the Depreciation Deduction/Loss Basis would be reduced by all allowable depreciation deductions. So, no loss would be realized, because the Depreciation Deduction/Loss Basis would not have exceeded the amount realized.\(^{132}\)

VI. **Precedent for Implementing Tax Benefit Principles to Code Sections Involving Depreciation Deductions**

The implementation of tax benefit principles to Code sections involving depreciation deductions is not a novel concept. As additional support for their implementation to eliminate the Basis Reduction Tax Trap, this Part VI of the Article discusses two such existing Code sections in which tax benefit principles have been prudently incorporated into their application.

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\(^{132}\) Per the loss computation formula of section 1001(a), there would be no loss because the “adjusted” Depreciation Deduction/Loss Basis ($234,000) does not exceed the amount realized ($257,500). On the other hand, if the “adjusted” Gain Basis were utilized as the minuend in the loss computation formula, there would have been a realized loss of $1,193, the excess of $258,693 over $257,500.
A. **NO HARM NO FOUL - BASIS REDUCTION FOR EXCESSIVE ALLOWED DEDUCTIONS THAT PRODUCE NO REDUCTION IN TAX**

Ironically, one of the two Code sections to incorporate tax benefit principles is section 1016(a)(2). As discussed above, the *Virginian Hotel* case established the rule that section 1016(a)(2) required the decrease of basis by allowed deductions in excess of the amount of allowable deductions whether or not the excessive amount of the deduction produced a tax benefit.\(^{133}\) In 1952, nine years after the case was decided, however, Congress reversed the *Virginian Hotel* holding by amending section 1016(a)(2) to allow for an upward adjustment to basis with respect to excessive depreciation not resulting in a tax benefit.\(^{134}\) Then, in 1954, Congress modified its prior amendment of section 1016(a)(2) to its current version by simply not requiring a basis adjustment for excessive depreciation that did not reduce the taxpayer’s taxes.\(^{135}\)

By reversing *Virginian Hotel*, Congress must have recognized the inequity and unnecessary punitive consequences caused by a basis reduction of excessive but useless depreciation deductions. Accordingly, there is no reason why Congress should not extend the same relief to useless allowable depreciation deductions that are transformed into phantom taxable gain.

2. **SECTION 1245: DEPRECIATION RECAPTURE FROM A TAX BENEFIT PERSPECTIVE**

Section 1245 is a perfect example of a way the Code has created tax symmetry between tax benefits and tax detriments without penalizing the taxpayer. Specifically, the purpose of section 1245 is to require a taxpayer who enjoyed the tax benefit of reducing ordinary income by section 1245 property\(^{136}\) depreciation deductions to “recapture” the gain attributable to those deductions as ordinary income (“Recapture Income”) upon the disposition of such property.\(^{137}\)

Sequentially, if the disposition of section 1245 property results in recognized gain, section 1245 is then applied to determine the characterization of all or part of such

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\(^{133}\) See *supra* notes 104-110 and accompanying text.

\(^{134}\) Act of July 14, 1952, Ch. 741, 66 Stat. 629, which amended section 113(b) and added section 113(d) to the Internal Revenue Code of 1939, 26 U.S. C.A. § 113(b, d).

\(^{135}\) 83 P.L. 591; 83 Cong. Ch. 736; 68 Stat. 730, 68A Stat. 3

\(^{136}\) Section 1245(a)(3).

\(^{137}\) Section 1245(a).
gain as Recapture Income. Recapture Income is the difference between the “recomputed basis” and the adjusted basis of the section 1245 property.\textsuperscript{138} Simply stated, the recomputed basis is the adjusted basis increased by the amount of all previously taken depreciation deductions.\textsuperscript{139}

For example, assume that a taxpayer acquires section 1245 property with an original basis of $1,000. Further assume that during the first tax year in which the section 1245 property is in service, the taxpayer deducts $200 of allowable depreciation against ordinary income. Pursuant to section 1016(a)(2), the original basis of the section 1245 property would be reduced to $800. If the taxpayer were to sell the section 1245 property for $1,000, the taxpayer’s recognized gain of $200 would be attributable to the previously taken depreciation deduction that reduced the property’s basis.\textsuperscript{140} For purposes of computing the Recapture Income, the recomputed basis would be $1,000 (the adjusted basis of $800 plus the previously claimed depreciation deduction of $200). Then, subtracting the adjusted basis of $800 from the recomputed basis of $1,000, the entire $200 of taxable gain would be characterized as Recapture Income.\textsuperscript{141}

In the big picture, due to the valuable tax benefit a depreciation deduction against ordinary income provides for the taxpayer, there is a need for symmetry so any gain attributable to those deductions is also characterized as ordinary income. To illustrate this point, consider the following fact pattern: Assume a taxpayer acquires section 1245 property for $1,000. Further assume in the first two years, the taxpayer claims $400 of depreciation deductions offsetting a like amount of ordinary income. Assuming a marginal tax bracket of 35%, the tax savings produced by the ordinary depreciation deductions would be $140. Then, assume in the third year, the taxpayer sells the section 1245 property for $1,000 (meaning the asset did not decline in value). The entire recognized gain of $400 would be attributable to the previously claimed depreciation deductions that reduced ordinary income.

If instead of being characterized as ordinary income, the $400 gain were characterized as long term capital gain taxed at 15%, the resulting tax liability would be

\textsuperscript{138} Section 1245(a)(1).
\textsuperscript{139} Section 1245(a)(2).
\textsuperscript{140} Section 1001(a).
\textsuperscript{141} Section 1245(a).
$60. Due to an overly taxpayer favorable $140 tax savings to $60 tax liability differential, the Government would be whipsawed. By characterizing the taxable gain as Recapture Income, the playing field becomes level as the tax savings of a deduction against ordinary income is offset by the tax liability of ordinary gain.

To this point in the section 1245 analysis, the computations of Recapture Income and gain on the disposition of depreciable property pursuant to section 1001(a) are seemingly identical. Conceptually, the recomputed basis and the amount realized are similar. Both amounts are utilized as the minuend from which the adjusted basis of the underlying property is subtracted. If, for example, the underlying section 1245 property were to be sold for an amount equal to its original basis, the difference between the respective minuends and the adjusted basis of the underlying property accounts for the prior tax years’ depreciation deductions in the computation of gain and Recapture Income, respectively. The two computations part ways, however, with respect to the tax benefit component built into the determination of the recomputed basis that is not factored into the reduction of the adjusted basis pursuant to section 1016(a)(2).

In the computation of taxable gain, the underlying property’s adjusted basis is reduced by all allowable depreciation deductions including those that did not produce tax benefits. This means the resulting taxable gain accounts for all depreciation deductions including those that produced no tax benefits during the ownership period of the underlying property. Conversely, although the computation of Recapture Income utilizes the same adjusted basis as the subtrahend, the recomputed basis; the minuend of the formula takes into account only those depreciation deductions actually claimed by the taxpayer. The flush language of section 1245(a)(2) adds this tax benefit component as follows:

[I]f the taxpayer can establish by adequate records or other sufficient evidence that the amount allowed for depreciation . . ., for any period was less than the amount allowable, the amount added for such period shall be the amount allowed.

Thus, due to the tax benefit principle contained in section 1245(a)(2), only depreciation deductions actually claimed by the taxpayer are transformed into Recapture
Income.\textsuperscript{142} For example, assume a taxpayer sold section 1245 property with an adjusted basis of $500 for $1,500. Further assume over the period in which the taxpayer utilized the section 1245 property in her trade or business, the allowable depreciation deductions were $1,000 of which she claimed only $800.\textsuperscript{143}

In spite of recognizing $1,000 of taxable gain, the Recapture Income would be limited to depreciation deductions actually claimed by the taxpayer. In this same fact pattern, the recomputed basis of the section 1245 property would be $1,300, the taxpayer’s adjusted basis ($500) plus her claimed depreciation deductions ($800). Subtracting the taxpayer’s adjusted basis ($500) from her recomputed basis ($1,300) would result in $800 of Recapture Income.\textsuperscript{144} Thus, the remaining taxable gain of $200 could potentially be characterized as capital gain.\textsuperscript{145}

The above example demonstrates how section 1245(a)(2) achieves equitable tax symmetry, without causing punitive tax consequences, because only the portion of gain attributable to depreciation actually deducted against ordinary income is characterized as Recapture Income. Although the allowable depreciation deductions were $1,000, the taxpayer claimed only $800. Obviously, an unclaimed depreciation deduction cannot reduce ordinary income; and, with a tax benefit principle built into its application, section 1245 never causes the harsh tax consequences of transforming unclaimed depreciation deductions into ordinary income.

Unfortunately, the computation of gain upon the disposition of depreciable property does not invoke a similar tax benefit principle. In the previous fact pattern, the taxpayer claimed only $800 of the $1,000 of allowable depreciation deductions. If the facts were changed to assume the taxpayer actually claimed allowable depreciation deductions of $1,000 of which only $800 produced tax benefits; the taxpayer would nonetheless be compelled to recognize the entire realized gain of $1,000, including the amount attributable to the $200 of depreciation deductions that produced no tax benefits. This is because unlike section 1245(a)(2), section 1016(a)(2) requires a dollar for dollar allocation.

\textsuperscript{142}See 26 C.F.R. § 1.1245-2(a)(7).
\textsuperscript{143}Pursuant to section 1001(a), the taxpayer’s taxable gain would be $1,000, the difference between the amount realized ($1,500) and the adjusted basis ($500).
\textsuperscript{144}Section 1245(a)(2).
\textsuperscript{145}See section 1231.
depreciation basis reduction with no consideration of whether those deductions produced equivalent tax benefits.

As a matter of tax policy, there is no rational reason why a tax benefit principle similar to that built into the computation of Recapture Income should not also be implemented in the computation of taxable gain upon the disposition of depreciable property. Both computations are intended to prevent the taxpayer from enjoying unwarranted tax benefits. Although section 1245 achieves this purpose with tax equity, the rigid, no exception depreciation basis reduction of section 1016(a)(2) creates a Basis Reduction Tax Trap for the unwary taxpayer. In all instances, the ultimate result should be an equal match of the tax benefits of the depreciation deductions with the tax detriment of the taxable gain. For purposes of computing gain, unless and until the gain attributable to useless depreciation deductions are excluded from gross income, i.e., the Basis Reduction Tax Trap is shut down, tax symmetry will never be achieved.

VII. OTHER UNKNOWN CRANE FOOTNOTES

As this Article has hopefully demonstrated to this point, there are numerous aspects of the Crane case, particularly as they affected Beulah that may be unknown to many Crane commentators. Although not relevant to the disposition of the case, this part of the Article reveals several “footnotes” that may also be unknown by many Crane enthusiasts, yet may nonetheless be of some academic interest.

A. THE FAIR MARKET VALUE OF THE BROOKLYN APARTMENT BUILDING AS WELL AS THE AMOUNT REALIZED ON ITS SALE WAS ACTUALLY $273,500

From the Supreme Court’s decision, it appears the fair market value of the Brooklyn Apartment Building and the amount realized on its sale was the principal balance of the nonrecourse mortgage ($255,000) plus the net monetary consideration ($2,500), or $257,500.\(^\text{146}\) Although not relevant to the Supreme Court’s ultimate holding, the correct amount was more realistically $273,500.

An examination of the particulars of the sale of the Brooklyn Apartment Building to Avenue C Realty lends support for the higher fair market value and amount realized. In October 1938, Bowery was in the process of initiating a foreclosure action against the

\(^{146}\) Crane, 331 U.S. at 4, 14.
Brooklyn Apartment Building. In order to avoid foreclosure, Beulah offered to execute and deliver a deed in lieu of foreclosure in favor of Bowery. That offer, however, was declined. Consequently, Beulah’s only alternative to losing the Brooklyn Apartment Building through foreclosure with nothing to show for it was to sell the property to Avenue C Realty. Although the Record does not reflect Bowery’s actual approval of the sale, it is unlikely Bowery would decline Beulah’s offer of a deed in lieu of foreclosure, yet allow her to sell the Brooklyn Apartment Building to a third party without its permission. Moreover, the following language in the Contract of Sale is indicative of Bowery’s likely acquiescence of the sale:

Subject to a first mortgage now a lien on said premises, held by Bowery Savings Bank, upon which there is due the principal amount of Two Hundred Fifty Five Thousand Dollars ($255,000) and arrears of interest in the sum of Fifteen Thousand Eight Hundred Fifty-seven 71/100 Dollars ($15,857.71) and interest to accrue after this date.

The foregoing provision of the Contract of Sale also demonstrates Avenue C Realty acquired the Brooklyn Apartment Building from Beulah subject to the principal amount of the nonrecourse mortgage and the interest arrears. The simple math indicates the amount realized, selling price and fair market value of the Brooklyn Apartment Building was approximately $273,500 ($255,000 plus $16,000 plus $2,500). If, as some may believe, its fair market value were $257,500, then Avenue C Realty overpaid for the property by the $16,000 in interest arrears also secured by the property. More realistically, however, the fair market value must have been $273,500 because it is unlikely Avenue C Realty would have paid Beulah net monetary consideration of $2,500 in addition to taking the property subject to the $16,000 in interest arrears. Even if Avenue C Realty been willing to do that, it is more probable Bowery would have insisted that any cash in the deal not be paid to Beulah, but instead to Bowery to reduce the interest arrears.

147 Tax Court Petition VI (14).
148 Id.
149 Id. at 8 VI (15).
150 Tax Court Stipulation of Facts, Exhibit K.
151 This being the amount realized as determined by the Supreme Court.
152 In spite of the fact that Avenue C Realty was not personally obligated to repay the principal balance and/or the interest arrears of the nonrecourse mortgage, it was nonetheless obligated to make principal and interest payments to Bowery in order to retain the Brooklyn Apartment Building.
Parenthetically, the potential inclusion of the interest arrears in the amount realized did not escape Beulah. According to Beulah’s Reply Brief, the Revenue Agent who proposed to include the principal balance of the nonrecourse mortgage in the amount realized disregarded the interest arrears. In arguing the Commissioner had taken inconsistent positions by including the nonrecourse mortgage in the amount realized but ignoring it in determining the section 1014(a) basis of the Brooklyn Apartment Building (i.e., by not offsetting the fair market value of the unencumbered real property by the outstanding balance of the nonrecourse loan), Beulah made the following observation:

It is true that in our case the Revenue Agent disregarded the increase which had occurred in the mortgage lien; but the Commissioner’s line of reasoning permits of no distinction as to the nature or source of the mortgage lien, and it would be entirely immaterial how much of the mortgage was attributable to principal and how much of the mortgage lien was attributable to interest, since the mortgage secures both principal and interest.153

In the final analysis, however, whether or not the fair market value of the Brooklyn Apartment Building and the amount realized on its sale was actually $273,500 would have made no difference in the Supreme Court’s holding. Although the amount realized on the disposition of property subject to nonrecourse debt includes the interest arrears in addition to the principal balance,154 the corresponding discharge of liability in the transaction is treated as if the transferor sold the property for “cash equivalent to the amount of the debt and had applied the cash to the payment of the debt.”155 Thus, from a tax perspective, the deemed payment of $16,000 by Avenue C Realty to Beulah who in turn would have been deemed to pay it to Bowery as interest would have entitled her to an interest deduction offsetting the addition income triggered by the inclusion of the interest arrears in the amount realized.

Moreover, a careful reading of the Supreme Court’s decision indicates it perfunctorily dispensed of the issue in a footnote by agreeing with the Commissioner’s determination not to include the $16,000 of interest arrears in the amount realized

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153 Petitioner’s Reply Brief at 5.
154 See Allan v. Commissioner, 545 F.2d 1169 (8th Cir. 1988); Catalano v. Commissioner, T.C. Memo 2000-82 * 12-13 (2000), rev’d on other grounds 279 F.3d 682 (9th Cir. 2002).
because of the offsetting interest deduction. More specifically, in Footnote 6, the Supreme Court stated as follows:

The Commissioner explains that only the principal amount rather than the total present debt secured by the mortgage, was deemed to be a measure of the amount realized, because the difference was attributable to interest due, a deductible item.156

Thus, other than noting the amount realized should have included the debt relief of the additional $16,000 of interest arrears that would have been offset by a corresponding interest deduction, its exclusion from the amount realized has no further significance. Any analysis of the case predicated on Beulah’s receiving net monetary consideration of $2,500 over and above the nonrecourse debt relief remains the same. In either scenario, whether the amount realized and fair market value of the Brooklyn Apartment Building was $273,500 or $257,500, the amount of net monetary consideration Beulah received was $2,500.

B. ANY HYPOTHETICAL TAX RELIEF BEULAH MAY HAVE RECEIVED FROM OTHER PROVISIONS OF THE CODE WERE SIMPLY NOT IN FORCE DURING THE CRANE YEARS

As documented in this Article, other than the taxable gain generated by the 1938 sale of the Brooklyn Apartment Building, the Crane Estate and Beulah had minimal taxable income or tax liability between 1932 and 1938 (the “Crane Years”).157 All of that taxable income and tax liability, however, was reduced to zero by depreciation deductions. In Beulah’s own words, all her efforts to reverse the fortunes of the Brooklyn Apartment Building during the Crane Years were “by all dictates of common sense . . . a ruinous disaster.”158 Therefore, any other avenues of tax relief that might have been available to the Crane Estate or Beulah would not have resulted in any tax savings.

In any event, during the Crane Years (in the midst of the Great Depression), many pro-taxpayer provisions that had been in the Code at various times in tax law history (before and after the Crane Years) were simply not in place at that time. This section of

156 Crane, 331 U.S. at 4.
157 The one caveat to this statement is the Record does not include any of Beulah’s personal tax information for the years the estate was open (1932-1936). However, based on the overall sense of financial hardship, it is unlikely Beulah had any significant income or tax liability during this period.
158 Crane, 331 U.S. at 15 (citing a statement Beulah made in her brief).
the Article explores a number of those provisions that might have hypothetically provided the Crane Estate and Beulah with some tax benefits had they been in effect.

1. **Net Operating Loss Deduction**

For taxpayers who sustain net operating losses, the net operating loss deduction provides an offset of taxable income in prior or subsequent tax years.\(^{159}\) Although the net operating loss deduction was available to taxpayers before and after the *Crane* Years, they were not available during those Great Depression years. For example, Section 204(c) of the Revenue Act of 1918 and the Revenue Act of 1921 allowed the pass through of the net operating loss deduction from an estate to its beneficiaries.\(^{160}\) Because the Crane Estate sustained net operating losses in each of its five year existence, it could have potentially passed those losses through to Beulah, the sole beneficiary of the estate. Whether Beulah might have been able to utilize the net operating loss deduction is academic because in 1924, Congress eliminated the pass through of the net operating loss deduction from an estate to the beneficiaries by restricting the use of the deduction to the estate.\(^{161}\)

Following the repeal of the pass through of the net operating loss deduction from an estate to a beneficiary, an estate was relegated to utilizing its own net operating loss deduction. Moreover, the net operating loss deduction was available to individual taxpayers such as Beulah. Yet, even if the Crane Estate and/or Beulah could have utilized their own net operating loss deductions, Congress had completely repealed the deduction for during the *Crane* Years. First, a 1932 amendment to the net operating loss deduction applicable to all taxpayers, including estates, limited the carry forward period

\(^{159}\) Section 172. Early in tax law history, net operating losses were not available as all deductions in a given tax year had to be deducted in that year, or not at all. “The expenses, liabilities, or deficit of one year can not be used to reduce the income of a subsequent year.” Rev. No. 1918, ¶¶ 422.425. The disallowance of net operating losses is consistent with the general tax principle of each tax year standing on its own. See *Burnet v. Sanford & Brooks*, Co. 265 U.S. 359, 365 (1931).

\(^{160}\) Obviously, carrying on a trade or business is a prerequisite for a net operating loss deductions. Although an estate does not usually carry on a trade or business, when it does, it is entitled to take the net operating deduction. See *People’s Pittsburgh Trust Co. v. United States*, 6 F.Supp. 447 (Ct Cl 1934); *Kleberg v. Commissioner*, 31 B.T.A. 95 (1934).

\(^{161}\) Section 206(h) of the Revenue Act of 1924, 43 Stat. 253. In eliminating the pass through of the net operating deduction from the estate to the beneficiaries, the Senate Finance Committee stated, “[t]he bill confines the benefits to an estate . . . because the beneficiary’s capital is not affected by a net loss of the estate. . . and consequently he should not be entitled to a net loss in computing income for the subsequent year. *S.Rep. No. 398, 68th Cong., 1st Sess., p. 21.*
to one year.\textsuperscript{162} Then, effective January 1, 1933, Congress repealed the net operating loss allowing for no carryovers to 1933.\textsuperscript{163} The net operating deduction was not reenacted until 1939.\textsuperscript{164}

Another way the net operating loss might have benefited Beulah would have been the pass through of the deduction from the Crane Estate in its terminal year. In 1936, the Crane Estate’s last tax year, the estate, as it had in each of its other tax years, sustained a net loss.\textsuperscript{165} Under section 642(h)(1), if in the year of termination, an estate has a net operating loss deduction, such deduction is passed through to the estate’s beneficiaries for their own use.\textsuperscript{166} Since Beulah was the sole beneficiary of the Crane Estate, she would have been eligible for this pass through. Whether Beulah could have utilized the pass through of the terminal year net operating loss deduction is a moot point since it was not enacted into the Code until 1954,\textsuperscript{167} section 642(h) would not have been available to Beulah.\textsuperscript{168}

2. Pass Through of Crane Estate’s Depreciation Deduction to Beulah

Another potential tax benefit was the pass through of the Crane Estate’s depreciation deduction to Beulah. During the Crane Estate’s five years of existence, Beulah was the sole beneficiary of the estate. During those years, the Crane Estate claimed depreciation deductions on the Brooklyn Apartment Building. Similar to the pass through of the net operating deduction from an estate to its beneficiaries,\textsuperscript{169} the depreciation deductions of an estate may under certain circumstances, be passed through to its beneficiaries. Specifically, section 642(d) provides that an estate “shall be allowed

\textsuperscript{162} 47 Stat. 169.
\textsuperscript{163} Section 218(a) of the National Industrial Act of 1933, 48 Stat. 195. In Miller v. Commissioner, 40 B.T.A. 515 (1939), the taxpayer sustained a substantial net operating loss in 1932 that he sought to carryforward to 1933. On the basis of the repeal of the net operating loss deduction, the Commissioner disallowed the carryforward. In holding for the Commissioner, the Board rejected the taxpayer’s argument that Congress could not enact a repeal provision that had retroactive effect.
\textsuperscript{164} Section 211 of the Revenue Act of 1939, 53 Stat. 862.
\textsuperscript{165} Tax Court Petition IV (10).
\textsuperscript{167} 83 P.L. 591; 83 Cong. Ch. 736; 68 Stat. 730, 68A Stat. 3
\textsuperscript{168} Additionally, as discussed above, Congress had repealed the net operating loss deduction.
\textsuperscript{169} See supra note 163 and accompanying text.
the deduction for depreciation . . . only to the extent not allowable to beneficiaries under section 167(d) . . . .” The last sentence of section 167(d) provides “in the case of an estate, the allowable deductions shall be apportioned between the estate and the heirs, legatees, and devisees on the basis of the income of the estate allocable to each.”

In application, section 167(d) provides for the allocation of depreciation deductions between the estate and the beneficiaries in proportion to the income retained by the estate and the income distributed to the beneficiaries. In 1932 and 1933, the estate had a small amount of net rental income. Although the Crane Estate was obligated to pay the net rental income to Bowery, since Beulah was the ultimate beneficiary of the Brooklyn Apartment Building, perhaps an arrangement could have been made to distribute the income to Beulah, who in turn would have paid it to Bowery. Assuming the Commissioner did not challenge that arrangement, along with the income distributed, the Crane Estate’s depreciation deduction could have been passed through to Beulah.

Aside from a possible challenge by the Commissioner, it is not clear whether the Crane Estate had the authority under state law to make distributions of income to Beulah during the years it was open. In spite of Beulah’s being the sole beneficiary of his estate, her husband’s simple will comprised of four sections made no provision for income distributions to her during the administration of the estate. Notwithstanding the will’s silence, as a general rule, an executor may distribute income to a beneficiary of an estate even if the will is silent. Thus, had New York law allowed such distributions, in 1932 and 1933, Beulah could have potentially distributed the Crane Estate’s income to herself.

Assuming Beulah had taxable income from other sources during those two years and she had distributed the Crane Estate’s income to herself, the pass through of the depreciation deduction would have offset the income distributed from the Crane Estate plus an additional amount to deduct against her other income, if any. Unfortunately, Beulah was the beneficiary of an estate not a trust. During the Crane Years, the predecessor to section 167(d) limited the allocation of depreciation deductions to a

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170 See supra note 41 and accompanying text.
171 Tax Court Stipulation of Facts Exhibit A
172 See, e.g., Lamkin v. U.S., 533 F. 2d 303, 305 (5th Cir. 1976) citing a Texas statute as a representative example of such a statute.
173 Section 23(k) of the Revenue Act of 1928, H.R. 1 (Pub. L. No. 562), 70th Cong. 1st Sess. ch. 852 (1928)
beneficiary of a trust. The expansion of section 167(d) to beneficiaries of estates was made in the codification of that section in the Internal Revenue Code of 1954. Thus, the pass through of the estate’s depreciation deductions would not have been available to Beulah during the Crane Years.

C. A Few Personal Crane Tidbits

Very little insight into Beulah’s personal life can be gleaned from the Crane decisions and the underlying Record. In this section of the Article, some of those unknown personal tidbits are revealed. In March 1877, Beulah was born in Kutztown, Pennsylvania to Walter B. Bieber (1845-1910) and Ella C. Bieber (1854-1921). Beulah’s parents were married in 1876, the year prior to her birth. On two occasions, Walter Bieber a distinguished member of the Kutztown community unsuccessfully ran for Congress.

Beulah’s husband, William Montgomery Crane was born on June 14, 1852 in Rosselle, New Jersey. At the age of sixteen, he began working for a wholesale hosiery

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174 See MacMurray v. Commissioner, 16 T.C. 616, 622 (1951). In that case, the Tax Court made it clear that the allocation of depreciation deductions was limited to beneficiaries of a trust (“A careful study of the legislative history and the committee reports shows no indication that the term ‘trust’ used in this section was intended to embrace estates as well as trusts. It is not within the power of this Court to read the word ‘estate’ into this provision.”).

175 See Nissen v. Commissioner, 345 F.2d 230, 233-234 (4th Cir. 1965) rev. and rem. 41 T.C. 522 (1964). In explaining the reason for allowing an estates to allocate depreciation deductions to its beneficiaries, the Fourth Circuit stated: “Although entitled to the benefit of the deduction, many times the estate had no taxable income because all ‘distributable income,’ whether actually distributed or not, was required to be deducted from gross income in computing the estate’s taxable income. In cases where all the income was ‘distributable,’ the estate had no income from which the benefit of the deduction could be realized; the heirs, devisees, legatees or beneficiaries had income but no depreciation deduction. Consequently, the deduction was wholly lost. This created a recognized basic inequity which Congress obviously intended to correct in 1954 when it amended [section 167(d)] by adding the last sentence pertaining to estates.”

176 Crane v. Commissioner, 3 T.C. 585 (1944); Crane v. Commissioner, 153 F.2d 504 (2d Cir. 1945); Crane v. Commissioner, 331 U.S. 1 (1947).


178 Ancestry.com 1900 United States Federal Census

179 http://webcemeteries.com/Hope/Individual.asp?Id=302&T=0

180 http://webcemeteries.com/Hope/Individual.asp?Id=237&T=0

181 See supra note 176.

182 See supra note 179 (Obituary of Walter B. Bieber).

house in New York City (John J. Hinchman & Co.). In ten of the nineteen years he spent with the firm, he was a traveling salesman. Then, in 1885, at the age of 33, William left the hosiery house; and, with no prior experience entered the business of manufacturing of gas stoves and heating apparatus. Later he founded William M. Crane & Co., a manufacturer of gas ranges and appliances eventually opened a factory in Peekskill, New York.

In William’s spare time, he cultivated “his musical talents, which [were] of a high order.” At one time, William was the vice-president of the Baton Club and a patron of the Manuscript Society. Later, he became chairman of the board of the Standard Gas Equipment Company. As a result of his involvement in the gas industry, William served as president of the National Gas Appliance Manufacturers Exchange and at one time was the chairman of the War Service Committee of the National Gas Appliance Manufactures of the United States.

On January 10, 1907, relatively late in life (age 54), William married Beulah (age 29) in Beulah’s hometown of Kutztown, Pennsylvania. The Cranes had two sons, Richard Jasper Crane born on September 15, 1908 and Howard Bieber Crane born on February 20, 1910. In 1924, William purchased the Brooklyn Apartment Building for approximately $1 million. This was around the time William M. Crane & Co. merged into the Standard Gas Equipment Company. For the last years of his life, William was in poor health.

On January 11, 1932, one day after the Cranes’ twenty-fifth wedding anniversary, at the age of 79, William passed away at his home in Shore Acres, Mamaroneck, New York.

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185 Id.
186 Id.
187 Id.
188 Id.
189 Id. The membership roster of the Manuscript Society at the time William was a who’s who of famous conductors and composers including Walter Damrosch, Theodore Thomas, Dudley Buck, Anton Seidl and others.
190 Supra note 183 at 102.
191 Id.
192 Id.
193 Id.
194 See Yin, supra note 177 at 251.
195 Supra note 184.
In addition to Beulah, the Cranes’ two sons also survived William. At the time of her husband’s death, Beulah was 54 years old. She was 70 years old when the Supreme Court rendered its decision against her on April 14, 1947. On July 11, 1955, at the age of 78, Beulah died in New York City.

**CONCLUSION**

Like the scores of *Crane* authors and commentators who have written articles on one of the most famous vocabulary cases in tax history, this author shares a fascination with the *Crane* case. Although *Crane* presented the relatively straightforward issue of how to report gain on the sale of depreciable real estate rental property subject to a nonrecourse mortgage, it was Footnote 37 a hypothetical question of dictum towards the end of the opinion that propelled *Crane* into the realm of being a vocabulary tax law case. For the next thirty plus years following the decision, whether the Supreme Court’s response to the hypothetical question would be the precursor for subsequent judicial decisions blessing Footnote 37 Tax Shelters remained an open question.

Then, in the late seventies, two courts perhaps desperately seeking a judicially correct way to end Footnote 37 Tax Shelters found such a way. By invoking the Vilifying Double Deduction Rationale as the essence of the Supreme Court’s holding in *Crane* as the authority to overrule Footnote 37 without appearing to overrule it, Beulah was unjustly portrayed as a tax villainess who sought the unwarranted tax benefits of double deductions so as to not pay her fair share of tax.

Ironically, the unwarranted tax benefits of double depreciation deductions attributed to Beulah did not exist. Not only did the allowable depreciation deductions on the Brooklyn Apartment Building produce minimal benefits for her and the Crane Estate; upon its subsequent sale, the section 1016(a)(2) basis reduction of those mostly useless depreciation deductions caused their transformation into taxable gain. So, in the process of the judicial attempt to end Footnote 37 Tax Shelters, the Basis Reduction Tax Trap Beulah fell into remains open.

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197 Id.
198 Id.
199 Crane v. Commissioner, 331 U.S. 1 (1947).
To this day, the Basis Reduction Tax Trap continues to be a potential hazard for
the unwary taxpayer entitled to claim allowable depreciation deductions that produced no
tax benefits. Although the section 1016(a)(2) basis reduction of depreciation deductions
is intended to prevent taxpayer abuse of those deductions, in this instance it misses the
mark. This is because it not only fails to prevent a nonexistent tax benefit; it also
produces punitive taxable gain. Hopefully, this Article has revealed the real facts of
Beulah’s untold story so as to vindicate her unjust depiction as a tax villainess; and, at the
same time inspire Congress to put an end to the Basis Reduction Tax Trap.

As the way to end this inequity, this Article advocates the implementation of tax
benefit principles in the computation of gain from the disposition of depreciable property.
Specifically, the Article recommends two alternative ways to accomplish this result. The
first way would be to extend the tax benefit rule to depreciation deductions so as to
exclude from gross income any gain attributable to depreciation deductions that produced
no tax benefits. The second way would be to create a Gain Basis and a Depreciation
Deduction/Loss Basis. By utilizing the Gain Basis as reduced by only those depreciation
deductions that produced tax benefits as the subtrahend in the gain computation formula,
tax symmetry would be achieved, as the tax detriment of taxable gain would always
exactly match the tax benefits of the previously claimed depreciation deductions.

On the other hand, the Depreciation Deduction/Loss Basis would be utilized for
all the other legitimate purposes of the current law adjusted basis as reduced by section
1016(a)(2). By utilizing the Depreciation Deduction/Loss Basis as the minuend in the
loss computation formula, depreciation deductions from other tax years that did not
produce tax benefits could not be transformed into a loss in a subsequent tax year.

It is this author’s hope that by vindicating Beulah’s undeserving reputation as a
the poster child of greedy taxpayers and advocating the implementation of tax benefit
principles will inspire Congress to make the necessary changes to eliminate the Basis
Reduction Tax Trap; and, yet, preserve the function of the current law version of section
1016(a)(2) and adjusted basis to prevent taxpayer abuse of depreciation deductions.
Abstract of Article by I. Jay Katz:

DOUBLE DEDUCTIONS, OR NOTHING:
WHY THE VINDICATION OF BEULAH CRANE
POSTER CHILD OF GREEDY TAXPAYERS
SHOULD INSPIRE CLOSING THE TAX TRAP LEFT OPEN AFTER TAX
SHELTERS WERE SHUT DOWN:
AND OTHER CRANE FOOTNOTES REVEALED

Crane v. Commissioner is arguably the most celebrated case of any kind where a footnote of dictum is more relevant than the actual holding. It was the Supreme Court’s famous Footnote 37 hypothetical query that gave Crane its vocabulary tax law case status. For the three decades following the decision, whether the Supreme Court’s response to the query portended future judicial decisions blessing tax shelters remained an open question.

Subsequently, two lower courts faced the challenge of implementing the Supreme Court’s reasoning in Footnote 37 scenarios. Without appearing to overrule the Supreme Court, the courts squelched the tax shelters by relying upon a statement in Crane proclaiming the essence of the decision was to prevent Beulah Crane from receiving unwarranted double depreciation deductions. In the process, Beulah Crane was vilified as the poster child of greedy taxpayers.

Ironically, Beulah’s so called infamous double deductions were nonexistent. On the front end, during the ownership period of an apartment building, she received minimal tax benefits from the depreciation deductions. Then, when she sold the building, the section 1016(a)(2) basis reduction of those useless depreciation deductions caused their transformation into taxable gain. This was the tax trap Beulah fell into.

So, although tax shelters were shut down, the tax trap Beulah Crane fell into remains open to this day. The purpose of this Article is to vindicate Beulah from her portrayal as a tax villainess; and, to use her story as an inspiration for Congress to implement appropriate tax benefit principles in the application the section 1016(a)(2) basis reduction so as to eliminate the tax trap that caught Beulah.
DOUBLE DEDUCTIONS, OR NOTHING:  
WHY THE VINDICATION OF BEULAH CRANE  
POSTER CHILD OF GREEDY TAXPAYERS  
SHOULD INSPIRE CLOSING THE TAX TRAP LEFT OPEN  
after tax shelters were shut down:  
and other crane footnotes revealed  
I. Jay Katz

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