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The gravity of our slum problem requires that our various laws and institutional arrangements be thoroughly examined to ascertain the extent to which each unintentionally furthers the development and perpetuation of slum conditions, especially among rental dwellings in urban areas. For this reason, we are indebted to Arthur D. Sporn for his study, published in the November 1959 issue of the *Columbia Law Review,* on "Some Contributions of the Income Tax Law to the Growth and Prevalence of Slums."[1] Much has been written, particularly by enthusiastic campaigners for housing, on the ways in which tax policy could be used to stimulate investment in urban housing.[2] What Sporn has done is to center attention more narrowly on those aspects of our income tax policy that seem to him to have a propensity to generate and maintain slums directly counter to our other government policies designed to retard the growth of slums. Sporn is here on solid ground and has performed a useful service. If a significant answer to our slum problem is a government subsidy, there is little reason to expect the income tax law to be a good vehicle for distributing and administering the subsidy. There is even less reason to expect that in a campaign to eliminate slums, time might profitably be spent dreaming up novel gadgets for incorporating a subsidy into the tax law.

In performing this service, however, we believe Sporn has fallen into error and has made proposals that are unlikely to assist in the drive against slums and that clash with sound income tax policy. In Sporn's analysis the chief villain in the income tax is our depreciation policy. There are four separable but related elements involved.[3] One is that in allocating costs between nondepreciable land and depreciable improvements, the developer of new housing is at a disadvantage compared with an investor in old housing. This comes about, Sporn notes, because the expense of preparing land for new construction is regarded by our tax law as a cost of land rather than of the improvements placed upon it. The developer is trapped by his own records, while the buyer of old housing is able to allocate his purchase price between land and improvements in a more flexible manner. A second element is that the relationship between the period for depreciation and the quality of maintenance tends to be perverse. In the view of tax administrators, a bet-

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1. 59 Colum. L. Rev. 1026 (1959).
2. For a discussion of some of these proposals see Blum & Bursler, *Tax Subsidies for Rental Housing*, 15 U. Chi. L. Rev. 255 (1948).
3. While Sporn does not state his points in quite these terms or order, we believe that the analysis in the text states them fairly.

ter maintained building has a longer estimated economic life than a less well maintained structure; and so it appears that sound maintenance of rental housing is penalized by a lengthening of the period over which invested capital can be recovered through depreciation charges. A third element is the relationship between the recent liberalization of depreciation methods and the capital gains provisions in the law. Under this relationship a write-off that exceeds the reduction in market value amounts to an exchange of deductions against ordinary income for a capital gain taxed at highly preferential rates. This, Sporn asserts, encourages higher turnover of rental housing and under-maintenance of the structures by each successive owner. The fourth element, apparently the most potent, is the right of a purchaser of used rental housing to predicate his total allowable depreciation on the price he paid for the structure rather than on the remaining undepreciated original cost. This right exists today even though the aggregate depreciation deductions taken by successive owners exceed the original investment in the structure and all subsequent improvements incorporated in it. When it is coupled with the fact that under-maintained housing has a relatively short economic life for depreciation purposes, the result, according to Sporn, is that investors in old housing get favorable depreciation treatment. The treatment is so favorable, he suggests, that it largely nullifies the incentive to construct new rental housing that was a principal objective of the recent change allowing investors in new structures to employ accelerated methods of computing depreciation for tax purposes.

From this analysis Sporn develops what is apparently a three-point program for modifying the income tax law. First, he would allow demolition and clearance costs to be added to depreciable structure (rather than compel addition to the basis of nondepreciable land), or even permit complete immediate write-off of these items as ordinary expenses. Second, he would make the calculation of economic life for depreciation purposes independent of the degree to which a structure was being maintained. Third, and most important, he would limit total depreciation charges to the original investment (and subsequent improvements) in the structure, so that a purchaser of used housing would be confined to taking depreciation on that part of the original cost (and subsequent improvements) not recovered by previous owners.

On the surface all parts of this program might seem to be predicated on the proposition that the existing tax law contributes to slum development by favoring investment in old housing over investment in new units. But before analyzing the impact of the tax law, we should note an assumption that Sporn does not fully make apparent, perhaps for the reason that on this matter our housing policy itself has been ambivalent. Generally Sporn seems to assume that retardation of investment in new housing relative to investment in old fosters the spread or entrenchment of slums. Yet at some points in his article he deplores the tendency of the tax law to encourage under-maintenance of old buildings, that is, to promote accelerated depreciation in the physical sense. On the question whether national policy should be directed toward investment in new housing and demolition of existing structures or toward rehabilitation of decaying units, informed opinion is sharply divided, and this division is reflected in the patchwork of laws and programs designed to deal with inadequate and submarginal housing.[4] There are those who believe that the road to improvement lies in constructing new housing, and there are those who think that, dollar for dollar of investment, greater urban improvement is to be obtained by rehabilitation. The latter group includes those who assert that if housing is in short supply (whatever that means) the logical remedy can not involve reducing the total quantity of units in existence. Probably the most that can be said about these two positions is that under some conditions, apparently not easily susceptible of generalized description, it is better to demolish and build anew, while under other circumstances, equally difficult of statement, emphasis on rehabilitation is preferable.

We mention these differences in approach to slums not to take sides but to note that on closer look Sporn's own analysis and program seem to move in both directions somewhat inconsistently. Allowing land preparation costs to be deducted currently or through depreciation is likely to induce more new construction and demolition; while divorcing the depreciation period from the level of maintenance seems likely to encourage repair of old structures. (It might be added that present tax policy also has the effect of looking both ways with respect to the debate about climination of slum conditions, and in this sense it may be neutral on the question of which way to solve slum problems.) Apart from these possible inconsistencies, we question whether Sporn's program would have the intended effect of inducing more construction of new rental housing. Undoubtedly the proposed limitation on total depreciation would dampen investment in old structures and might thereby make it cheaper for developers of new structures to acquire areas for demolition and rebuilding. But it does not necessarily follow that there would be a corresponding increase in the flow of capital into new buildings. There clearly is a relationship between the attractiveness of investment in new construction and the market for used structures, insofar as resale potentialities are a factor in assessing the risks and opportunities entailed in new building.

4. The Housing Act of 1937, 50 Stat. 888, as amended, 42 U.S.C. §§ 1401-30 (1958), and the Housing Act of 1949, 63 Stat. 413, as amended, 42 U.S.C. §§ 1441, 1450-62 (1958), particularly Title 1 on Urban Redevelopment, are thus predicated on a demolition program. The Housing Act of 1954, 68 Stat. 590, as amended, 42 U.S.C. §§ 1450-60 (1958), called the Urban Renewal Act, emphasizes rehabilitation.

We know, for example, that the market for new owner-occupied housing is highly sensitive to the second-hand market for single family dwellings. While the relationship between new and used markets might be less significant in the case of rental housing, the two are not wholly divorced. Under the proposed depreciation cut-off, the distribution of investment within the rental housing field might well shift in favor of new construction, but the total investment in rental housing might decline because investment in rental housing would become relatively less attractive than alternative outlets for investment. Whether or not the decline would be deep enough to reduce the level of new construction, and so defeat the very purpose of the proposal, there is ample room for skepticism about fighting slums with a ceiling on depreciation that would tend to reduce total investment in rental housing.

In this connection it should be noted that not all parts of Sporn's program would have such a tendency. There seems to be no way of predicting the effects of his suggestion that the depreciation period be independent of maintenance levels. Presumably investors in used housing would find better maintained properties relatively more attractive than under-maintained structures. However, the impact of this suggestion on total investment in rental housing would appear to depend on whether it would, on the average, lengthen or shorten the period for recovering investment through depreciation. Nothing inherent in it requires a change in the average period; and at best one can only guess whether the tax administrators would bring about such a change in the process of putting the suggestion into operation. As to Sporn's proposal that land preparation costs be depreciable or immediately deductible, the effect clearly would be to encourage more total investment in rental housing, relative to alternative opportunities, because it would shorten the time for recovering investment out of otherwise taxable income. The impact of this part of his program, however, is likely to be minor compared to the consequences of limiting total depreciation to original investment (plus subsequent improvements). Thus on balance we must conclude that the net effect of adopting the whole program would be adverse to investment in rental housing.

Having explored Sporn's program, we are ready to consider the analysis that led him to conclude that the existing income tax laws generate and perpetuate urban slums. The core of his reasoning is that investors are tempted to buy used structures on small equities, squeeze out maximum revenues in short periods during which depreciation is taken at rapid rates, and then sell out, paying only the capital gains tax on the difference between their unrecovered investment and the selling price. The buyer then starts this process all over again on the basis of his cost.

We may assume for present purposes that this description is accurate and typical for real estate transactions involving slum buildings; at least we all have observed enough of these transactions to agree that this happens. But Sporn's position requires that he go further in his analysis and assert that it is the income tax laws that tend to produce the resulting under-maintenance and inadequate repair. Here he is in trouble, for in other real estate contexts the same configuration of tax laws appears to aid in bringing about the opposite result, that is, over-maintenance and generous repair. There are numerous instances in which investors have purchased old buildings, apartment hotels for example, upgraded them by making repairs and providing a higher level of maintenance with dollars deductible from ordinary income, and then sold them at profits taxable at capital gain rates. The elementary tax manuals make no secret of the fact that under our tax laws real estate investment often offers an opportunity for trading deductible maintenance costs now for capital gains later. And where investors take advantage of this opportunity the tax laws can hardly be said to contribute to the degeneration of rental housing.

How is it possible that the same set of tax laws seems to produce such diverse results under different conditions? While we are not sure of the answer, it would appear to us that the income tax depreciation and capital gain provisions are rather neutral in the matter of encouraging or discouraging slums, and that other factors relating to the demand for housing are much more significant in the property owner's decision to upgrade or downgrade his dwelling units. If there is a demand for upgraded dwelling units in old structures, the income tax offers a bargain for the successful operator; and if downgrading is the direction in which demand is tending, another form of the same tax bargain is available to the winner. The impact of changes in demand upon construction of new rental units as against construction of single-family housing is well documented,[5] and there is no reason to believe that this same change in demand has not affected maintenance decisions for rental housing. However much the tax subsidy given to owner-occupied housing has stimulated this change in demand, it does not appear that depreciation policy itself has played much of a role, if any, in determining which standard of housing maintenance is more attractive in any particular rental situation.

Wholly apart from whether Sporn's program is based on a sound analysis or would further the fight against slums, we believe that in the main it would be highly undesirable from a tax point of view. We agree that taxpayers should not be permitted to transmute overly rapid depreciation into capital

5. In 1900, 35 out of every 100 newly constructed dwelling units were in structures containing 2 or more such units; in 1927 the number was 43, but by 1955, during one of the largest building booms in our history, only 9 out of each 100 new dwelling units were rental units in structures of two or more units. See GREBLER, BLANK & WINNICK, CAPITAL FORMATION IN RESIDENTIAL REAL ESTATE—TRENDS AND PROSPECTS table B-2 (1956); U.S. Housing & Home Finance Agency, Housing Statistics, April 1957, p. 2; WINNICK, RENTAL HOUSING: OPPORTUNITIES FOR PRIVATE INVESTMENT 19-25 (1958).

gain. This avenue of tax reduction is no more justifiable in the case of improved real estate than it is in the case of any other variety of depreciable assets, and its elimination would represent a step in the right direction in straightening out the present capital gains jumble. Moreover, we do not strongly take issue with Sporn's view that land preparation costs should be added to depreciable building costs. It may well be that the assumption that "land" is a nondepreciable item needs reexamination in our highly urban society where what we have called "land" in the past is as much a part of the consumable and nonsalvageable product as the elaborate marbles, woods, and bricks put into buildings to make them merchantable. We know that the nineteenth century gridiron pattern of streets, with twenty-five foot lots on which buildings parallel with lot lines were located, was as much consumed during the life of the buildings as the brick-row houses with marble balustrades placed upon the lots. Who today can say that the now fashionable whole block or area development, with no lot lines, few parallel buildings, and irregular streets, will not be consumed as readily during the life of these buildings as the modern decorative materials that they feature.

Sporn also suggests that the land preparation costs might be deductible immediately as a business expense. This alternative to depreciation of the land preparation costs needs greater exploration. Should the cost of preparing land for, say, a parking lot be immediately deductible (even if the possibility of commuting that deduction into a capital gain were blocked off)? If we deny the privilege in this situation, why should we grant it where improvements, other than an office shack, are placed on the land? And if we are to discriminate between the two situations, what should be the result where the preparer of the land is not certain whether he will build an apartment house or a parking lot?

It is at the point of placing a ceiling on depreciation deductions that we definitely part company with Sporn. In our view a cardinal principle in income taxation is to come as close as practicable to measuring the change in economic position of taxpayers during the period for which the tax base is being determined. Sporn's proposal would deny depreciation deductions to owners of rental properties on their investments even though the structures were losing value through use and the passage of time. Very likely Sporn is accurate in his observation that present depreciation schedules for rental buildings depart radically from expected economic lives. If so, the remedy is to redefine the rules for arriving at realistic schedules rather than to impose an arbitrary ceiling on total allowable depreciation deductions. It is both unfair and unwise to deny depreciation to an owner of a building because previous owners have recovered the original investment (plus subsequent improvements). Our income tax ultimately should be based on personal economic experience and not on the experience of particular assets.

Nor should we forget that departures from measuring income on a personal (or family) basis invite consequences that frequently are unexpected and sometimes difficult to counter. If a depreciation ceiling were imposed, might not fully or largely depreciated rental housing gravitate into the hands of taxpayers in low tax brackets? Certainly such properties would be less attractive to high income than to low income owners. Indeed, might not these properties tend to find their way into the portfolios of tax-exempt institutions? Perhaps it will be urged that in this possibility lies the real hope that Sporn's program will strengthen our arsenal for combating slums. History, unfortunately, lends little support to that hope. Neither the rich, nor the poor, nor the public service organizations have a specially enviable record in the handling of their rental properties. In this connection it is not to be forgotten that one of the first great legal controversies concerning government policy on slum properties involved a public service organization.[6]

6. Health Dep't v. Rector of Trinity Church, 145 N.Y. 32, 39 N.E. 833 (1895).