mains undisturbed, it may induce a belief on the part of the business community that the scope of the patent grant justifies price protection among competitors.[33]

Taxation—Income Tax—Depreciation of Mortgaged Property in Computing Gain or Loss—Basis of Mortgaged Property—[Federal].—The taxpayer was executrix as well as sole devisee and legatee under her husband's will. The husband died in 1932 leaving an apartment building and land, subject to a mortgage of $262,042.50.[1] Valuation for Federal Estate Tax purposes was $262,042.50, thus the taxpayer's equity was zero. She never was liable personally on the mortgage debt.[2] Full depreciation deductions for tax purposes were claimed and allowed on the property.[3] In 1938, to avoid foreclosure, the taxpayer conveyed the property, subject to the mortgage[4] and past due taxes, for $3,000. Sales expenses were $500. The taxpayer reported $2,500 as a capital gain in 1938, including half that amount as taxable income.[5] The Commissioner of Internal Revenue assessed a deficiency of $1,932.99 contending that the taxpayer sustained a capital loss of $528.85 upon sale of the land and an ordinary gain of $24,031.45 on the apartment building. The taxpayer's position was sustained by the Tax Court of the United States.[6] On appeal to the circuit

[33] Although the General Electric decision is clearly in need of re-examination, the present case is a difficult one in which to challenge the validity of the doctrine of that case. The presence of complementary patents suggests a superficial distinction between the principal case and the General Electric case with respect to price-fixing. On the other hand, the evidence of joint action by the licensees in the principal case suggests a combination going beyond the doctrine of the General Electric case. The validity of the General Electric decision will be raised squarely in a suit by the Government against the General Electric Company now being argued in the District Court for the District of New Jersey (Civil Actions, numbers 1364 and 2590). It appears improbable that that case will reach the Supreme Court before the Line Material case.

[1] The mortgage lien consisted of $255,000 principal and $7,042.50 accrued interest.

[2] In New York an heir or devisee does not assume personally a mortgage debt solely by inheriting title to mortgaged property. Hauselt v. Patterson, 124 N.Y. 349, 26 N.E. 937 (1891); Levy v. Comfort, 13 N.Y.S. 2d 845 (1939), aff'd 257 App. Div. 1037, 13 N.Y.S. 2d 847 (1939).

[3] The taxpayer operated the property under an agreement with the mortgagee acting as executrix for the estate from 1932 through 1936 and in her individual capacity as titleholder in 1937 and 1938. The entire net income, after taxes and operating expenses, was applied on interest. Income tax returns for the estate from 1932 through 1936 included rentals as gross income; taxes, operating expenses, interest payment, and depreciation as deductions. Similar gross income and deductions were reported in the taxpayer's personal returns during 1937 and 1938. The net effect of the gross income report and deductions, other than depreciation, was zero. Taxes, operating expenses and interest paid were deductible in full. Revenue Act of 1938, § 23(a)(1), (b), (c), 52 Stat. 460 (1938), 26 U.S.C.A. § 23(a)(1), (b), (c) (1940). Thus, except for the amount claimed for depreciations, no increase or reduction in taxes or taxable income resulted. For a discussion of the depreciation deduction, see notes 13 and 33, infra.

[4] The purchaser assumed a mortgage principal of $255,000, interest due of $15,857.71, and taxes of undetermined amount assessed for the second half of 1938.

[5] Revenue Act of 1938, § 117(b), 52 Stat. 501 (1938), 26 U.S.C.A. § 117(b) (1940).

[6] Beulah B. Crane, 3 T.C. 585 (1944). The Tax Court of the United States determined that gain realized on the sale of the building was ordinary, not capital, gain. Capital gain was re-

court of appeals, *held*, the position of the Commissioner was correct. Order reversed, one judge dissenting. *Com'r v. Crane.*[7]

The income tax system is based upon the assumption that property does not fluctuate in value during the period it is held by any one person.[8] Consequently, basis and depreciation are figured upon a constant valuation. To compensate for the inaccuracy of this assumption, the tax law provides for an adjustment when property is sold. This adjustment appears as a capital gain, loss, or, in the case of an unfortunate mortgagee, as a bad debt deduction.[9] Depreciation deductions are allowed in order to compensate for capital loss due to wear and tear with the passage of time.[10] Each year a minimum deduction must be taken on depreciable property by the person entitled to the depreciation.[11] The aim of the tax system is to approximate as closely as possible the actual yearly loss due to depreciation so that gain or loss represents only value fluctuation occurring since acquisition of the property. To the extent that the approximation is inaccurate, either a positive or a negative depreciation allowance is hidden in the gain or loss adjustments.

Two solutions for the instant case were afforded by the courts. The tax court treated the taxpayer as receiving an equity of zero; consequently her basis was zero. Since depreciation is computed as a percentage of the basis, the depreciation was zero, and therefore the adjusted basis was also zero.[12] The gain on the

ceived on the land. Revenue Act of 1938, § 117(a)(1), 52 Stat. 500 (1938), 26 U.S.C.A. § 117(a)(1) (1940). This point was not in issue before the circuit court. A deficiency of $27.77 was assessed by the Tax Court on its finding. Otherwise the taxpayer's position was supported. Brief of the Petitioner, at 32, Beulah B. Crane, 3 T.C. 585 (1944).

[7] 153 F. 2d 504 (C.C.A. 2d, 1945), cert. granted 66 Sup. Ct. 980 (1946).

[8] ". . . . appreciation in value of property is not even an accrual of income to a taxpayer prior to the realization of such appreciation through sale or conversion of the property." Treas. Reg. 101, art. 41–2, 4 Fed. Reg. 675 (1939), Code Fed. Reg., tit. 26 § 9.41–2 (Supp. 1939); Mertens, Law of Federal Income Taxation § 5.05 (1942).

[9] Treas. Reg. 101, art. 23 (k)-3, 4 Fed. Reg. 645 (1939), Code Fed. Reg., tit. 26 § 9.23 (k)-3 (Supp., 1939); IT 3548, CB 1942–1, pp. 74, 158, modifying IT 3121, CB 1937–2, p. 138, and revoking IT 3167, CB 1938–1, p. 190.

[10] Revenue Act of 1938, § 23(l), 52 Stat. 462 (1938); Treas. Reg. 101, art. 23(l)-1, (l)-2, (l)-4, 4 Fed. Reg. 645 (1939), Code Fed. Reg. tit. 26 § 9.23(l)-1, (l)-2, (l)-4 (Supp., 1939); see Detroit Edison Co. v. Com'r, 319 U.S. 98, 101 (1943); United States v. Ludey, 274 U.S. 295, 300 (1927).

[11] Revenue Act of 1938, § 113(b)(1) (B), 52 Stat. 494 (1938), 26 U.S.C.A. § 113(b)(1) (B) (1940). Under this section, adjusted basis for determining gain or loss on a sale is found by including at least the minimum depreciation that could have been taken, regardless of whether the taxpayer actually did take depreciation in prior years. United States v. Ludey, 274 U.S. 295 (1927); Beckridge Corp., 45 B.T.A. 131 (1941), aff'd Beckridge Corp. v. Com'r, 129 F. 2d 318 (C.C.A. 2d, 1942); Kittredge v. Com'r, 88 F. 2d 632 (C.C.A. 2d, 1937); Treas. Reg. 101, art. 113(b)-1, 4 Fed. Reg. 723 (1939), Code Fed. Reg. tit. 26 § 9.113(b)-1 (Supp., 1939).

[12] In the sale of assets, adjusted basis is the basis of the property at the time it was received by the seller, less depreciation. Revenue Act of 1938, §§ 113(b)(1) (B), 113(a)(5), 52 Stat. 490 (1938), 26 U.S.C.A. §§ 113(b)(1) (B), 113(a)(5) (1940). Depreciation is figured on the full value of the property. Revenue Act of 1938, §§ 114(a), 113(b), 113(a), 52 Stat. 494 (1938),

sale was $2,500, the net sale price less the basis.[13] If a zero basis is assumed, the tax problem is relatively simple,[14] for the conclusion that the depreciation must be zero automatically follows. Since the taxpayer was not personally liable on

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26 U.S.C.A. §§ 114(a), 113(b), 113(a) (1940). Amount realized is the money and property received in return for the asset. Revenue Act of 1938, § 111(b), 52 Stat. 484 (1938), 26 U.S.C.A. §111(b) (1940). The gain or loss is the difference between the adjusted basis and the amount realized on the sale of the asset. Revenue Act of 1938, § 111(a), 52 Stat. 484 (1938), 26 U.S.C.A. § 111(a) (1940).

[13] Regardless of whether the taxpayer was entitled to claim depreciation, she had in fact made such claims and they had been allowed. A doctrine of estoppel has developed as a result of the statute of limitations which prohibits the reopening of a tax return after three years. The Commissioner is barred from assessing any tax or enforcing collection of any tax not assessed after three years from the date of filing a return. Revenue Act of 1938, § 275(a), 52 Stat. 539 (1938), 26 U.S.C.A. § 275(a) (1940). A similar time limit is provided for claims by the taxpayer for return of overpayments. Revenue Act of 1938, § 322(b)(1), 52 Stat. 545 (1938), 26 U.S.C.A. § 322(b)(1) (1940). No representation as to fact, taken in a return that is barred from change, can later be repudiated or inconsistently asserted. Alamo National Bank v. Com'r, 95 F. 2d 622 (C.C.A. 5th, 1938), cert. den. 304 U.S. 577 (1938), rehearing den. 304 U.S. 590 (1938); see Wichita Coca Cola Bottling Co. v. United States, 152 F. 2d 6, 8 (C.C.A. 5th, 1945); Portland Oil Co. v. Com'r, 109 F. 2d 479, 486 (C.C.A. 1st, 1940), cert. den. 310 U.S. 650 (1940); Karol, The Doctrine of Estoppel, 23 Taxes 1132 (1945). Inconsistent positions as to law, however, are permitted. Com'r v. Saltonstall, 124 F. 2d 110 (C.C.A. 1st, 1941); Helvering v. Schine Chain Theaters, 121 F. 2d 948 (C.C.A. 2d, 1941); Helvering v. Williams, 97 F. 2d 810 (C.C.A. 8th, 1938); Karol, op. cit. supra. Questions concerning prior claims and allowances of depreciation are said to be questions of law. Com'r v. Saltonstall, 124 F. 2d 110 (C.C.A. 1st, 1941); see East Bay Water Co. v. McLaughlin, 24 F. Supp. 222, 227 (Cal., 1938), app. dismissed, 104 F. 2d 1016 (C.C.A. 9th, 1939); Hartford-Empire Co. v. Com'r, 137 F. 2d 540, 541 (C.C.A. 2d, 1943), cert. den. 320 U.S. 787 (1943). Nevertheless, the circuit court intimates that estoppel should lie: "[The mortgagor] should be compelled to take the transaction as a whole, including such past advantages . . . . as allowances for depreciation." Com'r v. Crane, 153 F. 2d 504, 506 (C.C.A. 2d, 1945). Such reasoning places every taxpayer on the horns of a dilemma. If depreciation is claimed and allowed, it must be included in gain or loss computations regardless of whether in fact it should have been allowed. But if depreciation is not claimed, and later determination is that it should have been claimed, it again must be included in gain or loss computations. No matter which he chooses, the taxpayer must risk losing if his guess is wrong. In the instant case, depreciation claimed and allowed totaled $25,500 over eight years while the sum deducted by the Commissioner for depreciation allowable was $28,045.10. Beulah B. Crane, 3 T.C. 585, 587 (1944). The circuit court was not even consistent with its estoppel theory when it failed to limit the depreciation computation to the amount actually deducted.

[14] It might be argued that the tax court opinion introduces a rule that the correct basis for depreciation is the owner's equity, not the full value of the property. Com'r v. Crane, 153 F. 2d 504, 505 (C.C.A. 2d, 1945); see also Brief for the Petitioner, at 15. The result of such a rule would be administrative chaos. If the distinction between real and book equity were ignored it would force recognition of gain or loss resulting from each fluctuation in property value. Such a result would be contrary to basic premises of the present tax system. See note 8, supra. Furthermore, such a rule would ignore the fact that some one person always bears the full economic loss of depreciation. That person is the mortgagor so long as he holds a positive equity; otherwise it is the mortgagee or the personal debtor. If this is a proper construction of the tax court's opinion, indications are that the rule will not be extended since the value of a mortgage lien should be excluded from the computation of gain "only when the facts are so peculiar that the mortgage neither constitutes a liability of the seller nor is responsible for a part of the aggregate benefit received." Anna I. Hilpert, 4 T.C. 473, 476 (1944), reversed on appeal because the facts brought the case within the doctrine stated, which was expressly approved. Hilpert v. Com'r, 151 F. 2d 929 (C.C.A. 5th, 1945).

the mortgage debt, no difficulty arises in excluding the mortgage from the amount realized.[15] The circuit court found that the taxpayer's basis was the valuation of the entire property, $262,042.50, since she was the titleholder.[16] Depreciation was computed as a percentage of that basis and amounted to $28,045.10. The gain on the sale was sale price plus mortgage lien less adjusted basis.[17] Both of the above solutions proceeded upon the assumption that the

[15] Release from personal liability constitutes receipt of property other than money. Helvering v. American Chicle Co., 291 U.S. 426 (1934); United States v. Kirby, 284 U.S. 1 (1931); Com'r v. Green, 126 F. 2d 70 (C.C.A. 3rd, 1942). The release operates as payment of the debt. Although to protect her equity the taxpayer in the instant case had to pay interest, and to remove the lien she had to pay the principal, she was not personally liable to make either payment. N.Y. Real Property Law (McKinney, 1945) § 250. A later amendment did not affect this provision of the statute. N.Y.L. 1937, c. 75; Report of the N.Y. Law Revision Com'n 960 (1937). See note 2, supra. Sale of the property subject to a mortgage did not release the taxpayer from any liability; she had no liability to be released so could not receive property in the form of such a release. In the instant case all the purchaser from the taxpayer could acquire was an equity of redemption. His cost basis was $3,000. As the purchaser paid the mortgage, his basis would increase along with a corresponding increase in his property interest. The situation was analogous to the sale of an option to purchase. For $3,000 the taxpayer sold her right to redeem the property. She sold no more because she owned nothing more than a right to redeem. Cf. Hotel Astoria, Inc., 42 B.T.A. 759 (1940); Fulton Gold Corp., 31 B.T.A. 519 (1934); Com'r v. Hoffman, 117 F. 2d 987 (C.C.A. 2d, 1941); Polin v. Com'r, 114 F. 2d 174 (C.C.A. 3rd, 1940). In reaching the opposite conclusion, the Circuit Court of Appeals invoked a doctrine of constructive receipt. "When .... the mortgagor makes an allowance to the vendee of the amount of the lien, he secures a release from a charge upon his property quite as though the vendee had paid him the full price on condition that before he took title the lien should be cleared." Com'r v. Crane, 153 F. 2d 504, 506 (C.C.A. 2d, 1945). This statement illustrates a fallacy in the court's reasoning. If the mortgagor paid all or part of the mortgage debt she would, in effect, be buying that portion of the property. Cf. Hotel Astoria, Inc., 42 B.T.A. 759, 762 (1940). Payments would not reduce any personal liability since she has no liability to be reduced. The greater the debt payment, the greater her interest in the property, just as the greater any purchaser's payments the greater his interest. If the mortgagor paid $255,000 on the mortgage and immediately sold her interest for $255,000, no gain should result. It would be strange if ownership of the property free of the mortgage for a month, a week, or even a minute, could result in eight years' depreciation of the property, yet that is the result reached by the court. The court also dwells upon the point that the transaction between the taxpayer and the purchaser was a sale. Com'r v. Crane, 153 F. 2d 504, 506 (C.C.A. 2d, 1945). This was not in issue. Both parties conceded that a sale was involved.

[16] For a discussion supporting the opinion of the Circuit Court of Appeals in the instant case, see 46 Col. L. Rev. 486 (1946).

[17] The Commissioner's computations were as follows:

			Land	Building
Selling price			$54,471.15	$203,028.85
Cost or basis:				
Land			55,000.00	
Building		$207,042.50		
Less depreciation at 2% on $207,042.50:				
1932–37	$24,845.10			
1938 (claimed and allowed)	3,200.00			
		28,045.10	....	178,997.40
		Loss....	$ 528.85	Gain...$ 24,031.45
50% of loss allowable			$ 264.42	
100% of gain on sale of a building which is not a capital asset				$24,031.45

Beulah B. Crane, 3 T. C. 585, 587 (1944). No reason appears in the record for including only the mortgage principal in the sale price. The purchaser took title subject to interest payable in addition to mortgage principal. Note 4, supra.

mortgagor was the person entitled to take depreciation and left as the sole problem the computation of the gain. It is submitted that one important question brought forth by the principal case is the determination of *who* is entitled to take depreciation under these circumstances. Within the limitations of administrative feasibility, the aim of the tax system is to impose tax liability upon the person who has actually received the benefit of property ownership, and to allow deductions to the person who has suffered the loss from depreciation. A more consistent approach, therefore, would be to permit the mortgagor to take depreciation deductions until his positive book equity is reduced to zero, and then to permit no one to take depreciation.[18] The application of this rule to the instant case suggests a third solution: Basis was $262,042.50 with depreciation computed upon the full basis. But since the taxpayer never had a positive book equity, she was not entitled to depreciation deductions nor should she be charged with such in gain computations. With depreciation not chargeable, the basis equaled the adjusted basis and the gain on the sale was $2,500.

Normally the person entitled to claim depreciation deductions is the titleholder, hence the mortgagor is allowed such claims.[19] But the ultimate test of the right to deduct depreciation is economic loss suffered.[20] Depreciation will not be allowed a person who has not paid or assumed the cost of the property.[21] Thus,

[18] Where the mortgagor's equity is zero, depreciation will cause a loss to the mortgagee, if property values do not fluctuate. Although logically the mortgagee should be permitted depreciation deductions, under these circumstances, a claim for depreciation by one other than the titleholder would introduce serious administrative difficulties.

[19] Under both the lien and title theories of mortgages today, the mortgagor usually is the beneficial owner; the mortgagee is a preferred and secured creditor. 1 Glenn, Mortgages 36 (1943); 1 Jones, Mortgages §§ 18, 67 (8th ed., 1928). New York is a lien theory state. Ibid., at § 48. The person receiving benefit from property is the owner for tax purposes; see Doll v. Com'r, 149 F. 2d 239, 243 (C.C.A. 8th, 1945), cert. den. 66 Sup. Ct. 30 (1945). But see Corliss v. Bowers, 281 U.S. 376 (1930), where the court held that income under the control of a taxpayer was taxable to him even though benefit of the income was given voluntarily to another. The instant case differs since the mortgagor was not free to control the rentals until she acquired some positive equity. All net income was paid to the mortgagee under an agreement. Thus the Crane case presents the exception to the rule that mortgagors as beneficial owners are entitled to depreciation. The taxpayer was a mortgagor but she was not a beneficial owner.

[20] " 'Depreciation' .... is not predicated upon ownership of the property, but rather upon an investment in property which is thereafter used. The important question is not, in whom vests the fee or when it vested, but who made the investment .... which is to be recovered. .... The one who made the investment is entitled to its return." Gladding Dry Goods Co., 2 B.T.A. 336, 338 (1925); cf. Weiss v. Weiner, 279 U.S. 333 (1929); Detroit Edison Co. v. Com'r, 319 U.S. 98 (1943); Tunnel R. of St. Louis v. Com'r, 61 F. 2d 166, 174 (C.C.A. 8th, 1932), cert. den. 288 U.S. 604 (1933), rehearing den. 288 U.S. 607 (1933).

[21] Detroit Edison Co. v. Com'r, 319 U.S. 98, 102 (1943) (company cannot claim depreciation since customers paid the cost of equipment); Reisinger v. Com'r, 144 F. 2d 475 (C.C.A. 2d, 1944) (lessor denied depreciation when lessee paid the cost); Bonwit Teller, Inc. v. Com'r, 136 F. 2d 978 (C.C.A. 2d, 1943), cert. den. 320 U.S. 794 (1943) (new lessor denied depreciation on improvements made by old lessor).

at times the titleholder cannot take such a deduction,[22] one other than the titleholder may take it,[23] or perhaps no one at all is entitled to it.[24]

Three basic mortgage situations involving depreciation can occur. (1) The taxpayer has a positive book equity when the property is acquired. (2) The taxpayer has a zero or negative book equity at time of acquisition. (3) The taxpayer has a positive book equity to start, then mortgages his property to a greater value than this original equity.

(1) The circuit court's rationale and the suggested approach both permit the mortgagor to claim full depreciation in the normal case where he possesses a positive book equity. All economic loss due to depreciation is borne by the mortgagor. As the property depreciates, his equity becomes smaller; the mortgage debt remains constant. But depreciation deductions or unpaid interest may extinguish the book equity. At this point the two approaches differ. Economic loss no longer is borne by the mortgagor, but continued depreciation adds to the burden of the personal debtor as a potentially increased deficiency judgment, or to the mortgagee if no deficiency judgment is recoverable. The closest assumption to reality permitted by the non-fluctuation limitations of the tax system is that after a mortgagor's equity is gone, surrender of the property will eventually follow.[25] If the property is surrendered rather than sold, the mortgagor will not suffer a taxable gain.[26] If the mortgagor is permitted to continue

[22] Cf. Georgia R. & Electric Co. v. Com'r, 77 F. 2d 897 (C.C.A. 5th, 1935), cert. den. 296 U.S. 601 (1935); Gladding Dry Goods Co., 2 B.T.A. 336, 338 (1925). But cf. Helvering v. Terminal R. Ass'n of St. Louis, 89 F. 2d 739, 742 (C.C.A. 8th, 1937).

[23] Cf. Helvering v. F. & R. Lazarus & Co., 308 U.S. 252, 254 (1939); Cogar v. Com'r, 44 F. 2d 554 (C.C.A. 6th, 1930).

[24] Cf. Atlantic Coast Line R. Co. v. Com'r, 81 F. 2d 309 (C.C.A. 4th, 1936), cert. den. 298 U.S. 656 (1935), rehearing den. 298 U.S. 691 (1936); N.Y. Central R. Co. v. Com'r, 79 F. 2d 247 (C.C.A. 2d, 1935), cert. den. 296 U.S. 653 (1935). But cf. Alaska Realty Co. v. Com'r, 141 F. 2d 675, 678 (C.C.A. 6th, 1944).

[25] Depreciation can cause economic loss only when it reduces the value of a property interest. The most realistic approach would allow a mortgagor to claim depreciation only when the property value actually exceeded the total mortgage lien. But such an approach would be administratively impossible, requiring recognition of each temporary fluctuation in realty value. Accepting the assumption that property values do not fluctuate, the most realistic approach possible is to consider that a mortgagor with a positive book equity will eventually redeem the property, therefore the ultimate depreciation loss will fall on him. Conversely a mortgagor with zero or negative equity will eventually give up his property through surrender or foreclosure since payment of the mortgage lien would involve a greater sum than the property is worth. These assumptions could prove erroneous only when relatively large value fluctuations occur contrary to the basic non-fluctuation assumption. Discrepancy between reality and the above assumptions would be adjusted in the gain, loss, and bad debt computations when the property is sold or transferred just as such adjustments are made under the circuit court solution. But the suggested solution would decrease the adjustments necessary since it more closely approaches economic reality than does an assumption that a mortgagor is owner for all purposes.

[26] See Com'r v. Green, 126 F. 2d 70, 72 (C.C.A. 3rd, 1942); Stokes v. Com'r, 124 F. 2d 335, 337 (C.C.A. 3rd, 1941); Polin v. Com'r, 114 F. 2d 174, 176 (C.C.A. 3rd, 1940). A dictum in the

to claim depreciation deductions, when surrender is made he will have received undeserved tax deductions.[27] Far from being an unusual occurrence this windfall is granted the mortgagor under the circuit court solution every time that a mortgage is surrendered. In effect, a second depreciation deduction upon the same property is granted, when the mortgagee's bad debt deduction is allowed. To the extent that depreciation actually has decreased the property value, the mortgagee's bad debt deduction will be increased. Under the suggested procedure, the mortgagor would not be allowed depreciation after book equity is extinguished, nor would he receive a tax windfall. The economic loss would be reflected as it should be in the bad debt deduction taken by the mortgagee.[28]

(2) Where the original book equity is zero, the circuit court solution would allow depreciation and would include it in gain computation charged to the mortgagor. This result is inconsistent with any assumption that property values do not fluctuate, since the mortgagor could suffer economic loss due to depreciation only when the property actually appreciated in relation to its book value. If, instead of surrender, the property were foreclosed and sold at judicial sale, this solution would charge the mortgagor with a tax gain even though he might never have received a cent upon the property.[29] An identical tax charge would occur if the property had been sold for cash with the mortgage payable out of the proceeds.[30] This result is avoided when no depreciation is allowed to a per-

instant case indicates a similar conclusion. Com'r v. Crane, 153 F. 2d 504, 506 (C.C.A. 2d, 1945). Doubts concerning the rule that surrender of mortgaged property will avoid taxable gain have been expressed. 26 Col. L. Rev. 486 (1946). The desirability of the rule also has been questioned. Braunfeld, "Subject to a Mortgage," 24 Taxes 424, 435–42 (1946). Both discussions appear to be concerned with the double deduction problem. But the solution to this problem lies in denial of depreciation deductions to persons not suffering economic loss, not in forced inclusion of previous depreciation deductions in gain computations, particularly when such deductions frequently have been "allowable" rather than actually "allowed."

[27] When the property is surrendered the mortgagee has no taxable gain so is never held accountable for the depreciation deduction taken. Only in the unusual cases, when a mortgagor with a zero or negative equity eventually clears his property, is the circuit court solution closer to reality. Then the suggested theory is less accurate since it grants the mortgagor depreciation in one lump sum. But this is no worse than recognizing the depreciation at one time in the bad debt deduction of the mortgagee at foreclosure or surrender. After the mortgagor has lost his book equity the chances of surrender are greater, according to the non-fluctuation assumption, than the chances that the mortgage will be paid. The inaccuracy in this latter case is a burden the tax system should bear if it insists upon a non-fluctuation theory.

[28] Inability of the mortgagor to claim depreciation over a period of years because of a zero equity would not enable the mortgagee to claim increased depreciation for the remainder of the life of the property. To the extent that actual depreciation has caused a property loss, compensation for that loss will be hidden in the mortgagee's bad debt deduction. But upon surrender or purchase at a foreclosure sale, the mortgagee acquires the property at a new basis and subsequent depreciation will be computed on that new basis. See note 9, supra.

[29] Helvering v. Hammel, 311 U.S. 504 (1941).

[30] A slight change in the facts of the Crane case illustrate this point. Suppose that Mrs. Crane had sold her interest for $272,000 cash, the mortgage to be paid out of that sum. Gain on the sale would be computed at $28,000 depreciation plus $10,000 gain over original basis of $262,000, a total taxable gain of $38,000. Yet Mrs. Crane would not receive one penny of the

son who does not have a book equity. The only undesirable result under the suggested solution would occur if the mortgage were suddenly paid. The mortgagor would in effect be allowed depreciation in one lump sum by virtue of the recognized gain on sale.[31] But this effect would be negligible for when the mortgage is paid off in installments, depreciation would be chargable as soon as a positive book equity appeared.

(3) Where the mortgagor acquired a positive book equity, and then mortgaged to an extent greater than his book equity, the circuit court opinion would still permit the mortgagor, as titleholder, to collect depreciation deductions.[32] Thus, the mortgagor could take tax deductions while avoiding any ultimate accountability for such deductions by surrendering the property to the mortgagee. This situation should not present any problems not already met in the first two cases.[33]

$272,000. The $15,000 interest due would more than absorb the extra $10,000 received. She would still owe taxes on a "gain" of $38,000. Such an event would seem highly fictitious, yet the circuit court states that this would be the result. Com'r v. Crane, 153 F. 2d 504, 506 (C.C.A. 2d, 1945). It is arguable that the above results are solely a result of holding property on a shoestring. Holding property on a shoestring is gambling and gambling is bad. Results like those above, and like those in the Crane case itself are desirable since they discourage gambling. But is this argument valid? If the mortgagor is not permitted to claim depreciation unless he has a positive equity, the government is not harmed by continued unearned depreciation deductions. Upon surrender or foreclosure the mortgagor will receive actual depreciation compensation in his bad debt deduction, but that is true under either theory. If the property appreciates in value then the government benefits, both by collecting taxes upon the mortgagor's actual gain and also by avoiding an allowance to the mortgagee for a bad debt deduction. If the mortgagor's shoestring operation fails, the government loses equally under either theory.

[31] Payment of a mortgage will be rare after the mortgagor ceases to have a positive book equity. See note 25 supra. The alternative is to continue to grant a mortgagor depreciation deduction even though it has long since become clear that the outcome will be either eventual surrender or foreclosure.

[32] This situation normally can occur only when fluctuation makes the actual property value greatly in excess of book value or basis. The suggested rule would stop depreciation deductions as soon as the book equity is extinguished. In extreme cases this would obviously be unjustified since the chance of the mortgage being paid would be great. The mortgagor would be the person who bore actual depreciation loss. But the flaw in the suggested solution here is the flaw common to the entire tax system. Any assumption that property values do not fluctuate is quite erroneous. The error becomes material when large fluctuations do occur. Unless some administratively feasible method appears by which value fluctuations can be recognized as they occur, the flaw seems uncorrectable. To some extent, the tax loss to the government through allowing depreciation to appear in a lump sum would be offset by the large taxable gain which must inevitably result when this situation occurs.

[33] At first glance it might seem that skilful manipulation through successively incurring and removing mortgages would permit tax profiteering under the suggested solution. Such profiteering would be obtained by taking depreciation at an accelerated rate during the years the property was unencumbered. This scheme would hardly be feasible. Depreciation deductions are disallowed during years of negative equity under the assumption that the property will not be redeemed. This disallowance does not deny the fact that depreciation is occurring at a given rate; it is based on the inability of the tax system to determine who should be allowed the deduction. If the non-redemption assumption proves false, hindsight will show that deductions should be allowed the mortgagor. The statute of limitations bars the reopening of past returns

When the mortgagor possesses a positive equity he should be allowed depreciation deductions and he should be charged for depreciation in gain computation. Generally the mortgagor eventually will redeem the property, and the economic loss caused by depreciation is suffered by him. But where the mortgagor has a zero equity, he will not, in most cases, redeem the property; thus the economic loss of depreciation will not fall upon him. Since the economic loss will not be suffered by the mortgagor, he should not be permitted tax deductions for that loss.

The circuit court makes no attempt to approximate economic reality within the limitations of the tax system. It grants depreciation to every mortgagor and charges him with such deductions in gain computations regardless of the actual economic interest possessed by the mortgagor. This approach to the problem gives harsh results in unusual situations such as the instant case.[34] Such harshness is not necessary in order to attain a workable tax system. Limiting depreciation deductions by mortgagors to situations where they have a positive book equity would more closely approximate reality. It would grant depreciation to those who suffer economic loss due to depreciation, and deny it to those who do not. It would tax those who receive an actual gain on a sale but eliminate theoretical gain where none actually has been received.

Torts—Manufacturer's Liability—Intervening Negligence—[Tennessee].—The plaintiff, driving an automobile as a guest of the owner, was injured in an accident which resulted when a defective hood catch allowed the hood to fly up and block the driver's vision. The car in question had been through a number of sales—from the defendant manufacturer to the local dealer, then to one of its salesmen for use as a demonstrator, and, after he was no longer employed by the dealer, to the present owner. After the first cars of this model had been put on the market, the defendant discovered that each car had a defective catch on the hood. To remedy this the defendant distributed auxiliary catches to all

for more than a three-year period. See note 13, supra. To the extent that reopening of past returns is permitted, such returns will be reopened and depreciation deductions granted. This reopening of returns is quite desirable since it results in depreciation being taken by the persons that hindsight shows should be permitted to do so. Where the statute of limitations would bar reopening of returns, depreciation not allowed will have to be included in final gain computations. There would be little reason for the individual taxpayer to deliberately mortgage his property in order to defer depreciation deductions. Interest charges on the mortgage would more than counterbalance any tax advantage to be achieved.

[34] It is recognized that since Mrs. Crane received depreciation deductions, the suggested solution permits a double depreciation allowance. But this double deduction is permitted only because the statute of limitations prohibits reopening of past tax returns. See note 13, supra. The impossibility of reopening past tax returns should not determine the applicability of a plan designed to avoid such difficulty in future cases. One possible legislative solution of the double deduction problem would be extension of the present ability to reopen past tax returns to cover erroneous depreciation deductions. See Revenue Act of 1938, § 820, 52 Stat. 581 (1938), 26 U.S.C.A. § 3801 (1940).