REPLY BRIEF
PETITIONER

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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1946.

No. 68.

BEULAH B. CRANE,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S REPLY BRIEF.

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The Commissioner does not and cannot deny that the limiting factor of the statutory formula is that a taxpayer's gain cannot exceed the amount realized from the sale.

Although the language of Section 111(b) was and is explicit and unmistakable, viz., that "the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of property (other than money) received," the Commissioner seeks to attach to it by statutory construction, or insert in it through Treasury practice, the proviso that the amount of the mortgage held by the Bowery Savings Bank was "property (other than money) received" by Mrs. Crane, notwithstanding the conceded fact that Mrs. Crane did not own the mortgage, was not liable upon it, and received no benefit when the real estate was sold beyond the cash received.

Abandoning the argument repeatedly urged by the Commissioner in other cases and announced by this Court that, in the matter of taxation, realities and not legal niceties must control, the Commissioner here seeks to impose a tax not on what Mrs. Crane received but upon what she did not receive.

In so doing, the Commissioner seeks to extend the principle of *U. S. v. Hendler,* 303 U. S. 564 that assumption of taxpayer's indebtedness was property received by the taxpayer, into a holding that the non-assumption of an indebtedness of someone other than the taxpayer was likewise property received by the taxpayer.

Recognizing that, of itself, Sec. 111(b) is not susceptible of the construction urged, the Commissioner's argument takes the inductive form, commencing with the premise that the word "property" as used in the estate tax, disregards the mortgage encumbrance.

Right here the fallacy begins. Rejecting those meanings of the word "property" which include the element of value or the extent of the owner's interest, the Commissioner selects the definition which describes merely the technical character of the legal title acquired, e.g., title in fee simple absolute. That, he says, is the basis, not the value of the decedent's interest or the value of the property, i.e., the equity received by the devisee.

But under the estate tax law, neither the gross estate nor the tax imposed by the Revenue Act depends upon the character of the decedent's title. Instead it is imposed upon the value of the decedent's interest; i.e., his equity. It makes no difference in tax whether the full value of the real estate is listed in one schedule and the amount of the mortgage deducted in another, or whether only the equity is shown. The result is the same in either case.

When the Commissioner predicates his argument upon a distinction between the character of the title which passed upon Mr. Crane's death and the value of the interest passing, he ignores the basic concept upon which the estate tax, the gift tax, and the stamp tax on transfers depend, viz., the value of the interest owned or transferred. There is nothing in the estate tax or the gains tax, or in justice or common sense, which permits the Commissioner to use as his basis the title which was transmitted at death and to ignore entirely the element of value attributable to the decedent's interest.

The gains tax itself is based upon a very different theory from that argued by the Commissioner. As the statute expressly states, in the ordinary case it is the difference between the amount realized for the article and the taxpayer's cost. In the case of inherited property where the taxpayer paid nothing, or in the case of property acquired prior to the effective date of the Revenue Act or applicable amendment, value is used as the basis because it approximates as closely as possible the cost basis used in the normal case.

Title has nothing to do with it. Title might be in fee simple absolute, or by the entireties, or a conditional fee, or any of the innumerable common law or statutory creations which delight the legal theorist. Title may be good, bad or indifferent, or indeed the taxpayer might have no title at all. Yet in the case of inherited property, according to the Commissioner, the basis is not the cost or value of the interest acquired and subsequently sold by the taxpayer, but the value of the legal title free from encumbrances, making a difference in the present case of over $255,000.

The gains tax is a very practical one. It is obvious that a seller can only realize money or property other than money, for the interest which he has for sale. He cannot (lawfully at least) realize anything for an interest which he does not own, cannot convey, does not purport to sell, and from which he receives no benefit. By express command of the statute, the tax is imposed upon a realized gain, not on a theoretical or imaginary one.

This must be so in order to conform with constitutional requirements. Under the 16th Amendment, an income tax cannot be imposed upon an interest which the taxpayer never owned, never received, and of which he never had or could have the benefit.

Ignoring both the constitutional obstacle and the Tax Court's finding (R. 41, 42) upon the stipulated evidence (R. 29) that only the equity was sold by Mrs. Crane, the Commissioner argues thus:—The basis is the value of the real estate without regard to the mortgage; therefore, the amount realized cannot be simply the cash received for the equity, but must have included the amount of the mortgage.

With equal right and with far greater reason and common sense, we may reverse the argument thus:—The amount realized under Sec. 111(b) is the amount realized without including the undisturbed mortgage; therefore, the basis must be the equity and cannot include the amount of the mortgage encumbrance.

However, it is unnecessary for us to go beyond the amount realized. Since in the present case only the equity was sold (indeed since Mrs. Crane was virtually an owner out of possession all she could sell was the equity), and only $2,500 net was received, it is unnecessary to argue about the base. We conceded as the base the lowest possible arithmetical figure,—zero.

The Commissioner makes a great point of the fact that Mrs. Crane deducted depreciation, which the evidence showed gave her a petty tax advantage of some $150 or $200.

The issues involved in this case, however, do not depend upon the question of depreciation. The same issues would be presented even if the real estate had been unimproved and had not been susceptible of depreciation at all.

Thus upon Mr. Crane's death the real estate was appraised at $262,042.50 and was subject to a mortgage encumbrance of $262,042.50. (The executor claimed a lower valuation in the return, but the Revenue Agent raised it.) When Mrs. Crane sold her equity for $2,500, the mortgage lien had increased to $270,857.71, an increase of exactly $8,815.21. Under the Commissioner's argument, Mrs. Crane's taxable gain would have been $8,815.21 plus the cash of $2,500, even if the property had been unimproved and there had been no depreciation whatsoever. 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 lien was attributable to principal and how much to interest, since the mortgage secures both principal and interest. Under the Commissioner's argument the mortgage lien is disregarded for the purpose of determining the basis, and included in computing the amount realized, thereby actually taxing the owner not only upon the amount of the mortgage which he did not receive, but also upon the interest upon that mortgage which he was unable to pay.

Another example is appropriate. Suppose that the real estate was unimproved and at the date of death the amount of the mortgage exceeded the value of the real estate. According to the Commissioner's theory, if the devisee later sold his equity for a dollar, he would have a taxable gain equal to the difference between the value of the real estate at the date of death and the amount of the mortgage at the time of sale plus one dollar in cash. Does the Commissioner seriously contend that the devisee would realize a taxable gain in a case like this?

We give little weight to many Treasury regulations cited by the Commissioner. The Commissioner admits that none of them are in point. Whatever they say, they cannot run counter to Sec. 111(b) which defines the amount realized as the money received plus the fair market value of property other than money received. No matter what the regulations may provide, they cannot treat as property received by the taxpayer, the mortgage debt owned by the Bowery Savings Bank, which was never received by the taxpayer at all.

Nevertheless, it is noteworthy that the only regulation considering mortgages as property received is limited to the special case of installment sales. Instead of indicating, as the Commissioner argues, that ordinary non-installments are governed by the same rule, it seems to us that the maxim *expressio unius est exclusio alterius* is fully applicable, and that this regulation raises the inference that mortgages are to be included as amount realized only in the case of installment sales, and that in the case of sales such as the one in the case at bar, mortgages on which the taxpayer is not liable are to be treated otherwise.

That this is true, is shown by I. R. C. Sec. 44, which places installment sales in a special category and lays down special provisions applicable to such sales.

As for 1944 P-H par. 60512, and 1944 C. C. H. pars. 8843-8850, it should be noted that the discussion and criticism of the opinion of the Tax Court is predicated upon the erroneous assumption that Mrs. Crane was personally liable for the mortgage debt and that, therefore, she received a re-

lease of personal liability or equivalent benefit upon the sale.

See, however, the thoughtful and carefully reasoned discussion of the case in Chicago Law Review, Vol. 13, p. 510 (June 1946) which approves the Tax Court and disapproves the Circuit Court of Appeals decision.

It is submitted that the Commissioner's argument is fallacious and unsound, and that, for the reasons pointed out in our main brief, the judgment of the Circuit Court of Appeals, Second Circuit, should be reversed and the determination of the Tax Court should be affirmed.

Respectfully submitted,

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