securities instead of only the surplus after deducting the loans. The estate contended that the statute, properly interpreted, meant to include in the gross estate only the excess of the pledged securities over the amount of the obligation. This contention was rejected in language which is equally pertinent here. The court said (p. 913):

> The last question is whether the pledged securities should be excluded from the gross estate up to the amount of the loans. The statute, section 403 (a) (1), plainly meant the opposite; among the deductions allowed were "unpaid mortgages," an impossible item unless the whole value of the mortgaged property is to be included in the gross estate under section 402 (a), 40 Stat. 1097, as an "interest * * * subject to the payment of the charges against his estate." The regulations under the Act of 1918 (article 15, Regulations 37), specifically so provided; and their successors as well. Section 402 (a) was reenacted in 1921 and 1924 without change, though under a different section number; it is most unlikely that a contrary intent should have escaped expression for so long. * * *

Moreover, the statute refers specifically to the situs of the physical property. Section 303 (a) (1) of the Revenue Act of 1926, c. 27, 44 Stat. 9, allows a deduction for unpaid mortgages upon property "except in the case of a resident decedent, where such property is not situated in the United States." The quoted provision came into the law in the Revenue Act of 1921, c. 136, Sec. 403 (a) (1), 42 Stat. 227, after the Attorney General had ruled, 31 Op. A. G. 287 (1918), that under an earlier Act real estate located outside of the United States, belonging to a resident of the United States at the time of his death, was not to be included in determining the value of the gross estate. S. Rep. No. 275, 67th Cong., 1st Sess., p. 24. This seems clearly to negative the taxpayer's contention (R. 36) that the gross estate includes only the decedent's equity in mortgaged property.

In this case, notwithstanding the mortgage, the taxpayer was the sole owner of the entire property and she alone had the right to possess, use and dispose of it. She collected the rents and paid the operating expenses. (R. 36.) She claimed and was allowed depreciation by the Commissioner on the basis of the full value of the apartment house without any reduction on account of the mortgage. (R. 37.)[1] She paid interest on the mortgage while she was in possession of the property (R. 36) and claimed and was allowed deductions for interest by the Commissioner (R. 37)

[1] The Treasury has consistently allowed taxpayers who acquire real estate by bequest subject to a mortgage to take depreciation on the basis of the full value of the property without any reduction on account of the mortgage.

just as though the mortgage debt were her debt.[2] She reported the rentals from the apartment house as gross income and claimed deductions for the operating expenses of the property. (R. 37.) She paid taxes on the property, and claimed deductions in income tax returns on that account.[3] When she sold the property in the taxable year she conveyed the physical property itself, as shown by the deed of sale. (R. 32.)

In fact, the Tax Court decided that the taxpayer used the property in her trade or business, in passing upon the question whether the apartment house was a capital asset within the meaning of Section 117 of the Revenue Act of 1938. (R. 44.) This part of the Tax Court's decision cannot be reconciled with its conclusion in regard to the unadjusted basis, because in its discussion in regard to Section 117, the Tax Court used the

[2] This was in accordance with Treasury Regulations of long standing, which treated her as though she were directly liable on the mortgage and as though the mortgage debt were her debt. See Treasury Regulations 45, Art. 121; Treasury Regulation 62, Art. 121; Treasury Regulations 65, Art. 121; Treasury Regulations 69, Art. 121; Treasury Regulations 74, Art. 141; Treasury Regulations 77, Art. 141; Treasury Regulations 86, Art. 23 (b)-1; Treasury Regulations 94, Art. 23 (b)-1; Treasury Regulations 101, Art. 23 (b)-1; Treasury Regulations 103, Sec. 19.23 (b)-1; Treasury Regulations 111, Sec. 29.23 (b)-1.

[3] In general, taxes are deductible only by the person upon whom they are imposed; the vendee of real estate cannot claim a deduction on account of paying the vendor's taxes. See *Magruder v. Supplee*, 316 U. S. 394, 396, 398, 399.

word "property" in the sense of the physical thing, whereas in its discussion in regard to unadjusted basis, the Tax Court used "property" in the sense of net cash interest. No reason was given why the word should have different meanings in different sections of the same statute.

If Congress had intended to make the taxpayer's net cash interest on the date of acquisition the basis for determining gain or loss, it probably would have used a term like "cash interest," "equity," "equity of redemption";[4] that would be a more accurate description. If the Tax Court is correct in assuming that the word "property" in the statute refers to equity or net cash interest and the taxpayer sold only an equity in the property, the purchaser from the taxpayer acquired only an equity, so that the basis for gain

[4] See Section 81.38 of Treasury Regulations 105, where reference is made to the equity of redemption (or value of the property, less the indebtedness). This provision of the Regulations first appeared in 1937 pursuant to T. D. 4729, 1937-1 Cum. Bull. 284, 289, amending Article 38 of Treasury Regulations 80 (1934 ed.). The purpose of this provision in the Regulations was to avoid putting the full value of physical property in the gross estate, where the estate could not claim a deduction on account of unpaid mortgages. The statutory provision in regard to deductions on account of unpaid mortgages is limited to cases where they were incurred or contracted bona fide and for an adequate and full consideration in money or money's worth. See also Section 3482 of the Internal Revenue Code, relating to the stamp tax, where the value of any lien or encumbrance is expressly excluded from the value of the property conveyed; and Treasury Regulations 71, Section 113.82.

or loss and for depreciation (see Section 114 (Appendix, *infra*)) is the amount of cash paid for the equity, namely, $3,000.[5]

Moreover, the phraseology of the Regulations confirms the view that the value of the physical thing, rather than the value of taxpayer's net cash interest in the physical thing, was intended. Article 113 (a) (5)-1 of Treasury Regulations 101 provides in subdivision (c) that the basis of property acquired by devise is the value of the property as of the date of the death of the decedent *as appraised* for the purpose of the federal estate tax. This provision of the Treasury Regulations has been in effect since 1918,[6] and the statutory provision to which it refers has been reenacted in substantially the same form in all succeeding Revenue Acts.[7] Therefore the

[5] This would be contrary to the generally prevailing accounting practice. See II Kester, Accounting Theory and Practice (2d ed., 1925) 333; also, 1944 P-H, par. 60,512.

[6] See Treasury Regulations 45, Art. 1562; Treasury Regulations 62, Art. 1563; Treasury Regulations 65, Art. 1594; Treasury Regulations 69, Art. 1594; Treasury Regulations 74, Art. 596; Treasury Regulations 77, Art. 596; Treasury Regulations 86, Art. 113 (a) (5)-1 (c); Treasury Regulations 94, Art. 113(a)(5)-1(c); Treasury Regulations 101, Art. 113 (a) (5)-1 (c); Treasury Regulations 103, Sec. 19.113 (a) (5)-1 (c); Treasury Regulations 111, Sec. 29.113 (a) (5)-1 (c).

[7] Sec. 202 (a) (3) of the Revenue Act of 1921, c. 136, 42 Stat. 227; Sec. 204 (a) (5) of the Revenue Act of 1924, c. 234, 43 Stat. 253; Sec. 204 (a) (5) of the Revenue Act of 1926, c. 27, 44 Stat. 9; Sec. 113 (a) (5) of the Revenue Act of 1928, c. 852, 45 Stat. 791; Sec. 113 (a) (5) of the Revenue Act of 1932, c. 209, 47 Stat. 169; Sec. 113 (a) (5) of the Revenue Act

regulation is entitled to great weight. See *Helvering* v. *Reynolds Co.*, 306 U. S. 110, 114-115; *Merchants Bank* v. *Commissioner*, 320 U. S. 256, 260. The word "appraised" in the regulations suggests that reference was being made to the physical property rather than the equity which is computed from the appraised value.

In recognition of the statutory deduction for mortgages, Article 38 of Treasury Regulations 70 (1929 ed.) provides that the full value of real estate without any deduction for mortgages *must* be included in the gross estate and that the amount of any mortgage may be deducted to the extent that it was incurred or contracted bona fide for an adequate and full consideration in money or money's worth.[8] This regulation was followed by

of 1934, c. 277, 48 Stat. 680; Sec. 113 (a) (5) of the Revenue Act of 1936, c. 690, 49 Stat. 1648; Sec. 113 (a) (5) of the Revenue Act of 1938, c. 289, 52 Stat. 447; Sec. 113 (a) (5) of the Internal Revenue Code, as amended by Sec. 144 of the Revenue Act of 1942, c. 619, 56 Stat. 798.

[8] Under later Treasury Regulations it is mandatory to include the full value of the property subject to the mortgage in the gross estate if the decedent's estate is liable for the amount of the mortgage or indebtedness. But if the decedent's estate is not so liable, only the value of the equity of redemption (or value of the property, less the indebtedness) need be returned as part of the value of the gross estate. See Treasury Regulations 105, Sec. 81.38. This change in the Regulations first appeared in 1937 as T. D. 4729 (see fn. 4, *supra*). Since the decedent in this case died in 1932 and Treasury Regulations 70 (1929 ed.) were not amended, the changed regulation would not seem to be applicable. The record in this case does not clearly indicate whether the decedent assumed liability on the mortgage or not.

the taxpayer as executrix of her husband's estate, because the Tax Court found as a fact that the property was reported at the value of $262,042.50, and the amount due on the mortgage was reported as indebtedness of the estate in the same amount. (R. 36.)

We submit that the word "property" in the statute and the Treasury Regulations should properly be construed as the physical thing and not as the devisee's equity or net cash interest in the property. If we are correct, the unadjusted basis of the property within the meaning of the Treasury Regulations would be $262,042.50. The stipulation of facts shows that of this sum, $55,000 should be allocated to the land and the balance, or $207,042.50, should be allocated to the building. (R. 15.) It may be pointed out that the Tax Court in its opinion paid no attention to the estate tax regulations, although they were relied upon by the Government in its brief. In fact the Tax Court cited no authorities and gave no reasons for its conclusion in regard to the unadjusted basis of the property.

But assuming for the purposes of the argument that the applicable statute and regulation could reasonably be construed as meaning either the value of the physical thing or the taxpayer's net cash interest in the property, it would introduce administrative complication and confusion if the devisee's equity, rather than the value of

the physical thing, were to be treated as the proper basis. While the question involved in this case is the basis for determining gain or loss, the basis for depreciation is necessarily involved because Section 114 of the Revenue Act of 1938 (Appendix, *infra*) provides that the basis for depreciation shall be the same as the basis for gain or loss. Since depreciation is defined in the statute[9] as exhaustion, wear and tear of property, it could not reasonably be based upon the taxpayer's financial interest in the property, but only upon the value of the physical thing itself. The court below was impressed with the difficulties attendant upon making taxpayer's equity the basis. Suppose, for example, that a taxpayer inherits business property with a fair market value

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[9] See Section 23 (l) of the Revenue Act of 1938. It may be noted that Congress has treated the life tenant as though he were the absolute owner with respect to the deduction for depreciation; and has provided in the case of property held in trust that the allowable deduction should be apportioned on the basis of the trust income allocable to each beneficiary, in the absence of other provisions in the trust instrument.

The policy seems to be to give the allowance to the person who reports the income and the Commissioner's practice in dealing with mortgaged property promotes that policy. If he had made a distinction between those liable on a mortgage and those not, the full depreciation on literally thousands of pieces of property would not be reflected in any income tax return. There is no authority for taxpayer's suggestion that the mortgagee should have the allowance when the owner is not liable on the mortgage. The mortgagee does not use the property in his business and is accordingly foreclosed from receiving an allowance.

of $90,000, subject to an unassumed mortgage of $40,000, leaving as his equity $50,000; that he depreciates the property on a straight line basis on an estimated life of 20 years; and that he makes an annual $2,000 payment on mortgage principal. In the first year the depreciation on the equity is $2,500. For each successive year the basis will have to be adjusted to reflect the principal payments on the mortgage, and depreciation for previous years will have to be subtracted from the adjusted basis to determine the amount of depreciation allowable for the next succeeding year. Thus for the second year the depreciation will be [($50,000 plus $2,000) – $2,500] divided by 19, or a result of $2,605.26; for the third year $2,716.38; and for the fourth year $2,834.02. The depreciation allowances will increase progressively as the property's estimated life decreases; the nineteenth mortgage principal payment of $2,000 will be entirely depreciated within the twentieth year; and the property's estimated life will have expired before the twentieth payment of $2,000 on mortgage principal can be depreciated.

Moreover, if taxpayer fails to amortize the mortgage for a number of years and then under pressure of threatened foreclosure makes a substantial payment in one year, the consequence will be to compress a large allowance for depreciation within a relatively short period. Should the taxpayer in the above illustration make no

payments on the mortgage until the sixteenth year and then reduce the mortgage by $30,000, he will be entitled, under the taxpayer's contention, to depreciate the $30,000 capital outlay in the remaining five-year life of the property, together with the remaining five years' depreciation of his original equity interest.

Another result would be to set up a zero basis for the property in those cases where the amount of the mortgage equals the fair market value of the property on the critical date (the date of the decedent's death).

In this case the taxpayer claimed and was allowed deductions for depreciation based on the full value of the building on the date of the death of the decedent without any reduction on account of the mortgage. The deductions aggregated $25,500 (R. 37), which approximates the amount of gain determined by the Commissioner (R. 38). This is the first case in which the practice of the Treasury Department in using the full value of the property as the basis both for depreciation and for determining gain or loss has been challenged. It was undoubtedly for this reason that some of the federal tax services adversely criticized the opinion of the Tax Court in this case.[10] The court below said in its opinion (R. 55):

[10] 1944 P-H par. 60,512; 1944 C. C. H., pars. 8843–8850, inclusive.

We cannot doubt, especially in view of the long uniform practice, that the right "basis" for depreciation is the actual value of the buildings.

II. ADJUSTED BASIS

Section 113 (b) (1) (B) of the Revenue Act of 1938 provides that "proper adjustment in respect of the property shall in all cases be made * * * for exhaustion, wear and tear * * * to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws." Moreover, this Court had decided in a case arising under the Revenue Act of 1916, c. 463, 39 Stat. 756, as amended, which did not contain a provision similar to Section 113 (b) (1) (B) requiring adjustment of the basis on account of depreciation and depletion,[11] that the basis for determining gain or loss must be adjusted on account of depreciation and depletion to the extent allowable. *United States* v. *Ludey*, 274 U. S. 295. Incidentally, in the *Ludey* case the taxpayer did not deny that Congress had the power to require that the original cost should be adjusted on account of depreciation and depletion. 274 U. S. 295, 298. As this Court noted in its opinion, unless the statute is construed as requiring an adjustment of the basis on account of depreciation, the taxpayer would get a double deduction for the loss of the same capital assets.

[11] Until 1924, none of the Revenue Acts provided in terms that, in computing the gain from a sale of any property, a deduction shall be made from the original cost on account of depreciation and depletion during the period of operation.

The taxpayer herein filed income tax returns for the estate of the decedent covering the period January 11 (the date of decedent's death) to December 31, 1932, and for the years 1933, 1934, 1935 and 1936; and income tax returns for the years 1937 and 1938, in which she claimed deductions for depreciation in amounts ranging from \$3,200 to \$3,900, and aggregating \$25,500. (R. 37.) While \$25,500 represents the amount of depreciation allowed, the Commissioner determined that the amount allowable was \$28,045.10. (R. 38.) Since the parties stipulated that of the sum of \$262,042.50, \$55,000 should be allocated to the land, and \$207,042.50 to the improvements (R. 15), and that the rate of depreciation applicable to the apartment house is two per cent per annum (R. 17), the amount of depreciation, namely, \$28,045.10, is merely a matter of simple computation.

Applying Section 113 (b) (1) (B) to the facts of this case, it is necessary to subtract the amount of depreciation allowable, namely, \$28,045.10, from the part of the basis allocated to the apartment house building, namely, \$207,042.50, in order to obtain the adjusted basis, namely, \$178,997.40. (R. 38.) As to the part of the basis allocated to the land, namely, \$55,000, there is no need to adjust the basis because it is not subject to depreciation.

The Tax Court made no finding with respect to tax benefits. Presumably the Tax Court disagreed with the action of the Commissioner in adjusting the basis of the apartment house building by the amount of $28,045.10, only because it determined that the unadjusted basis was zero (R. 43.) The statute is clear and the principle upon which adjustments are made is universally accepted.

III. AMOUNT REALIZED

Section 111 (a) of the Revenue Act of 1938 provides that the gain from the sale or other disposition of property shall be the excess of the "amount realized" therefrom over the adjusted basis provided in Section 113 (b), and the amount realized is defined in Section 111 (b) as the "sum of any money received plus the fair market value of the property (other than money) received."

We have argued that the word "property" in Section 113 and in Article 113 (a) (5)-1 of Treasury Regulations 101 means the physical thing, rather than taxpayer's net cash interest or equity in the property, or the value of the property less the mortgage. Under this construction of the statute, the basis of the land (which is not subject to adjustment on account of depreciation) is $55,000 as shown by the discussion under Point I, *supra*, and the adjusted basis of the building is $178,907.40, as shown under Point II, *supra*. If

the word "property" in Section 113 means the physical thing and the amount of the mortgage is not deducted for the purpose of ascertaining the basis, it would seem to follow that the word "property" in Section 111 must mean the same thing and that the amount of the mortgage should not be deducted. Only in this way may the symmetry of the statutory scheme be preserved. See *Maguire* v. *Commissioner*, 313 U. S. 1, 8.

If the word "property" in Section 111 means the physical thing, the fair market value of the real estate sold by the taxpayer on November 29, 1938, was the amount of cash paid, $3,000, plus the amount of the mortgage, because the taxpayer's vendee could have owned the property free and clear of the mortgage on the day of the sale by paying $255,000 to the mortgagee.[12] Since the property was in effect sold for $258,000, it is fair to say that the fair market value of the real estate on the day of the sale was $258,000. See *Rogers* v. *Helvering*, 107 F. 2d 394, 396 (C. C. A. 2d); *Robertson* v. *Routzahn*, 75 F. 2d 537, 539 (C. C. A. 6th); *New York* v. *Sage*, 239 U. S. 57, 61.

Assuming that $258,000 was the fair market value of the real estate, that the land and building are what was sold, rather than taxpayer's

[12] We may disregard for tax purposes the amount of outstanding interest, taxes, etc., because they were deductible from gross income or from the proceeds of sale.

equity in the property and that the basis included the value of the mortgage, it would be absurd to say that the taxpayer realized only $3,000 gross, or $2,500 net, from the sale. It would mean that the taxpayer would suffer a loss of $54,471.15[13] on the sale of the land, and a loss of $177,026.25[14] on the sale of the building, although she concedes, and the Tax Court decided, that she realized a gain of at least $2,500. Furthermore, it would mean that the purchaser from the taxpayer has a basis for depreciation, as well as for gain or loss, of only $3,000, which is contrary to the generally prevailing accounting

[13] Since the basis is $55,000 and the total amount realized for the land and building would be $2,500 and the parties stipulated that the proportion of the selling price allocable to the land is $\frac{5,447,115}{25,750,000}$ (R. 17), the amount of the selling price allocated to the land would be $528.85. The excess of the basis, $55,000, over the part of the selling price allocable to the land, $528.85, represents a loss on the transaction in the amount of $54,471.15. Since the land is a capital asset under Section 117 and it was held for more than 24 months, only one-half of this amount would be recognized as a deductible loss.

[14] Since the adjusted basis for the building is $178,997.40 and the total amount realized for the land and building would be $2,500 and the parties stipulated that the proportion of the selling price allocable to the building is $\frac{20,302,885}{25,750,000}$ (R. 17), the amount of the selling price allocated to the building would be $1,971.15. The excess of the basis, $178,997.40, over the part of the selling price allocable to the building, $1,971.15, represents a loss of $177,026.25. Since the building is not a capital asset under Section 117, the entire loss would be deductible on the sale of the building.

practice. See fn. 5, *supra*, p. 16. The only way in which a reasonable result can be reached is to add the principal amount of the mortgage to the amount of cash received. See *Estate of Ebert* v. *Commissioner*, 37 B. T. A. 186, which the Tax Court failed to distinguish in its opinion in the instant case.

Perhaps it is sufficient to say that the amount of the mortgage must be included in the computation of the "amount realized" because the amount of the mortgage is included in the basis. Thus its inclusion in the amount realized can be justified solely on the ground that that is a condition for permitting the taxpayer to include it in the basis. The taxpayer contends that the amount of the mortgage should be disregarded both in the basis and in the amount realized. She does not contend that if it is included in the basis it should nevertheless be excluded from the amount realized. It is implicit in her argument, and we think there can be no doubt, that there must be similar treatment at both ends of the transaction. The Regulations provide that whatever basis is used for estate tax purposes must similarly be used as the basis by the devisee. Accordingly, since we think we have established that Congress intended that the amount of the mortgage should be reflected in the value of the property for estate tax purposes, it should follow that the amount of the mortgage must be included in the amount realized.

The Tax Court said in its opinion that if the taxpayer had assumed liability for the payment of the mortgage debt and her vendee had in turn assumed taxpayer's liability, such assumption by the vendee would be the equivalent of the receipt of "money" by the taxpayer to the extent of the amount of the liability so assumed. (R. 41.) While the taxpayer did not assume liability on the mortgage, she held the apartment house subject to the conditions and covenants of the mortgage. She was the owner for all purposes; she had all the income; she managed it; she sold it and the increase in value went to her. The mortgagee (the bank), on the other hand, was nothing more than a preferred creditor, even though the taxpayer was not liable on the debt. While it is true that the mortgagee had recourse only to the property, it was a creditor nonetheless. The taxpayer paid the bank interest on the mortgage, and by paying $2,500 in back interest she obtained from the bank a reduction in the interest rate to four percent (R. 25–26).

When the taxpayer sold the property subject to the mortgage, she secured a release from a charge upon her property just as though the purchaser had paid her the full price on condition that before he took title the lien should be cleared.[12] Therefore she

[12] The same is true of a gift. Since the release similarly may be considered as received by a donor of real estate subject to a mortgage, it is not surprising that the value of the gift is only the amount of the donor's equity. Taxpayer's

received property other than money when she sold the property subject to the mortgage and the fair market value of the property was the principal amount of the mortgage, namely, $255,000. In this connection the court below said (R. 55–56):

> She insists, however, that because she was not liable, the lien should not be considered as an equivalent. But the lien of a mortgage does not make the mortgagee a co-tenant; the mortgagor is the owner for all purposes; indeed that is why the "gage" is "mort," as distinguished from a "vivum vadium." *Kortright* v. *Cady*, 21 N. Y. 343, 344. He has all the income from the property; he manages it; he may sell it; any increase in its value goes to him; any decrease falls on him, until the value goes below the amount of the lien. The mortgagee is a creditor, and in effect nothing more than a preferred creditor, even though the mortgagor is not liable for the debt. He is not the less a creditor because he has recourse only to the land, unless we are to deny the term to one who may levy upon only a part of his debtor's assets. When therefore upon a sale 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 con-

argument (Br. 37–38) ignores the fact that in computing both estate and gift taxes the amount of the mortgage is ultimately excluded.

dition that before he took title the lien should be cleared, or as though it were a condition upon the sale of Whiteacre that the vendee should clear the vendor's Blackacre of a mortgage. In neither case would anyone question the conclusion that the vendor had received "property (other than money)"; yet the effect is precisely the same of the transaction at bar.

There is another way of illustrating that the taxpayer realized a substantial gain upon the sale of the apartment house, although the actual cash received was only $3,000 gross or $2,500 net. While the taxpayer sold the same apartment house which she inherited from her husband about seven years earlier, seven years of the useful life of the apartment house had been used up in the meantime. Assume that the apartment house building was worth about $200,000 when the taxpayer acquired it and that its useful life was 50 years; it might be said to consist of 50 units of $4,000 each. When the taxpayer sold it, it consisted of only 43 units of $4,000 each, because seven of those units had been used up. Therefore, even though the taxpayer sold the building for the same amount as the value at the time she acquired it seven years earlier, she would nevertheless have realized a gain of $28,000. As a matter of fact, the portion of the selling price allocated to the building by stipulation of the parties was about $4,000 less than the portion

of the basis allocated to the building (R. 38), so that the net gain on the building was about $24,000.

It may be noted that in recent income tax legislation, Congress has made no distinction for basis purposes between the acquisition of property subject to a liability and the assumption of liability. See Section 213 (d) of the Revenue Act of 1939, c. 247, 53 Stat. 862, amending Section 113 (a) (6) of the Internal Revenue Code. The Treasury Regulations relating to installment sales have provided that no distinction shall be drawn between cases where property is taken subject to a mortgage and cases where the mortgage is assumed by the purchaser.[16]

The Tax Court summarily disposed of this regulation on the ground that it was limited to installment sales. That reasoning is obviously too superficial. The Regulations embody a principle which the Tax Court is required to follow, if applicable. The principle has not been limited to installment sales. A taxpayer who is not liable on a mortgage is nevertheless regarded as making the sale upon a foreclosure. *Edward F. C. McLaughlin v. Commissioner*, 43 B. T. A. 528.

[16] See Treasury Regulations 69, Art. 44; Treasury Regulations 74, Art. 352; Treasury Regulations 77, Art. 352; Treasury Regulations 86, Art. 44-2; Treasury Regulations 94, Art. 44-2; Treasury Regulations 101, Art. 44-2; Treasury Regulations 103, Sec. 19.44-2; Treasury Regulations 111, Sec. 29.44-2.

The taxpayer relies upon a recent decision of the Circuit Court of Appeals for the Fifth Circuit, *Hilpert* v. *Commissioner,* 151 F. 2d 929, to show that the amount realized by the taxpayer on the sale should not include the sum of $255,000 representing the unpaid principal of the mortgage. (Br. 29.) In the *Hilpert* case the Tax Court[17] assumed that the taxpayers were personally liable on the mortgage and held that since the redemption of the mortgage by taxpayers' vendee eliminated the indebtedness, the amount of the mortgage must be included in the amount realized. The Circuit Court of Appeals reversed the decision of the Tax Court on the ground that under the law of Florida no debt had been created; that the land was put up purely as a pledge under such circumstances that the courts deem it to be a mortgage, but the mortgagee could not enforce any personal liability against the taxpayers. We think that the decision of the Fifth Circuit was wrong for the reasons given by Judge Hutcheson in his dissenting opinion.[18]

In any event no consideration was given to the critical question here of the proper basis and the need for correlating the basis for depreciation with the computation of gain or loss

[17] 4 T. C. 473.

[18] See also discussion of the case in 59 Harv. L. Rev. 622 (1946); and in 24 Taxes 443 (May 1946).

upon sale. The same is true of the other cases which have drawn distinctions between taxpayers who are and those who are not personally liable on mortgages.

The taxpayer also argues that the result of the decision of the court below is to subject the mortgagor to a tax upon a gain which is out of all proportion to what she received in cash; to a tax which may indeed be greater than the whole cash consideration. (Br. 50, 51.) This reasoning ignores the past advantages which she was entitled to, including allowances for depreciation, which in this case aggregate $25,500.

The taxpayer argues that the reversal of the Tax Court by the court below was a violation of the rule of this Court in *Dobson* v. *Commissioner,* 320 U. S. 489. (Br. 14.) According to our interpretation of the *Dobson* case, the rule does not apply where the Tax Court has made a clear-cut mistake of law. See *Commissioner* v. *Wilcox,* 327 U. S. 404. We believe that the construction of the term "property" in Section 113 (a) (5) and of the term "amount realized" where the taxpayer sells property subject to a mortgage, which she acquired by bequest subject to a mortgage, are questions of law which were properly reviewed by the court below. See Section 1003 (b) of the Revenue Act of 1926, c. 27, 44 Stat. 9.

CONCLUSION

The decision of the court below is correct and should therefore be affirmed.

Respectfully submitted.

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November 1946.

APPENDIX

Revenue Act of 1938, c. 289, 52 Stat. 447:

Sec. 111. Determination of amount of, and recognition of, gain or loss.

(a) *Computation of gain or loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount realized.*—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 the property (other than money) received.

* * * * *

Sec. 113. Adjusted basis for determining gain or loss.

(a) *Basis (Unadjusted) of property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(5) *Property transmitted at death.*—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition. * * *

* * * * *

(b) *Adjusted basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined