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Improvements by a Tenant as Realized Income to the Landlord

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Becker. The Samuel Breckinridge Prizes, awarded to the students having the highest averages in their respective classes: for the senior class, 1938-1939, Frank R. Kennedy, first; Francis H. Becker and Andrew Ludwig, Jr., second; for the second year class, 1937-1938, Frank R. Kennedy, first; Carrol Donohue and Andrew Ludwig, Jr., second; for the first year class, 1937-1938, Sterling F. Tremayne, first; Edwin M. Schaefer, Jr., second. The Breckinridge Law Review Editorial Prize was awarded to Edwin M. Schaefer, Jr., and Breckinridge Law Review Managerial Prize was awarded to Sterling F. Tremayne for the editorial year 1939-1940. Final honors were awarded to Lackland Bloom, Carrol Donohue, Frank R. Kennedy, Joseph Kutten, and Andrew Ludwig, Jr.

NOTES

IMPROVEMENTS BY A TENANT AS REALIZED INCOME TO THE LANDLORD

In 1919, for the first time, a United States Circuit Court of Appeals was called upon to decide whether a lessor realized taxable income upon repossession of his property after a lessee had made improvements thereon at his own expense.[1] Since then there has been wide difference of opinion as to when, if ever, a lessor realizes income as the result of improvements made by the lessee. The Board of Tax Appeals and the lower Federal Courts have decided a number of cases involving the problem, often basing their decisions on factors and circumstances given very little consideration in previous or subsequent cases. Not until recently was the question decided by the Supreme Court of the United States[2] and that court's opinion lends little aid in attempting a correct solution of this much unsettled question.

Probably the most important issue is as to the constitutionality of the regulations of the Treasury Department promulgated under the various revenue acts since the adoption of the Sixteenth Amendment to the Federal Constitution. That Amendment provides:

> The congress shall have power to lay and collect taxes on incomes, from whatever source derived, without appor-

1. Miller v. Gearin (C. C. A. 9, 1919) 258 Fed. 225, cert. denied (1919) 250 U. S. 667.
2. M. E. Blatt Co. v. United States (1938) 305 U. S. 267.

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> tionment among the several states, and without regard to any census or enumeration.

The broad language of this amendment would seem to enable Congress to pass laws taxing income almost without limit except as regards the safeguards of fundamental rights protected by other clauses of the constitution such as "due process" and "equal protection."[3] The Revenue Act of 1939,[4] in so far as it affects the question here involved, provides:

> "Gross income" includes gains, profits, and income derived from * * * sales or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property, * * * or gains or profits and income derived from any source whatever * * *.

The language is practically the same as that of previous acts under which promulgations of the Treasury Department with regard to the lessor's income were made. The latest promulgations issued by the Treasury Department thereunder read as follows:

> If buildings are erected or improvements made by a lessee and such buildings or improvements immediately become the property of the lessor, as, for instance, if they are not subject to removal by the lessee, the lessor may at his option report the income therefrom upon any one of the following bases:
>
> (a) The lessor may report as income for the taxable year in which such buildings or improvements are completed their fair market value at the time of their completion.
>
> (b) The lessor may report as income at the time when such buildings or improvements are completed the fair market value of such buildings or improvements subject to the lease.
>
> (c) The lessor may spread over the life of the lease the estimated depreciated value of such buildings or improvements at the expiration of the lease and report as income for each year of the lease an aliquot part thereof.
>
> Except in cases where the lessor has reported income upon basis (a), if the lease is terminated so that the lessor comes into possession or control of the property prior to the time originally fixed for the expiration of the lease, the lessor shall report income for the year in which the lease is so terminated to the extent that the value of such buildings or improvements when he becomes entitled to such possession exceeds the amount already reported as income

3. Irwin v. Gavit (1925) 268 U. S. 161; Brushaber v. Union Pac. R. R. (1916) 240 U. S. 1.
4. (1939) 1 U. S. Code Current Serv. 19, sec. 22(a).

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> on account of the erection of such buildings or improvements. No appreciation in value due to causes other than the termination of the lease shall be included.
>
> If the buildings or improvements are destroyed prior to the expiration of the lease, the lessor is entitled to deduct as a loss for the year when such destruction takes place the amount previously reported as income because of the erection of such buildings or improvements, less proper adjustment for depreciation in case option (a) is exercised, and less any salvage value subject to the lease to the extent that such loss is not compensated for by insurance or otherwise.[5]

Upon the face of the Regulations it does not appear that they violate any constitutional rights of the taxpayer. It would seem that if Congress should pass a revenue act providing that improvements by a lessee should constitute taxable income to the lessor, either upon completion of the improvements or upon termination of the lease, the courts would not be likely to construe the language of the Sixteenth Amendment so narrowly as to hold such a statute invalid if a practical method of administration could be found.[6]

It is submitted, therefore, that it would be quite logical to call such improvements income,[7] and some lower Federal court decisions have been cited as holding that improvements do constitute income at the time they are completed.[8] It should be noted, however, that in *Miller v. Gearin*[9] and *Cryan v. Wardell*,[10] such a statement was not necessary to the decisions and therefore it would seem that those cases are not authority for that proposition.[11] In *United States v. Boston & Providence R. R.*,[12]

5. U. S. Treas. Reg. 101, art. 22(a)-13, approved 1939, promulgated under the Rev. Act of 1938.

6. A study of the cases shows that taxpayers have seldom attacked the constitutionality of the regulations, but have generally found fault with the valuations placed upon the property and the methods used by the commissioner in computing the tax.

7. Hewitt Realty Co. v. Comm'r of Int. Rev. (C. C. A. 2, 1935) 76 F. (2d) 880, 98 A. L. R. 1201.

8. Crane v. Comm'r of Int. Rev. (C. C. A. 1, 1934) 68 F. (2d) 640; Kentucky Block Coal Co. v. Lucas (D. C. W. D. Ky. 1933) 4 F. Supp. 266; United States v. Boston & P. R. R. (C. C. A. 1, 1930) 37 F. (2d) 670; Cryan v. Wardell (D. C. N. D. Cal. 1920) 263 Fed. 248; Miller v. Gearin (C. C. A. 9, 1919) 258 Fed. 225, cert. denied (1919) 250 U. S. 667; cf. Austin, Are Leasehold Improvements Income? (1934) 12 Tax Mag. 469.

9. (C. C. A. 9, 1919) 258 Fed. 225, cert. denied (1919) 250 U. S. 667.

10. (D. C. N. D. Cal. 1920) 263 Fed. 248.

11. Julian B. Hart (1938) 37 B. T. A. 360, nonacquiescence (1938) XVII-1 Cum. Bull. 44; Hilgenberg v. United States (D. C. D. Md. 1937) 21 F. Supp. 453; Staples v. United States (D. C. E. D. Pa. 1937) 21 F. Supp. 737; Hand, J., in Hewitt Realty Co. v. Comm'r of Int. Rev. (C. C. A. 2, 1935) 76 F. (2d) 880, 98 A. L. R. 1201; also Comment (1935) 30 Ill. L.

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the statement is *dictum* and the *Kentucky Block Coal* case[13] cites no authority for its holding. But logic is not the sole test of constitutionality; the courts also consider practical problems of administration.[14] The more recent cases have held that such improvements are not realized income within the meaning of the Sixteenth Amendment until the property has been sold or exchanged.[15] One recent case, on the other hand, affirmed a Board of Tax Appeals decision holding that the lessor did realize income when improvements were made,[16] but in that case the petitioner failed to overcome the presumption of correctness of the commissioner's finding. The *Hewitt Realty Co.* case[17] was first to hold that the regulations were unconstitutional, and this was followed by *Hilgenberg v. United States*,[18] *Staples v. United States*,[19] and *English v. Bitgood*,[20] *Campbell v. United States*[21] being decided contra. The Board of Tax Appeals, how-

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Rev. 392; Austin, Are Leasehold Improvements Income? (1934) 12 Tax Mag. 469; Note (1921) 6 ST. LOUIS LAW REVIEW 26.

12. (C. C. A. 1, 1930) 37 F. (2d) 670.

13. Kentucky Block Coal Co. v. Lucas (D. C. W. D. Ky. 1933) 4 F. Supp. 266.

14. Magill, *Taxable Income* (1936) 20, where the author says, "* * * It is obvious, of course, that for tax purposes income must be determined in some single unit of measurement, and that the money of the particular country is regularly employed as such a unit. * * * Since an estimate of value has an extremely subjective character, being simply a summary of some person's ideas with respect to the probable selling price or income-producing capacity of the particular object, it is clear, as already stated, that courts and legislatures will tend to avoid such estimates so far as possible. This tendency leads to the limitation of the recognition of income for tax purposes to receipts either in money or susceptible of easy valuation therein. From a purely practical point of view, therefore, courts are justified in considering the form of the receipt, although it should always be recognized that this problem is merely one of measurement, and not one of the existence of income itself." See also Comment (1935) 35 Col. L. Rev. 1320, on the majority opinion in the Hewitt case; Comment (1936) 20 Minn. L. Rev. 320.

15. English v. Bitgood (D. C. D. Conn. 1938) 21 F. Supp. 641; Fifteenth Street Inv. Co. v. Nicholas (D. C. D. Colo. 1938) 23 F. Supp. 863; Hilgenberg v. United States (D. C. D. Md. 1937) 21 F. Supp. 453; Staples v. United States (D. C. E. D. Pa. 1937) 21 F. Supp. 737; Hewitt Realty Co. v. Comm'r of Int. Rev. (C. C. A. 2, 1935) 76 F. (2d) 880, 98 A. L. R. 1201.

16. Campbell v. United States (D. C. Terr. of Hawaii 1938) 1 Prentice-Hall 1938 Fed. Tax Serv. par. 2201.

17. Hewitt Realty Co. v. Comm'r of Int. Rev. (C. C. A. 2, 1935) 76 F. (2d) 880, 98 A. L. R. 1201.

18. (D. C. D. Md. 1937) 21 F. Supp. 453.

19. (D. C. E. D. Pa. 1937) 21 F. Supp. 737.

20. (D. C. D. Conn. 1938) 21 F. Supp. 641; see also Fifteenth Street Inv. Co. v. Nicholas (D. C. D. Colo. 1938) 23 F. Supp. 863.

21. (D. C. Terr. of Hawaii 1938) 1 Prentice-Hall 1938 Fed. Tax Serv. par. 2201. In Everett Dominick v. United States (D. C. S. D. N. Y. 1938) 1 Prentice-Hall 1938 Fed. Tax Serv. par. 5.533, the court indicated that the Hewitt case may have been intended to be limited to the life of the

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ever, refused[22] to follow the *Hewitt* case, and, until the decision by the Supreme Court in the *Blatt* case,[23] continued to hold that the lessor did realize income from such improvements. However, since the *Blatt* case, the Board has taken the position that the Regulations are invalid.[24] In that case the petitioner leased his building, which was to be remodelled by the lessee, for use as a moving picture theater. Seats, draperies, and other equipment were to be installed in the theater and were to become property of the lessor at the termination of the lease. The commissioner, in accordance with the Regulations, determined the depreciated value of the improvements at the end of the ten year lease period and apportioned one-tenth of this as income for each year of the term. The court held that the one-tenth allotted to the first year did not constitute realized taxable gain in that year. The Regulations[25] promulgated after the *Blatt* case have not been changed, probably because the department intends to make them the subject of special treatment.

The *Hewitt* case pointed out that while inseparable improvements could logically be held income, they were not "realized" income within the definition of "realized income" in *Eisner v. Macomber*[26] and therefore are classed as capital accretions.[27] In the *Macomber* case the Court said:

> The fundamental relation of "capital" to "income" has been much discussed by economists, the former being likened to the tree or the land, the latter to the fruit or the crop, the former depicted as a reservoir supplied from springs,

lease, but in view of the language used the court felt itself constrained to hold there was no income upon the termination of the lease.

22. Julia Willms Sloan (1937) 36 B. T. A. 370, in which three members of the board dissented; cf. Emma C. Morphy (1937) 35 B. T. A. 298, in which four members of the board rendered a separate concurring opinion favoring the holding of the majority in the Hewitt case.

23. M. E. Blatt Co. v. United States (1938) 305 U. S. 267.

24. Cleveland Trust Co. (1939) 39 B. T. A. (adv. op.) no. 18; Merkra Holding Co., Inc. (1939) 39 B. T. A. (adv. op.) no. 19; William H. Kirkpatrick (B. T. A. 1938) 1 Prentice-Hall 1939 Fed. Tax Service, par. 6.119.

25. U. S. Treas. Reg. 101, art. 22(a)-13, approved 1939, promulgated under the Rev. Act of 1938.

26. (1920) 252 U. S. 189, 9 A. L. R. 1570.

27. For a good discussion concluding that such increment to value is capital, see Austin, Are Leasehold Improvements Income? (1934) 12 Tax Mag. 469. See also Note (1921) 6 ST. LOUIS LAW REVIEW 26; Developments in the Law (1934) 47 Harv. L. Rev. 1174, 1268. In the Blatt case (1938) 305 U. S. 267, 278, the court said, "So far as concerns taxable income the value of the improvements is not distinguishable from excess, if any there may be, of value over cost of improvements made by lessor. Each was an addition to capital; not income within the meaning of the statute." It should be noted that this language in the Blatt case was *dictum*, and Justice Stone in his separate concurring opinion disagreed with this part of the decision.

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> the latter as the outlet stream, to be measured by its flow during a period of time. * * *[28]

In defining income the Court says:

> "the *gain-derived-from-capital*" * * *. Here we have the essential matter: *not* a gain *accruing* to capital, not a *growth* or *increment* of value in the investment; but a gain, a profit *from* the capital however invested or employed and *coming* in, being "derived," that is, *received* or *drawn by* the recipient [the taxpayer] for his *separate* use, benefit and disposal;—*that* is income derived from property. Nothing else answers the description.[29]

Thus the definition in *Eisner v. Macomber* seems to place strong emphasis on "separation" of income from capital. Similar emphasis was placed upon the "separation" idea in the *Hewitt* case and cases following it; and notably in the *Blatt* case in which the Supreme Court said:

> It does not appear that if detached from the building they [the fixtures] would have any value * * * [at the end of ten years]. If any value is to be attributed to them as of that time, it is included in and not separable from that of the leased premises.[30]

It is generally agreed that if improvements are separable so as to remain property of the lessee, the lessor receives income therefrom only if the lessee abandons them or whenever the lessor actually acquires them.[31] In the *Hewitt* case, Hand, J., does not say whether they are realized income when the lease is made or when the term ends.[32] However, the question of separation was

28. (1920) 252 U. S. 189, 206.
29. 252 U. S. at 207.
30. (1938) 305 U. S. 267, 278.
31. Kentucky Block Coal Co. v. Lucas (D. C. W. D. Ky. 1933) 4 F. Supp. 266. In this case the lessee made improvements to miners' houses which became an integral part of the realty, and also installed a locomotive and tracks in the mine which were removable chattels. The court held that the improvements to the houses became property of the lessor in 1919 when they were completed, and the lessor was charged with their value as income in 1919. However, the court held the locomotive and rails did not become property of the lessor until they were surrendered to him at termination of the lease in 1920, and therefore they could not be taxed as income to the lessor in 1919. To the same effect is G. C. M. 9755 (1931) X-2 Cum. Bull. 120.
32. In United States v. Boston & Providence R. R. (C. C. A. 1, 1930) 37 F. (2d) 670, the court held that the assumption on an obligation by the lessee to discharge the funded debt of the lessor was income to the lessor when the lease was signed. O'Day Inv. Co. (1928) 13 B. T. A. 1230, held that a $20,000 advance payment of rent was income in the year it was received. Cf. Federal Street &. P. V. Passenger Ry. v. Comm'r of Int. Rev. (C. C. A. 3, 1936) 84 F. (2d) 972, holding that assumption of a mortgage due in forty-six years was not income to the assignor until paid and should not be prorated over the forty-six year period.

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not there involved. It is with buildings or improvements, which by their nature, become an inseparable part of the realty to which they attach, that the chief difficulty arises.

It should be noted that the Supreme Court has recently departed materially from the idea of "separation" as a test for determining when income is realized in stock dividend cases. In *Helvering v. Gowran*,[33] a preferred stockholder received a dividend of common stock which he sold back to the corporation at par value. The stockholder contended this was a sale of capital assets and should not be taxed as income. The court, however, held that the dividend was income within the meaning of the Sixteenth Amendment and the proceeds were taxed accordingly. Other cases have held that in order to constitute income under the Sixteenth Amendment property received need not necessarily be separately disposable.[34] In *Cullinan v. Walker*,[35] a Texas corporation with capital stock of the par value of $100,000 was reorganized and its assets were transferred equally to two new corporations which were formed. Cullinan owned 26.64 per cent of the stock of the old corporation for which he had paid $26,640. A holding company was then formed to which was transferred all the stock of the two new corporations. Stock of the holding company and bonds of the two new corporations were distributed *pro rata* among stockholders of the old corporation. The new corporations had no assets other than those received upon liquidation of the old. Cullinan received securities of the aggregate value of $1,598,400 as his *pro rata* share. The court held that when the trustees in liquidation distributed the securities in the three new corporations, Cullinan realized his gain and it became taxable income. It has also been suggested that the true basis for determining income is the nature of the transaction[36] and not the nature of the property or the use to which it may be put. The Supreme Court in *Peabody v. Eisner*[37] held that receipt of property may constitute taxable income. The

33. (1937) 302 U. S. 238; Koshland v. Helvering (1936) 298 U. S. 441, 105 A. L. R. 756; Note (1936) 105 A. L. R. 761. For an analysis of the "separation" test in stock dividend cases, see Note (1938) 51 Harv. L. Rev. 702. Note (1932) 45 Harv. L. Rev. 1072, discusses the limitations on Eisner v. Macomber and points out that the court has apparently abandoned any "definitive concept of taxable income."

34. Cullinan v. Walker (1923) 262 U. S. 134; cf. United States v. Phellis (1921) 257 U. S. 156; Rockefeller v. United States (1921) 257 U. S. 176.

35. (1923) 262 U. S. 134.

36. Magill, *Taxable Income* (1936) 204 ff.; Comment (1935) 30 Ill. L. Rev. 392; Comment (1935) 35 Col. L. Rev. 1320; Rottschaefer, The Concept of Income in Federal Taxation (1929) 13 Minn. L. Rev. 637, 670, where the author also discusses subsidies.

37. (1918) 247 U. S. 347.

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receipt of stock in payment for services has also been held taxable income.[38]

Generally the idea that improvements are accretions to capital rather than income is based on an analogy to increment in value of property resulting from growth of the surrounding neighborhood, or increase in value of a share of stock.[39] In case of improvements by a lessee, however, increase in value does not result from growth of the neighborhood or the gradual increase of a share of stock, but is a result of the acquisition of a physical tangible asset which comes into the hands of the lessor as the result of his business transaction with the lessee.

Upon this analysis it seems clear that there is no clash between the Regulations and the Sixteenth Amendment, nor were the courts shackled by precedent to hold that a denomination of improvements as income was unconstitutional.[40] It is believed that the distinction between improvements by lessees and other types of increment to value of property as pointed out above would justify a holding that improvements to land may be income. This brings us to the real reason behind the courts' holdings that improvements by the lessee do not constitute realized income to the lessor until sold, *viz.*, that of practicability. In cases so holding the courts have emphasized the difficulties encountered in valuation and collection under Regulations similar to those now in effect. It is submitted therefore that the *Blatt* case might possibly have been decided differently had the question arisen under different circumstances,[41] or had there been

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38. Salvage v. Comm'r of Int. Rev. (C. C. A. 2, 1935) 76 F. (2d) 112; Robinson v. Comm'r of Int. Rev. (C. C. A. 6, 1932) 59 F. (2d) 1008. G. C. M. 5866 (1929) VII-1 Cum. Bull. 200, held that the lessor received taxable income from payment by the lessee of a special assessment for constructing a highway. Terre Haute Electric Co. v. Comm'r of Int. Rev. (1933) 67 F. (2d) 697, held that where the lessee paid taxes in accordance with a provision in the lease, the lessor received income in the year in which the obligation arose.

39. Hewitt Realty Co. v. Comm'r of Int. Rev. (C. C. A. 2, 1935) 76 F. (2d) 880, 98 A. L. R. 1201. See also, Austin, Are Leasehold Improvements Income? (1934) 12 Tax Mag. 469.

40. Poe v. Seaborn (1930) 282 U. S. 101, held that constitutional requirements as to the receipt of income are satisfied if the taxpayer has become the owner of property the value of which represents the gain, and that it is properly accountable as income though the owner's possession and use is postponed; cf. Huggitt v. Burnet (1933) 64 F. (2d) 705, which involved gains from sales of stock by a legatee taking a vested remainder on the death of testatrix. The court held the gain was determinable on the basis of the fair market value of the stock at the time of testatrix' death in 1912 or on the date set by law, whichever was greater, and not the value at the date of distribution or death of the life tenant.

41. In the Blatt case (1938) 305 U. S. 267, the government contended that if it is assumed that improvements made by lessee which will outlast

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a satisfactory method of fairly ascertaining the amount of income.[42]

If it is not a violation of the constitution to call improvements income, when is income realized and how should it be returned? An analysis of the Regulations, the constitutionality of which is questioned, suggests a classification of the cases into two groups: (1) where the improvements materially enhance the value of the realty to such an extent that their value will outlast the lease, in which case the lessor naturally expects to realize some benefit therefrom; and (2) where the improvements are such or the term of the lease is so long that any material enhancement in the value of the property will disappear before the term has run, but where for some reason the lease is terminated or forfeited before expiration of the named term and the lessor comes into possession of valuable improvements which he never expected to receive.

The statute, though frequently repassed and though amended materially in other phases, has remained substantially the same so far as it affects the problem here involved. Despite similarity of the statutes the policy of the Treasury Department, as evidenced by its Regulations, has fluctuated in what was, perhaps, an unwise attempt to follow too closely the courts'

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the term constitute income to the lessor at some time, the question is whether such income is realized upon (1) completion of the improvements, (2) termination of the lease, or (3) disposition of the improved property, and that the "soundest theory seems to be that such income is taxable at the time the improvements are erected." The Court said, "We are not called on to decide whether under any circumstances income is received by lessor by reason of improvements made by lessee, nor to choose, for general approval or condemnation, any of the theories expounded by the United States. Concretely, the question presented is whether, under the lease here involved, one-tenth of what the commissioner and taxpayer call and agree to be 'estimated depreciated value,' as of the end of the term, was income to petitioner in the first year of the term." 305 U. S. at 276.

42. (1938) 305 U. S. 267, 278, the Court said, "The findings fail to disclose any basis of value on which to lay an income tax or the time of realization of taxable gain, if any there was. The figures made by the commissioner are not defined. The findings do not show whether they are intended to represent value of improvements if removed or the amount attributable to them as a part of the building.

"* * * present or future value, however, ascertained, is single in substance; it cannot be arrived at by mere summation of actual or estimated cost of constituent elements, new or depreciated. The addition to value of the leased premises resulting from the lessee's improvements may not be arrived at by formula or arithmetically by merely setting against each item or element its cost less depreciation estimated to accrue during the term of the lease. The amount included in the total value of the structure reasonably to be attributed to the improvements after use for ten years is not ascertainable by the simple calculation employed by the commissioner."

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decisions. At first, the Commissioner of Internal Revenue treated improvements as income to the lessor to the extent of their fair market value at the termination of the lease.[43] The decision in *Miller v. Gearin,*[44] however, was against the Regulations of the Treasury Department. In the *Miller* case the lessor, in 1907, leased premises for a term of 23 years. In accordance with the lease contract, the lessee erected a new building completed in 1907. In 1916 the lessee defaulted and the lessor repossessed the property. The collector accordingly assessed the lessor for the value of the building in 1916 as income for that year. The Circuit Court of Appeals, however, held that the lessor acquired nothing in 1916 except possession of that which for many years had been her own, and possession so acquired was not income. The court further stated that assuming the building was income it was "derived" when the completed building was added to the realty. Following the *Miller* case, a Federal District Court decided *Cryan v. Wardell,*[45] in which also the lessee had erected a building as required in the lease. The building was completed in 1910 and the lease was for a term of 26 years. The lessor repossessed the property in 1916 and the value of the building was assessed against him as income for that year. The court held the lessor received no income in 1916 and any accession of value accrued in 1910 when the building was completed.

After denial of certiorari in the *Miller* case,[46] the Regulations were changed[47] so that the lessor was considered to receive income at the time improvements were completed, to the extent of the fair market value thereof subject to the lease. These new Regulations also contained suitable provisions for adjustment in the event the improvements were destroyed, or if the lessor obtained possession before the term expired. There was no es-

43. T. D. 2135 (1917) 19 T. D. Int. Rev. Laws 25; T. D. 2442 (1917) 19 T. D. Int. Rev. Laws 26; U. S. Treas. Reg. 53, art. 4, approved 1917, promulgated under the Rev. Act of 1916, as amended 1917; and, to the same effect, U. T. Treas. Reg. 45, art. 48, approved 1918, promulgated under the Rev. Act. of 1918.

44. (C. C. A. 9, 1919) 258 Fed. 225.

45. (D. C. N. D. Cal. 1920) 263 Fed. 248.

46. (1919) 250 U. S. 667. The Blatt case does not cite either Miller v. Gearin or Cryan v. Wardell, and whether the Supreme Court would agree with them if a similar question were presented is a matter of conjecture. See quotation from the Blatt case, supra, note 41.

47. U. T. Treas. Reg. 45, art. 48, approved 1929, promulgated under the Rev. Act of 1918, as amended by T. D. 3062 (1920) III-2 Cum. Bull. 199. See Note (1921) 6 ST. LOUIS LAW REVIEW 26, which concludes that these Regulations are invalid because the method of valuation of the income was speculative and impractical.

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sential change until Regulations 62, Article 48,[48] were approved, under which an alternative method of returning income was first provided. The taxpayer could either return the fair market value of the improvements subject to the lease as income in the year in which such improvements were annexed to the property, or he could divide such value by the number of years which the lease had to run and return an aliquot part in each year, thus spreading the income over the term of the lease.[49] No material changes were made in the Regulations on this point until the approval of Regulations 86, Article 22 (a)-13.[50] The former Regulations[51] provided that the lessor received income when improvements were made "in pursuance of an agreement with the lessor." As a result it was the contention of many taxpayers that improvements were not income under the Regulations unless the lease required them to be made, and that where they were optional or voluntary by the lessee they were not income.[52] In Regulations 86, Article 22 (a)-13, and subsequent Regulations, including the most recent ones,[53] that language has been omitted, making it clear that the department meant to draw no distinction between improvements provided for in the lease and those voluntarily made by the lessee.[54]

It should be noted that both the *Miller* and *Cryan* decisions, according to which the department altered its Regulations, were cases in which improvements were completed before ratification of the Sixteenth Amendment and any statements in them indicating that income was actually received by the lessor upon completion of the improvements were *dicta*. It is the opinion, therefore, of most writers and a few courts that the *Miller* and

48. Approved 1922, promulgated under the Rev. Act. of 1922, amended by T. D. 4280 (1929) VIII-2 Cum. Bull. 285.

49. G. C. M. 550 (1926) V-2 Cum. Bull. 155. It would seem that the provision for an alternative method of returning the income does not affect the constitutionality of the Regulations. The situation cannot be improved by having more than one horn to the dilemma. On the other hand, conditions upon persons exercising the option would not make the regulations unconstitutional because they are, in a sense, the price paid for the option. In this connection note also that once it is established that there is a tax liability, the courts will give a wide latitude to the time and method of collection. Tappan v. Merchants' Nat. Bank (U. S. 1873)19 Wall. 490; Witherspoon v. Duncan (U. S. 1866) 4 Wall. 210.

50. Approved 1934, promulgated under the Rev. Act of 1934.

51. U. S. Treas. Reg. 77, art. 63, approved 1933, promulgated under the Rev. Act of 1932.

52. Everett U. Crosby (1926) 4 B. T. A. 1147; Henry I. Brown (1926) 4 B. T. A. 1129.

53. U. S. Treas. Reg. 101, art. 22(a)-13, approved 1939, promulgated under the Rev. Act of 1938.

54. G. C. M. 10969 (1932) XI-2 Cum. Bull. 64; W. H. Martin (1931) 24 B. T. A. 813.

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Cryan cases really only held that the lessor received no income at the termination of the lease.[55] In any event it seems clear that under these cases it could never be held that the lessor received income at the termination of the lease. However, in *Appeal of Gilbert Butler*,[56] the Board of Tax Appeals took a contrary view and held that where a lease was to run during the life of a mine so that at the natural termination of the lease any tunnels, shafts, etc., which the lessee might build would be valueless, the lessor received income to the extent of the value of such development work in the mine when the lease was prematurely terminated. After the *Butler* case the Regulations were amended[57] to contain substantially the same language as is found in the present Regulations, which provides:

> Except in cases where the lessor has reported income upon basis (a), if the lease is terminated so that the lessor comes into possession or control of the property prior to the time originally fixed for the expiration of the lease, the lessor * * * *derives income, to the extent that the value thereof exceeds the amount already reported.*[58]

55. Julian B. Hart (1938) 37 B. T. A. 360, nonacquiescence (1938) XVII-1 Cum. Bull. 44; Hilgenberg v. United States (D. C. D. Md. 1937) 21 F. Supp. 453; Hewitt Realty Co. v. Comm'r of Int. Rev. (C. C. A. 2, 1935) 76 F. (2d) 880, 98 A. L. R. 1201; Comment (1935) 30 Ill. L. Rev. 392; Note (1921) 6 ST. LOUIS LAW REVIEW 26; Austin, Are Leasehold Improvements Income? (1934) 12 Tax Mag. 469, points out that the sole question was whether the improvements were income when the lease was terminated. The court was very careful in the Miller case (C. C. A. 9, 1919) 258 Fed. 225, 226, to say, "assuming that the building was income derived from the use of the property * * *." Likewise in the Cryan case (D. C. N. D. Cal. 1920) 263 Fed. 248, 249, the court was careful to say, "whatever accession of value resulted * * *." In view of the circumstances this interpretation of the Miller and Cryan cases seems more sound. However, there is an abundance of authority to the contrary, Julia Willms Sloan (1937) 36 B. T. A. 370; Emma C. Morphy (1937) 35 B. T. A. 289; Louise C. Slack (1937) 35 B. T. A. 271; Hewitt Realty Co. v. Comm'r of Int. Rev. (C. C. A. 2, 1935) 76 F. (2d) 880, 98 A. L. R. 1201; G. C. M. 9755 (1931) X-2 Cum. Bull. 120; United States v. Boston & P. R. R. (C. C. A. 1, 1930) 37 F. (2d) 670; Shelby D. Scott (1928) 9 B. T. A. 1219; Joseph L. B. Alexander (1928) 13 B. T. A. 1169. In the Blatt case (1938) 305 U. S. 267, 280, the Court said: "But, assuming that at some time value of the improvements would be income of the lessor, it cannot be reasonably assigned to the year in which they were installed."

56. (1926) 4 B. T. A. 756.

57. U. S. Treas. Reg. 45, art. 48, approved 1921, promulgated under the Rev. Act of 1918, amended by T. D. 4279 (1929) VIII-2 Cum. Bull. 286; U. S. Treas. Reg. 62, art. 48, approved 1922, promulgated under the Rev. Act of 1921, amended by T. D. 4280 (1929) VIII-2 Cum. Bull. 285; U. S. Treas. Reg. 65, art. 48, approved 1924, promulgated under the Rev. Act. of 1924, amended by T. D. 4281 (1929) VIII-2 Cum. Bull. 244; U. S. Treas. Reg. 69, art. 48, approved 1926, promulgated under the Rev. Act. of 1926, amended by T. D. 4282 (1929) VIII-2 Cum. Bull. 82.

58. U. S. Treas. Reg. 101, art. 22(a)-13, approved 1939, promulgated under the Rev. Act. of 1938 (italics supplied).

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The *Butler* case, though apparently inconsistent with the *Miller* and *Cryan* decisions and the amended Regulations, was allowed to stand until the decision of the Board of Tax Appeals in *Louise C. Slack*,[59] which overruled the *Butler* case.[60] In the *Slack* case the lease was for 99 years. The lessee erected a building which had an estimated life of from 40 to 50 years. Six years after completion of the building the lease was terminated and the lessor went into possession. The Board held that the building would have had no value at the end of the 99 year lease period and therefore he derived no income by reason of the termination of the lease prior to the time originally fixed.[61] A number of decisions in accord with the *Slack* case have been handed down.[62]

In the light of these decisions it seems safe to conclude that where the nature of improvements is such, or the lease is so long, that they would have no material value at the end of the term, the lessor definitely does not realize income upon premature termination of the lease by which he obtains possession and enjoyment of valuable improvements which he did not expect because they would have been valueless had the lease

59. (1937) 35 B. T. A. 271.

60. For a discussion of the situation before the Slack case (1937) 35 B. T. A. 271, see Austin, Are Leasehold Improvements Income? (1934) 12 Tax Mag. 469.

61. In the Blatt case there was no premature termination of the lease and the decision throws no light on what the Court would hold in such a case. In conjunction with this, the practicability of charging a lessor with income at time of completion of improvements should be further noted. Suppose a sixty year old lessor leases property for a forty year term. Assuming that the lessee makes improvements which will still be valuable at the end of forty years, may the lessor reasonably expect to derive benefits therefrom during his lifetime? In Birdie Parr Marshall v. Seldon R. Glenn (D. C. W. D. Ky. 1939) 1 Prentice-Hall 1939 Fed. Tax Serv. par. 5.252, the lessor was past seventy years of age and the lease still had thirty years to run; cf. Nicollet Associates Inc. (1938) 37 B. T. A. 350.

62. F. S. Stimson Corp. (1938) 38 B. T. A. (adv. op.) no. 43, in which the Slack case is expressly followed; Durdheimer Inv. Co. (1937) 36 B. T. A. 423; Myer Dana (1934) 30 B. T. A. 83. In Cincinnati Gas & Electric Co. (1937) 36 B. T. A. 1122, the lessor leased its plant under a 99 year lease which required the lessee to make repairs, to pay for renewals and replacements, and to make expenditures for additions and betterments, the value of which greatly exceeded losses resulting from depreciation. Held, lessor was not entitled to deduction for depreciation in the taxable year 1923-1925. Although the value of additions greatly exceeded depreciation, the Board did not hold that the lessor realized income. The question of income seems not to have been raised by the Commissioner, probably because the lease was for 99 years during which time all additions and betterments would have become valueless, and probably would have been replaced several times; cf. Boca Ratone Co. v. Comm'r of Int. Rev. (C. C. A. 3, 1936) 86 F. (2d) 9; Eggerman Inv. Co. (1937) 36 B. T. A. 1196.

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run its regular term. However, under the latest Regulations[63] and the last mentioned decisions, there seems to be a single exception to what seems to this writer to be the correct interpretation of the *Cryan* and *Miller* decisions. That exception occurs where the nature of the improvements is such, or the term of the lease is so short, that the lessor would obtain possession of valuable increment to his property at the natural expiration of the lease.

Under the provisions of present Regulations it is apparent that where a taxpayer elects to report income upon basis (b) or (c)[64] and the improvements would have value at the natural termination of the lease, and the lease is prematurely terminated, the lessor receives taxable income in the year of termination in an amount equal to the difference between the amount already reported and the fair market value of the improvements at date of termination. This could apparently be avoided by reporting income upon basis (a). This raises the question of the consistency between the Regulations and the holdings thereunder, and the *Miller* and *Cryan* cases.[65] The *Miller* and *Cryan* cases held that the lessor does not receive taxable income at the termination of the lease. In both the *Cryan* and *Miller* cases the terms of the leases were less than the probable life of improvements and the leases were prematurely forfeited. The court held there was no income at the time of forfeiture. The Regulations therefore seem to put too narrow a construction on the decisions of these two cases. A distinction based on whether basis (a), or basis (b) or (c), is used for reporting income is unjustifiable. Also, it seems illogical to distinguish between cases where the lessor gets possession of valuable improvements which he would not have gotten had the lease not been prematurely terminated, and cases where the lessor merely receives improvements which he always expected to get while they were still valuable, but which, because of premature termination of the lease, have a greater value when he comes into possession than he had expected. It is submitted that in order to be in harmony with *Miller v. Gearin* and *Cryan v. Wardell*,

63. U. S. Treas. Reg. 101, art 22(a)-13, approved 1939, promulgated under the Rev. Act of 1938.

64. U. S. Treas. Reg. 101, art. 22(a)-13, approved 1939, promulgated under the Rev. Act of 1938, quoted supra, p.

65. Note that while the latest Regulations were promulgated after the Blatt case, it is not to be presumed that the Treasury Department intended them to reflect the holding in that case. Probably the Regulations will be amended and Article 22(a)-13, will be made the subject of special treatment by the department.

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the Regulations should provide that the lessor does not realize income upon the termination of the lease under any circumstances.

They, then, would leave two other possible times at which the lessor could be considered as having realized income, *viz.*, upon completion of improvements, or upon sale of the property.[66] It cannot be disputed that the lessor does realize income upon sale of the property.[67] Therefore the only question disputed under the present state of the Regulations is as to realization of income at the time improvements are completed, or possibly at the time of premature termination where the improvements would have retained their value beyond natural expiration of the lease.

Practically, this is a bad situation, for were it reversed, *viz.*, if the lessor received no income upon erection of the improvements, but did receive income upon termination of the lease, the practical problems could be dealt with more easily. Problems in the administration of the tax as the Regulations now stand revolve chiefly around the difficulty of computing the future value of improvements.[68] In determining future values the courts are rightly reluctant to accept depreciation tables which may prove incorrect by the passage of time or extraordinary circumstances.[69] This difficulty becomes most troublesome when there is a renewal clause, for how can value at the end of the lease be determined when it is not known how long the lease may run?

Realizing the extreme difficulty presented in attempting to administer the provisions of the Regulations in such a case, a General Counsel's memorandum opinion[70] was handed down holding that the taxpayer derived no taxable income upon completion of the building and other improvements erected by the

66. When the property is sold, however, it is not the improvements themselves which constitute income, but the amount actually received over and above the tax base. Thus a certain improvement may add $10,000 to the value of the property, and may increase the selling price by $10,000, and yet may not be taxable income if the amount received on sale does not exceed the tax base.

67. M. E. Blatt Co. v. United States (1938) 305 U. S. 267; Hilgenberg v. United States (D. C. D. Md. 1937) 21 F. Supp. 453; Hewitt Realty Co. v. Comm'r of Int. Rev. (C. C. A. 2, 1935) 76 F. (2d) 880, 98 A. L. R. 1201.

68. M. E. Blatt Co. v. United States (1938) 305 U. S. 267. See the dissenting opinion of Arundell in Emma C. Morphy (1937) 35 B. T. A. 289; Hewitt Realty Co. v. Comm'r of Int. Rev. (C. C. A. 2, 1935) 76 F. (2d) 880, 98 A. L. R. 1201.

69. Comment (1938) 51 Harv. L. Rev. 1113; cf. Burnet v. Logan (1931) 283 U. S. 404.

70. G. C. M. 6982 (1929) VIII-2 Cum. Bull. 190.

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lessee where the lease contained an option for three renewals.[71] It should be noted here that in the facts there considered, the lease provided that the title to the building and improvements should remain in the lessee until termination of the lease. However, a similar agreement was involved in the case of *Joseph Alexander*,[72] decided prior to the above memorandum opinion, and the Board of Tax Appeals held that the building became part of the realty, title vested immediately in the lessor, and the oral agreement was not considered sufficient to divest the lessor of such title.[73] In the *Cataract Ice Co.* case,[74] the lease was for five years with a renewal option. The Commissioner determined the value of the building at the end of the five year period and apportioned it as income over each of the five years. The Board of Tax Appeals upheld the Commissioner's action, but in that case the petitioner did not question the Commissioner's prorating the value over the five year period, but contended that it had received no income because obsolescence and uniqueness would make the building valueless at termination of the lease. In his separate concurring opinion in the *Hewitt* case, Judge Chase held that value of the building at termination of the lease could not correctly be determined unless consideration were given to the lessee's right to renew.[75] In the case of *Julian B. Hart*[76] the Board of Tax Appeals held that where the exercise of a renewal option would exhaust the useful life of the building, the question of taxable income realized by the lessor cannot be determined until the lessee decides whether to renew under the option. The Board distinguished this case

71. In W. H. Martin (1931) 24 B. T. A. 813, there was no provision in the lease as to how long it should run and the Board held the lessor received income to the full value of the improvements when they were completed.

72. (1928) 13 B. T. A. 1169.

73. It is submitted that in speaking of the title the actual effect of all the provisions of the lease should be considered and not merely a statement between the parties. Cf. condemnation proceedings in which persons having leasehold interests are considered owners within the meaning of condemnation statutes and entitled to a part of the compensation; Note (1934) 98 A. L. R. 254, 258.

74. (1931) 23 B. T. A. 654.

75. Cf. Bonwitt Teller and Co. v. Comm'r of Int. Rev. (C. C. A. 2, 1931) 53 F. (2d) 381; Millinery Center Building Corp. v. Comm'r of Int. Rev. (C. C. A. 2, 1934) 73 F. (2d) 1007. In these cases the taxpayer was the lessee. The leases contained renewal options, but the court held it was error to extend beyond the initial term of the lease the period over which exhaustion of its value as of March 1, 1913, was to be spread. The court pointed out that the renewal privilege might never be exercised. Cooper, Changes in Federal Tax laws and Important Recent Tax Rulings (1936) 14 Tax Mag. 135, 141, says the Bureau is following the Millinery Center Building Corp. case, supra.

76. (1938) 37 B. T. A. 360.

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from the *Morphy*[77] and *Sloan*[78] cases, in which it expressly refused to follow the *Hewitt* case, on the ground that no renewal options were there involved. Thus, though the Board, even before the decision of the Supreme Court in the *Blatt* case, had insisted that the Regulations were valid yet it recognized the difficulty of administration where renewal options were involved and held they did not apply to such cases.[79] This still leaves the practical objection against making the lessor pay a tax on a speculative estimate. The *Hewitt* case has been followed by the lower Federal courts. Thus in *English v. Bitgood*,[80] where the lease contained no renewal option, the court held that the element of uncertainty brought about by the renewal option

> is not present in the case at bar, but while that uncertainty apparently had some influence on the decision [in the *Hewitt* case] it was not the basic reason for the conclusion reached, and I believe the decision would have been the same if it had been absent.[81]

This opinion is cited by the Supreme Court in the *Blatt* case in which also no renewal option was involved.

From time to time the Board and the courts have considered other factors as important in determining whether improvements constitute income before the sale of the property. In some cases it is insisted that improvements are additional rents,[82] and rent constitutes income regardless of what form it takes.[83] It has been suggested, however, that improvements are not rent,[84] and in the *Blatt* case the Court said, "Even when required, improvements by lessee will not be deemed rent unless intention that they shall be is plainly disclosed."[85] Then quoting from *Duffy v. Central R. R.*,[86] the Court said:

> [rent is] "a fixed sum, or property amounting to a fixed

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77. Emma C. Morphy (1937) 35 B. T. A. 289.
78. Julia Willms Sloan (1937) 36 B. T. A. 370.
79. The Court of Claims in the Blatt case (1938) 87 Ct. Cl. 413, 23 F. Supp. 461, distinguishes the Hewitt case because of the presence of a renewal option in the latter. In the Blatt case the lease contained no renewal option.
80. (D. C. D. Conn. 1938) 21 F. Supp. 641.
81. 21 F. Supp. at 643.
82. Maurice Cross (1931) 24 B. T. A. 1079.
83. See supra, note 38.
84. Austin, Are Leasehold Improvements Income? (1934) 12 Tax Mag. 469, states that improvements do not come within the economists' definition of rent and that following the theory to its logical conclusion "would always result in a balance of rent to take into income upon a premature termination of the lease." This result would be contrary to the Miller and Cryan cases, which held that there can be no income upon forfeiture.
85. (1938) 305 U. S. 267, 277.
86. (1925) 268 U. S. 55, 63.

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> sum, to be paid at stated times for the use of property; * * * it does not include payments, uncertain both as to amount and time, made for the cost of improvements * * *."[87]

It may be, under the particular facts of the *Blatt* case, and especially since the Commissioner failed to prove values sufficiently, that the decision would have been the same even though improvements had specifically been called rent. However, in view of the language in the *Blatt* case, it would seem that improvements would be considered income in a proper case where circumstances were consistent with a clearly evidenced intention to pay rent by means of improvements, and where values were clearly proved.

It would seem that practical objections, even where no renewal clause is involved, justify the courts' finding that the present Regulations are unconstitutional. Of the three times at which improvements by a lessee might conceivably become realized income to the lessor, (1) at the time of the completion, (2) at the termination of the lease, and (3) at time of sale or exchange of the property, the first, which has been adopted by the Regulations, is most vulnerable to practical objections.

By holding that income is realized only when property is sold, the courts have avoided the uncertainties inherent in determining the value of a certain improvement a given number of years hence. That holding also avoids the problem of valuation of improvements at the time the lease is terminated. However, there is one difficulty with holding that income is realized only when the property is sold or exchanged, namely, that it affords opportunity for tax avoidance. Suppose, for example, that *A* owns a tract of land upon one part of which there is a building with a reasonable rental value of $10,000 per year. The other part of the tract is vacant. *A* could lease the entire tract to a contractor for two years upon the consideration that the contractor erect a $20,000 house on the vacant part of the tract. In two years *A* would get the land back with the $20,000 house. Obviously *A* has been enriched by a $20,000 house, but under the holding that he does not realize income therefrom until a sale he could escape taxation if he did not sell the property.

Assuming the holding that income is realized only on sale of the property to be objectionable on the above ground, and that the courts are justified in holding that improvements cannot be realized income at the time of completion on the ground that the tax would be based on an indefinite estimate of future value, the objections to holding that improvements constitute income

87. (1938) 305 U. S. 267, 277.

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at the termination of the lease should be considered. It is true that the *Miller* and *Cryan* cases held the lessor derived no income at the termination of the lease, but those are not decisions by the Supreme Court of the United States. Neither of those cases was cited in the *Blatt* case, and that they might not be followed is indicated by the following language:

> The leased property is capable of inventory and analysis for the purpose of ascertaining original and estimated present costs of its elements and other relevant facts as indications of worth to be taken into account in determining its value, i. e., the money equivalent of the property as a whole. But present or future value, however ascertained, is single in substance; it cannot be arrived at by mere summation of actual or estimated cost of constituent elements, new or depreciated.[88]

Nowhere in the opinion did the court state that the lessor could not realize income until there was a sale of the property. It is believed that the real gist of the *Blatt* case is in the following words:

> The addition to value of the leased premises resulting from the lessee's improvements may not be arrived at by formula or arithmetically by merely setting against each item or element its cost less depreciation estimated to accrue during the term of the lease. The amount included in the total value of the structure reasonably to be attributed to the improvements after use for ten years is not ascertainable by the simple calculations employed by the commission.[89]
>
> But, assuming that at some time value of the improvements would be income of lessor, it cannot be reasonably assigned to the year in which they were installed.[90]

It is possible, therefore, that the Supreme Court may uphold a Regulation that the lessor derives income from improvements either at the termination of the lease or upon a sale of the property, whichever occurs first, and that such income be computed by the excess, if any, of the amount received upon the sale, or of the estimated value of the property at the end of the lease,

88. 305 U. S. at 278. That part of this quotation which states that value, however ascertained, is single in substance, must probably be taken as holding that in the process of such valuation the improvements should not be considered separate and apart from the land or building to which they attach, but the whole (land, buildings, and improvements) must be considered as a unit. This means the procedure would be similar to that followed where the property is sold. The tax would be based, not upon the specific amount added by the improvements, but upon any excess of the estimated value at the end of the lease term over and above the tax base.

89. Id. at 279.

90. Id. at 280.

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over and above the tax base. It is true that in cases where the property is not sold this would involve the difficulty of estimating the value at the end of the term,[91] but at least it is free of the hazards of estimating future values and depreciation. Also, the question of income would not be affected by the question of whether improvements are required by the terms of the lease. Premature termination would present no particular difficulty. Whether improvements were separable, or whether title remained in the lessee, would present no problems. The valuation would include everything left on the land at the termination of the lease. However, the doctrine that a mere increase in value, not consummated by a sale or otherwise severed, does not constitute taxable income may effectually prevent adoption of the solution outline above. It would appear that at present the Board of Tax Appeals is of opinion that such doctrine will prevent the outlined solution. Such a result would appear regrettable because on practical grounds the solution outlined seems to this writer to be the most logical way out of a difficult situation.[92]

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91. In view of what the courts have allowed in the line of estimates in some other tax problems it seems that this would not be a fatal objection. Under the Income Tax law when property is sold the profit or income upon which the tax is based is the difference between the selling price and cost or estimated market value on March 1, 1913. It has also been suggested that the fact that the lessor receives nothing separable and tangible which he can sell in order to obtain the money with which to pay the tax is an objection, but in a number of cases where the lessee paid taxes or assumed an obligation of the lessor this objection was passed over without consideration.

92. Cf. Revenue Act of 1932, 48 Stat. 694, (1935) 26 U. S. C. A. sec. 44 (d), which provides, "If an installment obligation is satisfied at other than its face value a distributed, transmitted, sold or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and (1) in case of satisfaction at other than face value or a sale or exchange, the amount realized * * *." The court applied this provision in Boca Ratone Co. v. Comm'r of Int. Rev. (C. C. A. 3, 1936) 86 F. (2d) 9, in which land was sold on an installment contract. The taxpayer purchased the land at a cost of $54,244 and the selling price was $78,750. Had the contract been fulfilled a net gain of $24,506 would have been realized by the taxpayer. The purchasers paid half the price and the taxpayer made return of half the profit and paid tax thereon. Then the purchasers defaulted and the taxpayer repossessed. Land values had dropped so low that at repossession the land was worth less than its approximate cost to the taxpayer at that time. The court held that the return of the land was a satisfaction at other than face value and therefore the amount realized was the amount paid under the contract, less taxes paid on the profit previously reported, plus *estimated value of the premises at time of repossession,* less original cost to the taxpayer. In Eggerman Inv. Co. (1937) B. T. A. 1196, the purchaser made improvements under an executory contract of sale and later defaulted. The Board followed the Boca Ratone case, and the determination of taxable gain therefore involved a determination of the fair market value of the property at the time of repossession. These decisions were cited in Walter F. Haass (1938) 37 B. T. A. 948.

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