12 T.C. 801 (1949)

The basis of property for depreciation purposes includes the full amount of outstanding tax liens at the time of acquisition, even if the purchaser later buys those liens at a discount.

Summary

Blackstone Theatre Co. acquired real estate with a theatre building in 1941, subject to significant tax liens. The company initially included the full amount of these liens in the property's cost basis for depreciation. In 1946, Blackstone purchased the outstanding tax liens at a discounted rate. The Commissioner of Internal Revenue reduced the company's basis for depreciation for years before 1946, arguing only the amount spent to acquire the liens should be included. The Tax Court held that the original basis should include the full amount of the liens, aligning with the Supreme Court's decision in *Crane v. Commissioner*.

Facts

In 1941, Blackstone Theatre Co. (formerly Slavin Amusement Co.) purchased land and a building in Chicago, known as the Blackstone Theatre Building.

At the time of purchase, the property was subject to outstanding tax liens totaling $120,950.03, representing unpaid real estate taxes and penalties from 1929 to 1940.

Blackstone did not have sufficient funds to purchase the liens until 1945, when new investors acquired half of the company's stock and agreed to provide the necessary funds.

In 1946, Blackstone purchased the outstanding tax liens at a public sale for $50,220.77, and also incurred $13,000 in legal and title fees related to the acquisition.

The company initially recorded the property's cost on its books, including the full amount of the outstanding tax liens in addition to the cash paid to the vendor.

Procedural History

The Commissioner determined deficiencies in Blackstone's income tax for the years 1942, 1943, and 1944, and in excess profits tax for 1943.

The Commissioner reduced the basis for depreciation, leading Blackstone to petition the Tax Court.

The Tax Court addressed the single issue of the proper basis for depreciation before the purchase of the liens in 1946.

Issue(s)

Whether the basis of property for depreciation purposes should include the full amount of tax liens outstanding at the time of acquisition, or only the amount subsequently paid to purchase those liens at a discount.

Holding

Yes, because the basis for depreciation includes liens on the property, even if the taxpayer did not personally assume the liability, and the depreciation allowance should be computed on the full amount of this basis, consistent with *Crane v. Commissioner*.

Court's Reasoning

The Tax Court relied heavily on the Supreme Court's decision in *Crane v. Commissioner*, which established that the basis of property includes liens, even if not personally assumed by the taxpayer, and depreciation should be calculated on this full basis.

The court reasoned that Blackstone acquired the property subject to the tax liens, and the price paid to the vendor reflected the burden of these liens. The later purchase of the liens at a discount did not retroactively alter the original basis.

The court emphasized the administrative difficulties that would arise if the Commissioner's approach were followed, particularly concerning the statute of limitations for reopening earlier tax years.

Additionally, the court stated that the Commissioner's position would violate the principle that depreciation deductions should be determined based on conditions known to exist at the end of the period for which the return is made.

The court distinguished the case from scenarios where the property's value is less than the lien amount, noting that there was no evidence to suggest the property was worth less than the outstanding liens when acquired.

Practical Implications

This case clarifies that when acquiring property subject to existing liens, the initial basis for depreciation includes the full amount of those liens, regardless of any subsequent discounted purchase of the liens by the property owner.

This ruling prevents retroactive adjustments to the basis for depreciation, ensuring consistency in tax treatment based on the facts known at the time of acquisition. It simplifies tax planning by avoiding the need to recalculate depreciation deductions based on later transactions.

The decision highlights the importance of the *Crane* doctrine in determining the basis of property and its implications for depreciation, influencing how tax advisors counsel clients on property acquisitions involving existing debt or liens.

It reinforces the principle that the tax basis reflects economic reality at the time of acquisition, preventing taxpayers from obtaining a double benefit by depreciating the full value of the property and later reducing their basis based on discounted debt satisfaction.