### *Midler Court Realty, Inc. v. Commissioner, 61 T. C. 590, 1974 U. S. Tax Ct. LEXIS 158, 61 T. C. No. 63 (1974)*

The useful life of commercial buildings for depreciation purposes is determined by their physical and economic life, not by the terms of existing leases.

**Summary**

Midler Court Realty, Inc. purchased 19 buildings in an industrial park, subject to leases with varying terms. The company sought to amortize part of the purchase price over the initial lease terms and claimed a shorter useful life for depreciation. The IRS determined a 40-year useful life from the date of acquisition. The Tax Court held that the useful life for depreciation purposes was 33 1/3 years from acquisition, rejecting the taxpayer's attempt to amortize part of the cost as a separate asset. The decision emphasized that the entire purchase price must be depreciated over the buildings' useful life, not segmented based on lease terms.

**Facts**

Midler Court Realty, Inc. , and its subsidiaries purchased 19 buildings in the Syracuse Industrial Park for $11,983,661 on November 30, 1961. The buildings were leased to various tenants, including General Electric, with leases having initial terms ranging from 2 to 25 years, followed by renewal options at reduced rates. The petitioners initially claimed depreciation over 15 years using the declining balance method. After audit, they argued that part of the purchase price should be amortized over the initial lease terms due to 'excess' rentals and that the remaining cost should be depreciated over the lease terms including renewals.

**Procedural History**

The IRS determined deficiencies in corporate income taxes for the years 1962-1968, asserting a 40-year useful life for the buildings. Midler Court Realty filed petitions with the U. S. Tax Court, later amending to argue for amortization of part of the purchase price and a shorter useful life. The case was heard by Judge Quealy, who issued the opinion on January 31, 1974.

**Issue(s)**

1. Whether any part of the purchase price paid for properties leased to General Electric may be amortized over the initial terms of the leases due to 'excess' rentals.
2. What is the remaining useful life of the buildings for purposes of determining a reasonable allowance for depreciation under section 167 for the taxable years 1962 to 1968?

**Holding**

1. No, because the purchase price cannot be segmented into a separate amortizable

interest based on lease terms. The entire cost must be considered as the basis for the buildings and depreciated accordingly.
2. The useful life of the buildings was determined to be 33 1/3 years from the date of acquisition, as this reflects their physical and economic life, not influenced by the terms of existing leases.

**Court's Reasoning**

The court rejected the petitioners' attempt to allocate part of the purchase price to the value of the leases, citing prior decisions and the legal concept of real property ownership. The court noted that the petitioners purchased the fee simple interest, which included the right to receive rents and the right to possession after lease expiration. The court applied section 167, which allows depreciation deductions based on the useful life of the property, not segmented based on lease terms. The court considered the physical and economic life of the buildings, rejecting arguments about economic obsolescence due to the large space leased to General Electric. The court found that the IRS's determination of a 40-year life was overly conservative and settled on 33 1/3 years from the date of acquisition as more appropriate, considering obsolescence factors.

**Practical Implications**

This decision clarifies that the cost of commercial real estate cannot be segmented into amortizable leasehold interests when calculating depreciation. Taxpayers must consider the entire purchase price as the basis for depreciation over the useful life of the buildings, regardless of lease terms. This ruling impacts how real estate investors structure their tax planning around leased properties, emphasizing the need to assess the physical and economic life of assets. Subsequent cases have followed this principle, reinforcing that lease terms do not dictate depreciation schedules. For businesses, this decision means careful consideration of property valuation and depreciation strategies when acquiring leased commercial real estate.