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The New Treatment of Real Estate Tax Shelter Losses Resulting From Deeds in Lieu of Foreclosure

In *Crane v. Commissioner*,¹ the 1947 seminal tax decision of the Supreme Court of the United States, the Court required Mrs. Crane to include in both the basis of her property and the amount realized upon disposition of that property the amount of nonrecourse debt encumbering her apartment building and lot. Taxpayers, however, have since seized the sword that slew Mrs. Crane and have impaled the Internal Revenue Service (I.R.S.) on countless occasions with the operation of tax shelters. Tax shelters, in the context of this note, are investments designed to produce tax deductions for high-bracket taxpayers to offset their income from other sources.² Conflicting decisions by the courts demonstrate that neither the I.R.S. nor the judicial system has devised a method to deal in a reliable and predictable manner with the problems presented by real estate tax shelters.

This note examines the income tax treatment of a mortgagor when, upon the failing of a tax shelter,³ he voluntarily conveys back to the mortgagee property subject to a nonrecourse mortgage and realizes a loss on the transfer. Part I examines the tax shelter concept, and why for many investors a deed in lieu of foreclosure is an attractive alternative to foreclosure. Part II explores the *Crane* decision and its two bases for determining the amount realized from the disposition of an asset. Part III analyzes the nature of the loss that the mortgagor sustains on a voluntary reconveyance of the property, and examines in particular the “sale or exchange” requirement for capital loss treatment. Finally, Part IV discusses alternatives that might more effectively deal with such losses.

I. Tax Shelters: How They Work and the Problems They Present

Nonrecourse debt⁴ has been the traditional method by which

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¹ 331 U.S. 1 (1947). See Part II A infra for the facts of the case.
² See Part I infra.
³ See notes 8-10 and accompanying text infra.
⁴ Nonrecourse debt refers to an indebtedness secured by property, unaccompanied by personal liability of the debtor. If the debtor defaults on the debt, the creditor can look only to the secured property for satisfaction, since he has no personal recourse against the debtor.
taxpayers have created real estate tax shelters. The mortgagor gener-  
ally gives the lender a nonrecourse note for a portion of the prop-  
erty’s purchase price.\(^5\) The *Crane* principle requires that this  
nonrecourse debt be added to the property’s basis,\(^6\) thereby increas-  
ing the amount of the annual depreciation allowance (if the property  
is depreciable). By giving a nonrecourse note, the taxpayer, often a  
limited partner in a limited partnership,\(^7\) may obtain the benefit of  
this depreciation with a small actual cash outlay.

When the taxpayer begins to repay the mortgage, payments will  
consist mainly of deductible interest;\(^8\) gradually, however, the por-  
tion of the payments representing nondeductible principal will in-  
crease. As long as the depreciation deduction, which is available  
without cash outlay, exceeds the amount of nondeductible principal  
repayment on the debt, the taxpayer receives deductions without a  
cash outlay. The resulting deductions “shelter” other income of the  
taxpayer from taxation. However, when the depreciation deduction  
equals the amount of principal repayment, the tax shelter collapses,  
and the investor must make cash outlays exceeding the deductions he  
receives from the investment.\(^9\) If the investor is receiving income  
from the investment, the shelter collapses earlier, when the amount  
of income plus principal repayment equals the depreciation deduc-  
tion. The sine qua non, therefore, of any tax shelter is that deduc-  
tions available without cash outlay exceed nondeductible cash  
expenditures. The tax shelter stands or falls on the relationship be-  

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\(^5\) A rational third-party lender may be willing to accept a nonrecourse note because: (1)  
deficiency judgments are sometimes prohibited by state law, *see*, e.g., *Cal. Civ. Proc. Code*  
§ 580b (West 1955); (2) in return for nonrecourse debt, the lender may get a higher interest  
rate or an “equity kicker” (an arrangement for participation in the equity of a corporation  
through stock warrants, for example, so that a lender may share in the prospective growth in  
the value of the corporation’s common stock, *Monarch Cement Co. v. United States*, 458 F.  
Supp. 384, 385 (D. Kan. 1978), *aff’d*, 634 F.2d 484 (10th Cir. 1980)); or (3) personal liability  
may be unnecessary, such as where the property’s value adequately secures the loan or the  
loan security is the borrower’s only asset. *Javaras, Nonrecourse Debt in Real Estate and Other  

\(^6\) *Crane v. Commissioner*, 331 U.S. at 11. Mrs. Crane had argued that her equity in the  
property was its basis. *See* text accompanying notes 39 & 41 infra.

\(^7\) Limited partnerships are an attractive investment form because a limited partner’s  
liability for the partnership’s losses is limited to the amount of the partner’s investment. *See*  
*Javaras, supra* note 5, at 802.

\(^8\) I.R.C. § 163(a).

\(^9\) The tax shelter collapses when the cash outlay for interest and principal repayment  
equals the tax deduction for interest and depreciation, because the taxpayer must then start  
paying for all the tax benefits he has received. *See generally* Weidner, *Realty Shelters: Nonrecourse  
between principal repayment and the depreciation deduction.\textsuperscript{10}

The widespread use of nonrecourse debt in such tax shelters, as well as in the financing of nondepreciable real estate,\textsuperscript{11} prompted Congress in 1976 to enact section 465\textsuperscript{12} of the Internal Revenue Code (Code), which limited loss and depreciation deductions to that amount the taxpayer has at risk.\textsuperscript{13} Section 465(b)(4) states further that a taxpayer is not at risk with respect to nonrecourse financing.\textsuperscript{14}

Section 465 actually does little to hinder real estate arrangements, however. Although Congress, in the original Tax Reform Act of 1976,\textsuperscript{15} chose real estate shelters as a primary area for reform, section 465 omits them from coverage.\textsuperscript{16} Thus, taxpayers can still claim depreciation in real estate investments without considering the at-risk limitation.\textsuperscript{17} Because the real estate lobby has effectively guaranteed that real estate tax sheltering would continue to increase after the Tax Reform Act of 1976,\textsuperscript{18} pre-1976 tax shelter principles will apply to an even greater number of taxpayers and transactions.

Taxpayers have encountered problems in recent tax shelter investments in low-income housing. Taxpayers often establish such investments as general or limited partnerships, which, like other tax shelters, feature heavy mortgage financing and maximum depreciation deductions. Consequently, the partnership will quickly reach the point where the property’s adjusted basis falls below the amount of

\textsuperscript{10} Id. at 711, 713.
\textsuperscript{11} See Javaras, supra note 5, at 802.
\textsuperscript{13} I.R.C. § 465(a)(1) provides that “any loss from such activity for the taxable year shall be allowed only to the extent of the aggregate amount with respect to which the taxpayer is at risk . . . for such activity at the close of the taxable year.” By limiting the taxpayer’s allowable loss, the provision obviously limits his depreciation deductions also.
\textsuperscript{14} I.R.C. § 465(b)(4) provides that “a taxpayer shall not be considered at risk with respect to amounts protected against loss through nonrecourse financing . . . .”
\textsuperscript{15} H.R. 10612, 94th Cong., 1st Sess. §§ 101(a), 207, 208 (1975).
\textsuperscript{16} I.R.C. § 465(c)(3)(D) provides that “the holding of real property . . . shall be treated as a separate activity, and subsection (a) [limitation of losses to amount at risk] shall not apply to losses from such activity.”
\textsuperscript{17} 33 Sw. L.J. 1257, 1268 n.2 (1980). The 1976 Tax Reform Act’s recapture provisions, which prevent a taxpayer from converting ordinary income into capital gains by selling a depreciated § 1231 asset, deals with real estate activities. Section 1250, however, which does apply to real property, recaptures only the depreciation taken in excess of the straight-line depreciation; on the other hand, § 1245 may recapture all depreciation allowed or allowable, rather than only the accelerated portion of the depreciation. Collins & Doliner, The “At Risk” Provisions: The Internal Revenue Code’s New Double Basis Concept, 30 U. FLA. L. REV. 185, 202 & n.87 (1977). Collins and Doliner present an excellent discussion of the effect of the “at-risk” provisions on tax shelters.
\textsuperscript{18} Collins & Doliner, supra note 17, at 202, 211, 221.
mortgage indebtedness, resulting in the possibility of a taxable gain. Because by this time the fair market value is often less than the mortgage, the owner of the mortgaged property, especially during an economic recession, may be unable or unwilling to continue making mortgage payments. If the mortgagor then chooses to rid himself of the property, he faces the possibility of having to recognize a taxable gain.¹⁹

A different type of problem arises with unimproved land subject to nonrecourse debt. Because sections 167 and 168²⁰ permit no depreciation on this type of land, the owner's adjusted basis will equal the property's purchase price plus improvements. Thus, any payment on the mortgage principal produces an outstanding indebtedness of less than the adjusted basis. If the fair market value of the land drops below the amount of the outstanding mortgage, the owner may decide to discontinue mortgage payments, since the land is not worth the amount of the mortgage.²¹ Such a scenario occurred often in the stagnant real estate market of the late 1970s and early 1980s. In such a situation, the owner may either wait for the mortgagee to foreclose and use the foreclosure sale proceeds to at least partially satisfy the mortgagor's debt, or execute a deed in lieu of foreclosure, thus transferring ownership of the land to the mortgagee in full settlement of the outstanding mortgage debt.²² In the second instance, the mortgagor realizes a loss, because the property's adjusted basis exceeds the outstanding mortgage balance (the potential amount the mortgagor could "realize" on the conveyance of the deed). The remainder of this note analyzes the mortgagor's alternative to convey a deed in lieu of foreclosure when the balance of the outstanding mortgage exceeds the fair market value of the property.

¹⁹ Weiss, The Crane Case Updated, 32 TAX LAW. 289, 302-03 (1979). In such a situation, a sale or exchange may produce a phenomenon known as the "phantom gain," which is a taxable gain unaccompanied by a receipt of cash with which to pay the resulting taxes. This problem may arise whenever the mortgage on the property, the potential amount realized, exceeds the property's adjusted basis. See id at 303; L. FAGGEN, D. BLOCKOWICZ, J. SCHWIETERS, D. BRADFORD, J. BROWN, M. SCHWARZ, R. STEVENS & D. WATERS; FEDERAL TAXES AFFECTING REAL ESTATE 12-17 (5th ed. 1981) [hereinafter cited as FAGGEN]. See also Part II C infra.

²⁰ Code section 167 allows depreciation deductions on property placed in service prior to January 1, 1981, while section 168 governs depreciation deductions for property placed in service after December 31, 1980 under the new Accelerated Cost Recovery System.


²² Id. at 245.
A. The Deed in Lieu of Foreclosure

A mortgagor's voluntary transfer of the deed to the mortgagee in lieu of foreclosure results when the mortgagee agrees to accept the deed transfer in full settlement of the outstanding mortgage debt. A valid transfer of a deed in lieu of foreclosure requires only that the mortgagee accept the mortgagor's deed.

A mortgagor may wish to voluntarily convey property to the mortgagee for one of a number of reasons. Those reasons include: (1) the ability to select the year in which he will recognize gain or loss; (2) the desire to claim an ordinary loss; (3) an attempt to escape all or a part of the gain by claiming renegotiation of the purchase price where the mortgagee is also the seller; (4) quick relief from personal liability for additional property operating costs; and (5) avoiding mortgagee pressure, particularly if the mortgagee holds mortgages on other property of the debtor, or if the debtor has other transactions pending with the mortgagee.

Conveying a deed in lieu of foreclosure affords the mortgagee the advantages of avoiding the cost, delay, bad publicity, and uncertainties associated with foreclosure sales, and avoiding an unnecessary additional loss that would result from the costs of an immediate foreclosure.

Although conveying a deed in lieu of foreclosure can benefit the

26 Id. But see Part III infra for a discussion of this taxpayer alternative in light of recent developments.
27 Boris, supra note 25, at 988. See note 70 infra for an explanation.
28 Boris, supra note 25, at 988.
29 Id.
30 Handler, Tax Consequences of Mortgage Foreclosures and Transfers of Real Property to the Mortgagee, 31 TAX. L. REV. 193, 212 (1976).
31 G. ROBINSON, FEDERAL INCOME TAXATION OF REAL ESTATE 9-9 (3d ed. 1979). Despite certain advantages, the mortgagee may wish to avoid the deed in lieu of foreclosure because of the risks involved, namely: (1) the voluntary conveyance of the deed within 90 days of an involuntary bankruptcy proceeding against the debtor could be set aside as a voidable preference (if made within the prior one year, it may also be set aside as a voidable preference if the mortgagee, among other things, was an insider vis. the debtor), Bankruptcy Reform Act of 1978, 11 U.S.C. § 547(b) (1979); (2) a voluntary transfer might not cut off junior creditors and lienors; (3) the deed could be deemed a merger, and cause junior creditors to take priority over the mortgagee; (4) the deed could be subject to a transfer tax; (5) the mortgagee may have to take the deed subject to existing leases or tenancies that a foreclosure proceeding would have extinguished; (6) concerns about title problems and title insurance;
mortgagee and the debtor, the method has been vexatious to the I.R.S. and the courts, particularly when nonrecourse debt rather than recourse debt encumbers the transferred property. The dichotomy of scholarly and judicial opinion concerning the proper measurement of the amount realized by the mortgagor when the amount of the nonrecourse debt exceeds the property’s fair market value is confusing to taxpayers, as is the even wider split of authority concerning whether such a voluntary transfer for no in-hand consideration meets the “sale or exchange” requirement for capital loss treatment.

II. Crane’s Footnote 37: What is the “Amount Realized”?  

A. Crane v. Commissioner

The Crane case, which spawned the modern tax shelter, involved a taxpayer who received an apartment building and lot, which were subject to a nonrecourse mortgage, as beneficiary of her husband’s estate. The property’s mortgagee permitted Mrs. Crane to continue operating the property; however, the unpaid interest arrearage led the mortgagee to threaten foreclosure. Mrs. Crane then sold the property, subject to the mortgage, to a third party for $3,000, paid $500 in sale expenses, and reported a taxable gain of $1,250. After the sale, however, Mrs. Crane was no longer liable for the $255,000 mortgage that had encumbered the property. The Supreme Court agreed with the Commissioner of the Internal Revenue Service (Commissioner) that this amount represented a realized gain to Mrs. Crane in addition to her receipt of cash.

Mrs. Crane argued that the “property” that she inherited and later sold was merely the equity in the asset. Since the building was fully mortgaged, her equity was zero. Upon selling the equity, Mrs. Crane received $2,500 after expenses, so she reasoned that this was
her amount realized for purposes of computing gain on the sale.

The Commissioner contended that Mrs. Crane's "property" was the real estate, and not merely her equity in it. This notion, the Court agreed, comports with the ordinary meaning of "property," and with the Commissioner's interpretation of the term, since treasury regulations and estate tax law had previously valued property in this manner. Finally, the Court stated that, under Mrs. Crane's theory, depreciation deductions based upon an "equity" basis would fall far short of the actual physical exhaustion of the property, and that a basis recomputation would have to follow each mortgage payment. Thus, the Court accepted as the correct basis the property's full value, undiminished by mortgage balances.

The Court also addressed the issue of the meaning of the phrase "amount realized." The Court rejected the notion that Mrs. Crane would accept an "amount realized" of $2,500 on the sale of a $250,000 asset and thus take a 99 per cent loss. The Court discounted this possibility in view of its holding regarding the meaning of "property." Then, capitalizing on Mrs. Crane's concession that the debt would have been included in the "amount realized" had she been personally liable on it and had the purchaser either paid or assumed it, the Court held that the amount realized on the transfer included the mortgage transferred with the property irrespective of whether or not the transferor was personally liable on the debt.

Two primary principles emerge from Crane. First, the taxpayer must include in his basis the amount of a mortgage to which the acquired property is subject. Thus, the taxpayer can depreciate the value of the property encumbered by nonrecourse debt as well as

40 Section 111(b) of the Internal Revenue Code of 1938 (the predecessor of current § 1001(b)) defined "amount realized" as "the sum of any money received plus the fair market value of the property (other than money) received." § 111(a) (the predecessor of current § 1001(a)) defined "gain . . . from the sale of property" as "the excess of the amount realized . . . over the adjusted basis . . . ." Adjusted basis is, for most assets, original cost plus improvements, less depreciation.

41 331 U.S. at 6.

42 Id. at 7. The Court cited numerous provisions of the Code and regulations supporting the proposition that the "value" of property was its value undiminished by liens. See id. at 7 nn.17 & 18.

43 Id. at 9-10.

44 Id. at 11.

45 See note 40 and accompanying text supra.

46 331 U.S. at 13.

47 Id. See text accompanying notes 41-44 supra.

48 331 U.S. at 13.

49 Id. at 14.
that portion of the property acquired with cash. Second, the taxpayer must include in the amount realized from the sale the amount of nonrecourse debt to which property is subject when sold.

Inexplicably, however, the Court also chose to respond to a hypothetical situation posed in Mrs. Crane's reply brief, and thus inscribed "the most famous footnote in tax history" as an answer that the Court should never have given. In footnote 37 of the opinion, the Court stated:

Obviously, if the value of the property is less than the amount of the mortgage, a mortgagor who is not personally liable cannot realize a benefit equal to the mortgage. Consequently, a different problem might be encountered where a mortgagor abandoned the property or transferred it subject to the mortgage without receiving boot. That is not this case.

Thus, when dealing with nonrecourse debt, tax shelter investors have relied on footnote 37 to limit to the fair market value of the underlying property the amount realized upon a voluntary conveyance.

B. Property Fair Market Value as the Amount Realized

Commentators have debated the propriety of, and noted the problems resulting from, treating the entire amount of nonrecourse debt as the amount realized upon a deed transfer in lieu of foreclosure. Though Crane's footnote 37 is the only judicial evidence supporting the notion that the property's fair market value limits the amount realized upon conveyance, taxpayers challenging the basic

50 Mrs. Crane's reply brief, in attacking the inclusion of nonrecourse debt in the amount realized on the transfer, posed the following hypothetical situation:

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

Reply Brief for Petitioner at 5-6, Crane v. Commissioner, 331 U.S. 1 (1947) [hereinafter cited as Crane brief].

Earlier, the taxpayer in her reply brief had also stated that "[t]he issues involved in this case, however, do not depend upon the question of depreciation. The same issues would be presented even if the real estate had been unimproved and had not been susceptible of depreciation at all." Crane brief at 5. One commentator believes that these two excerpts are the source of Crane's footnote 37. See Note, Millar: Requiem for Crane's Footnote 37?, 41 U. PITT. L. REV. 343, 351 (1980) [hereinafter cited as PITTSBURGH Note].


52 331 U.S. at 14 n.37.

53 See Adams, Exploring the Outer Boundaries of the Crane Doctrine: An Imaginary Supreme Court
Crane holding also have strong policy arguments to assist them.

The taxpayers' policy argument develops as follows: because nonrecourse debt is secured only by the underlying property, the most that a nonrecourse debtor can realize upon a conveyance is the fair market value of that property, i.e., the debtor has only the value of this property at stake. Because the mortgagee cannot reach the mortgagor's personal assets to satisfy the remaining debt, the mortgagor is freed from liability only to the extent of the property's fair market value. Because the mortgagor is liable for no more than the fair market value, he realizes a benefit upon the mortgage's discharge only to the extent of the property's fair market value. The amount realized thus should not include the amount of debt in excess of the property's value at the time of the deed transfer.54

Most lawyers agree that the nonrecourse debtor does receive a benefit from the amount of the debt which exceeds the property's fair market value; however, the time at which the debtor receives the benefit is another policy argument favoring the taxpayer. Any benefit to the debtor occurs when he acquires the property or subsequently finances it. Although the taxable event with which the parties are concerned is the sale or other disposition of the property, the I.R.S. nevertheless taxes as the amount realized the prior benefit received from the excess of debt over the property's fair market value.

Professor Bittker attacks the overly simplistic approach the Court used in Crane to solve the dilemma concerning the amount realized.55 Bittker asserts that Crane overstates the resemblance between recourse and nonrecourse obligations.56 He contends that the Court classified together two very different types of obligations only

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55 See Bittker, supra note 51.

56 Id. at 282. The Court noted that the mortgagor, by having reported gross rentals as her income and having paid and deducted interest on the mortgage, must treat the mortgage conditions exactly as if they were the mortgagor's personal obligations. The Court added that, upon a transfer subject to the mortgage, the benefit to the mortgagor is as real and substantial as if the mortgage debt were discharged or an equivalent personal indebtedness had been assumed by another person. 331 U.S. at 14 & n.38.
for reasons of administrative simplicity.\textsuperscript{57} Had the Court in \textit{Crane} recognized in its opinion the difference between recourse and non-recourse obligations, it may have lessened the resulting confusion.

Another author\textsuperscript{58} believes that the \textit{Crane} decision was based upon the Court's desire for symmetry between the basis and amount realized rather than upon a strict construction of the Code. The Court's analogy of nonrecourse debt to recourse debt, based upon fair market value equaling the mortgage debt, may have pervaded the Court's entire opinion. This rendered the analogy inapplicable to fact situations not contemplated by the Court in \textit{Crane}.\textsuperscript{59}

Although few courts have interpreted or relied on \textit{Crane}'s footnote 37, the United States Court of Appeals for the Fifth Circuit did apply it in 1981 in \textit{Tufts v. Commissioner}.\textsuperscript{60} The court in \textit{Tufts} held that the fair market value of the property securing a nonrecourse debt limits the extent to which the I.R.S. can include the debt in the amount realized on disposition of the property.\textsuperscript{61} The court emphasized that \textit{Crane} had concerned property mortgaged at less than its fair market value,\textsuperscript{62} and urged that the "double deduction" argument mentioned in \textit{Crane}\textsuperscript{63} had been overemphasized as a basis for

\textsuperscript{57} Bittker, supra note 51, at 282. The primary difference between recourse and non-recourse debt consists of the mortgagor's personal liability for a recourse debt and his lack of personal liability for a nonrecourse debt. Thus, while both a recourse mortgagor and a nonrecourse mortgagor may report the income and deductions from the property in the same manner, see note 56 supra, the nonrecourse mortgagor could abandon the property without personal liability for the deficiency amount when the property's value drops below the mortgage balance. The recourse mortgagor, being personally liable on the debt, could not abandon the property without being personally liable. See also note 4 supra.


\textsuperscript{59} Id. at 134-35.

\textsuperscript{60} 651 F.2d 1058 (5th Cir. 1981), cert. granted, 50 U.S.L.W. 3873 (U.S. May 4, 1982) (No. 81-1536), rev'd 70 T.C. 756 (1978). The taxpayer and his partners, in order to finance construction of an apartment complex, secured a $1.8 million nonrecourse loan. Adverse economic conditions prevented the complex from earning enough income to pay off any of the loan principal, and after a year the property had declined in value to $1.4 million. All of the partners then sold their partnership interests to a third party, receiving no consideration other than the third party's agreement to pay the partners' expenses of the sale up to $250. 651 F.2d at 1059.

\textsuperscript{61} 651 F.2d at 1063. See Friedland, Tufts and Millar: Two New Views of the Crane Case and Its Famous Footnote, 57 NOTRE DAME LAW. 510 (1982), for a thorough discussion of \textit{Tufts} and its implications.

\textsuperscript{62} 651 F.2d at 1062.

\textsuperscript{63} 331 U.S. at 15. The "double deduction" theory, perhaps more properly referred to as the "double benefit" theory, compels the taxpayer including nonrecourse debt in his depreciation basis to also include the debt in his amount realized upon the sale or other disposition of the asset. This theory precludes the taxpayer from receiving the benefits of an amount real-
the *Crane* decision.64

The court in *Tufts*, however, erred in asserting that any tax benefit received by the mortgagor from prior deductions is already factored into the gain equation through adjustments to basis (such as depreciation) under section 1016. The court reasoned that requiring nonrecourse debt to be included in the amount realized in excess of fair market value would be taxing the taxpayer twice on the same portion of the gain.65 The court’s reasoning was faulty in two significant respects. First, the court concentrated on the property’s adjusted basis, although the issue before it was the determination of the amount realized. Second, the court apparently assumed that depreciation recapture66 would remedy matters upon disposition of the property. To the contrary, the amount of depreciation attributable to an inflated basis obtained through nonrecourse financing is never subject to recapture if the amount realized is limited to the property’s fair market value.67 *Tufts* will go before the Supreme Court shortly.68 The Court should reverse the Fifth Circuit’s conception of the recapture rules and recognize that the excess nonrecourse debt must somehow be taxed. A decision for the Commissioner in *Tufts* will restore the status quo and perpetuate the *Crane* doctrine.

C. Discharged Indebtedness as the Amount Realized

The majority of courts hold that the fair market value of the property transferred under a deed in lieu of foreclosure is immaterial in computing the gain or loss from the disposition of property.69 This

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64 651 F.2d at 1060. The *Tufts* court believed that the Court’s “double deduction” argument in *Crane* was merely a response to Mrs. Crane’s contention that she had not been taxed on income within the meaning of the sixteenth amendment.

65 Id. at 1061. The court reasoned that adjusting the asset’s basis downward due to the § 1016 depreciation deduction, combined with requiring the previous depreciation tax benefits to be included in the amount realized, results in taxing some part of the gain twice. Id. at 1061. This reasoning is premised, however, on the questionable assumption that the taxpayer could not have received a benefit greater than the property’s fair market value. If the amount of the mortgage were accepted as the amount realized, no “double taxation” argument could be made.

66 See note 17 supra.

67 The depreciation recapture provision, I.R.C. § 1250, will fail to recapture any amount by which the depreciation subject to recapture exceeds the fair market value of the property, if the property’s fair market value limits the amount realized, as the Fifth Circuit held in *Tufts*.


69 See, e.g., Millar v. Commissioner, 67 T.C. 656 (1977), aff’d, 577 F.2d 212 (3d Cir.), cert.
result may be justified by one of three approaches. Under the first, a mortgagor executing a deed in lieu of foreclosure is treated as having sold the property to the mortgagee for the amount of indebtedness discharged.\footnote{348 U.S. 426 (1955).} When the debtor disposes of property that is mortgaged in excess of its value, the amount of the mortgage represents an amount of unrepaid borrowing. As a result, if the mortgage is not fully included in the amount realized, then the unrepaid borrowing in excess of the property's value will escape taxation entirely. At some point on or before the disposition of the property through the transfer of the deed, the borrower must have enjoyed a taxable benefit by discharging an obligation with property worth less than the amount of that debt.\footnote{348 U.S. at 430. See Sales and Other Dispositions, supra note 71, at 227.}

A second, more general, but less tested, approach involves the application of the principle first enunciated by the Supreme Court in \textit{Commissioner v. Glenshaw Glass Co.}\footnote{348 U.S. at 431.} The \textit{Glenshaw Glass} principle directs courts to give Code section 61(a)\footnote{I.R.C. § 61(a) provides that "[e]xcept as otherwise provided . . . gross income means all income from whatever source derived . . . ."} a liberal construction, because Congress intended to tax all gains unless specifically exempted.\footnote{348 U.S. at 430. See Sales and Other Dispositions, supra note 71, at 227.} A gain (amount realized) arises from the disposition of property when a deed in lieu of foreclosure is executed. Because the taxpayer would realize an accession to wealth from the transaction, he should be taxed on the gain.\footnote{348 U.S. at 431.}

A third approach favoring the inclusion of the indebtedness amount in the amount realized is the "double deduction," or "double...
benefit," argument presented in Crane and subsequent cases. The double deduction argument arises where the mortgagor takes a depreciation deduction calculated upon a basis that includes the amount of the nonrecourse debt, but where the mortgagor does not account for those deductions when he reports his gain or loss on the property's disposition. The policy sought to be promoted by the double deduction argument is consistency—if the taxpayer is to benefit by depreciation deductions that are based on a debt-inflated basis, then he ought also to include that debt in the amount he realizes upon the disposition of the underlying property.

Although courts were initially reluctant to probe Crane's footnote 37, the I.R.S. eventually decided to test the footnote in Revenue Ruling 76-111. The I.R.S. ruled in Revenue Ruling 76-111 that gain or loss upon a voluntary surrender of mortgaged assets is recognized to the extent of the difference between the amount of the debt cancelled and the basis of the assets transferred. The I.R.S. further stated that, irrespective of inferences that may be drawn from footnote 37, the amount realized is the amount of indebtedness cancelled, regardless of the fair market value of the assets at that time. Thus, the I.R.S. explicitly rejected footnote 37. Recent Treasury regulations have also followed those court decisions that include the amount of discharged debt in the amount realized, even though the debt exceeds the fair market value of the underlying property.

Judicial response to footnote 37 started when the Tax Court in

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77 The double deduction, or double benefit, theory compels the taxpayer to include in the amount realized the amount of the debt. Because he used the amount of the debt in calculating his basis for depreciation, he cannot later claim that the amount realized does not include the amount of the debt. PITTSBURGH Note, supra note 50, at 347. See note 63 supra.

78 The First Circuit in Parker v. Delaney, 186 F.2d 455 (1st Cir. 1950), cert. denied, 341 U.S. 926 (1951), avoided the footnote 37 issue by saying there was no evidence that the value of the property was less than the mortgage. Woodsam Assocs. v. Commissioner, 198 F.2d 357 (2d Cir. 1952), aff'd 16 T.C. 649 (1951), presented the issue, but the petitioner had disclaimed reliance on footnote 37. 198 F.2d at 358 n.1.

79 1976-1 C.B. 214. The debtors bought cattle from the seller under a nonrecourse loan. The loan contained a provision allowing the debtor to return the herd to the seller in complete satisfaction of the debt. After a drop in market value, the debtors exercised the option to transfer the herd.

80 Id.

81 See Treas. Reg. §§ 1.1001-2(a)(2); 1.1001-2(a)(4)(i); 1.1001-2(b); 1.1001-2(c), Ex. (2); 1.1001-2(e), Ex. (7) (1980).
Woodsam Associates, Inc. v. Commissioner\textsuperscript{82} stated that the Supreme Court appeared to be reserving its views on the amount realized under the situation postulated in the footnote.\textsuperscript{83} Recently, in Millar v. Commissioner,\textsuperscript{84} the Third Circuit rejected outright any application of footnote 37. The court noted that footnote 37 was dictum and involved a different time and different set of legal circumstances.\textsuperscript{85} The Third Circuit in Millar concluded that footnote 37 should not affect the principal holding in Crane, and that amount realized includes the entire amount of nonrecourse debt. Though not specifically addressing footnote 37, the Tax Court has cited and followed Millar.\textsuperscript{86}

It now appears that at least the First (Parker v. Delaney\textsuperscript{87}), Second (Woodsam Associates), and Third (Millar) Circuits agree with the Tax Court and the I.R.S. that the amount realized on the disposition of property by the conveyance of a deed in lieu of foreclosure includes the total amount of nonrecourse indebtedness. A meticulous review and reversal of Tufts\textsuperscript{88} by the Supreme Court should bring the Fifth Circuit into line with the other circuits and dispel the confusion surrounding Crane's infamous footnote 37.

III. The Nature of the Loss: The "Sale or Exchange" Requirement

In determining the amount realized, most courts follow the traditional rule of including the total amount of nonrecourse debt to which the reconveyed property is subject.\textsuperscript{89} Less agreement, however, exists as to whether the character of the resulting gain or loss is capital or ordinary. Of course, the taxpayer will want capital treatment of any gain recognized, and ordinary treatment and full deductibility in the event of a loss.

\textsuperscript{82} 16 T.C. 649 (1951), aff'd, 198 F.2d 357 (2d Cir. 1952).
\textsuperscript{83} 16 T.C. at 655.
\textsuperscript{85} 577 F.2d at 215.
\textsuperscript{86} See Winston F.C. Guest, 77 T.C. 9 (1981); Estate of Delman v. Commissioner, 73 T.C. 15 (1979). In Brountas v. Commissioner, 73 T.C. 491 (1979), the Tax Court cited its opinion in Tufts v. Commissioner, 70 T.C. 756 (1978), rev'd, 651 F.2d 1058 (5th Cir. 1981), cert. granted, 50 U.S.L.W. 3875 (U.S. May 4, 1982) (81-1536), in holding that nonrecourse debt is fully includable in basis even though the property securing the debt is worth less than the amount of the debt. 73 T.C. at 571.
\textsuperscript{87} 186 F.2d 455 (1st Cir. 1950), cert. denied, 341 U.S. 926 (1951).
\textsuperscript{88} See notes 60-66 and accompanying text supra.
\textsuperscript{89} See, e.g., Crane v. Commissioner, 331 U.S. 1 (1947); Parker v. Delaney, 186 F.2d 455 (1st Cir. 1950), cert. denied, 341 U.S. 926 (1951); Lutz & Schramm Co. v. Commissioner, 1 T.C. 682 (1943).
A. Statutory Requirements for Capital Loss

To receive capital treatment, a gain or loss must result from a "sale or exchange of a capital asset."\(^{90}\) If in turn the taxpayer has held the capital asset for more than one year, the nature of the capital gain or loss is long-term.\(^{91}\) The gain or loss is short-term if the capital asset has been held for one year or less.\(^{92}\) Real estate investments generally qualify as "capital assets,"\(^{93}\) and it is relatively easy to determine whether the taxpayer has held the asset for the requisite time period. The traditional difficulty, however, has been in meeting the Code's "sale or exchange" requirement.\(^{94}\)

The "sale or exchange" requirement helps determine the nature of a loss sustained on the conveyance of a deed in lieu of foreclosure. If the Code characterizes the loss as an ordinary loss from the "sale or disposition of property,"\(^{95}\) it will be available as an unlimited deduction against ordinary income.\(^{96}\) On the other hand, a capital loss, assuming that net capital losses exceed net capital gains, is subject to limitations on its deductibility against a taxpayer's other income.\(^{97}\) Consequently, an individual taxpayer is permitted to deduct excess capital losses from ordinary income up to a maximum of only $3,000 in any taxable year.\(^{98}\) Given the unlimited deductibility of ordinary losses, a taxpayer with real estate investment losses of several hundred thousand dollars would naturally prefer to characterize such losses as ordinary.

B. Judicial Characterization of the Deed in Lieu of Foreclosure

Code section 1001(a) states that the amount realized is computed upon the "sale or other disposition" of property. Code section 1222, however, is a narrower concept that qualifies for capital treatment only property disposed of in a "sale or exchange." Thus, certain dispositions of property could conceivably result in an amount realized that does not qualify for capital treatment. As a result, a

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90 I.R.C. § 1222(1)-(4).
91 I.R.C. § 1222(3)-(4).
92 I.R.C. § 1222(1)-(2).
93 "Capital assets" are generally those assets not specifically enumerated in I.R.C. § 1221, and include such things as real estate investments.
94 I.R.C. § 1222(1)-(4).
95 I.R.C. § 1001(a).
96 I.R.C. §§ 165(a), 1001(c).
97 See I.R.C. § 1211.
98 I.R.C. § 1211(a)(2). The remaining loss will be available for carryover to other taxable years. I.R.C. § 1212.
gain resulting from a disposition of property not qualifying as a "sale or exchange" penalizes the taxpayer by subjecting him to taxation on the entire amount of the gain as ordinary income; the taxpayer, however, benefits from a full deduction for ordinary losses. Because the I.R.S. is likely to prefer saddling the taxpayer with capital loss treatment for losses resulting from a deed in lieu of foreclosure, it will assert that the conveyance of the deed was a "sale or exchange" within the meaning of section 1222.

However, courts have traditionally viewed a loss resulting from the conveyance of a deed in lieu of foreclosure as an ordinary loss. In Commonwealth, Inc. v. Commissioner, a corporation owning real estate subject to a mortgage executed a consideration-free conveyance in lieu of foreclosure to the mortgagee. The Board of Tax Appeals held that, because the mortgagee gave no consideration to the debtor, the transfer was not a sale or exchange. The Board thus sustained ordinary loss treatment, a result that has been followed by the Third Circuit and the Tax Court until 1980. The Third Circuit and the Tax Court, however, relied upon a line of precedent which, with one minor exception, was decided before Crane.

The 1941 Supreme Court decision in Helvering v. Hammel was a step in the direction of equalizing the treatment given the disposition of capital assets by the taxpayer. In Hammel, the Court held that a loss sustained by a taxpayer on the foreclosure of his property was a capital loss. Apparently, though, courts did not view the voluntary deed in lieu of foreclosure as being similar enough to a forced foreclosure sale to warrant the capital loss treatment dictated by Hammel.

99 See text accompanying notes 95-96 supra. Conversely, sections 1001(a) and 1222 reward the taxpayer for a gain and penalize him for a loss if the disposition of the asset does qualify as a "sale or exchange," and meets the other requirements for capital gain or loss treatment.

100 36 B.T.A. 850 (1937).

101 Id. at 852.

102 Stokes v. Commissioner, 124 F.2d 335 (3d Cir. 1941), aff’d 41-2 USTC (CCH) ¶ 9770; Polin v. Commissioner, 114 F.2d 174 (3d Cir. 1940), rev’d 39 B.T.A. 951 (1939).

103 Jamison v. Commissioner, 8 T.C. 173 (1947); Lapsley v. Commissioner, 44 B.T.A. 1105 (1941); Baird v. Commissioner, 42 B.T.A. 970 (1940).

104 Fox v. Commissioner, 61 T.C. 704 (1974). The court in Fox affirmed the traditional notion that no sale or exchange occurs when the debtor conveys without consideration property subject to nonrecourse debt, citing as authority Crane, Stokes v. Commissioner, 124 F.2d 335 (3d Cir. 1941), aff’d 41-2 USTC (CCH) ¶ 9770, and Jamison v. Commissioner, 8 T.C. 173 (1947). 61 T.C. at 715 n.7.


106 The Court in Hammel found no basis in the Code or in its legislative history or purpose
In 1980, the Tax Court in *Freeland v. Commissioner*\(^{107}\) surprisingly reversed the traditional judicial stance, and held that voluntarily conveying a deed in lieu of foreclosure produces a capital loss rather than an ordinary one, because it qualifies as a "sale."\(^{108}\) Furthermore, the conveyance results in a capital loss even in the case of non-recourse debt.\(^{109}\) The court urged that there existed no reason for the disparate treatment accorded involuntary foreclosures and voluntary, deeds in lieu of foreclosure, since the taxpayer in *Freeland* would have nevertheless received sale treatment had he chosen to wait for the mortgagee to foreclose.\(^{110}\) The court also relied on *Hammel* to state that Congress probably did not intend to allow the taxpayer to manipulate the character of his gain or loss by either voluntarily conveying the property or forcing the mortgagee to foreclose.\(^{111}\) The court emphasized the similarities between the voluntary reconveyance and involuntary foreclosure, and concluded that both should be treated the same for tax purposes.\(^{112}\) The court then averted another "footnote 37" situation by stating that, although the amount of the debt exceeded the value of the property, such a predicament should not change the character of the transaction.\(^{113}\) Thus, the court required the taxpayer to recognize a capital loss.

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\(^{107}\) 74 T.C. 970 (1980). In *Freeland*, the taxpayer purchased unimproved real estate in California for $50,000, giving the seller $9,000 cash and a purchase-money mortgage for $41,000. Under California law, the mortgagor was not personally liable for a purchase-money mortgage. After the value of the property dropped to $27,000, while the unpaid balance of the note was still $41,000, the taxpayer voluntarily reconveyed the property to the mortgagee-seller, with neither consideration nor the threat or institution of foreclosure proceedings.

\(^{108}\) 74 T.C. at 980.

\(^{109}\) *Id.*

\(^{110}\) *Id.*

\(^{111}\) *Id.*

\(^{112}\) The court noted that, in either case, the mortgagor’s interest in the property is terminated and transferred to someone else, with the mortgagor receiving "nothing" from the transaction. The mortgagor in both cases is relieved of paying taxes and assessments against the property, because he does not retain possession of it. The court also believed that the indebtedness was not forgiven in either case, though the taxpayer was relieved of repaying the debt. *Id.* at 981.

\(^{113}\) *Id.* at 982.
Freeland and its progeny\textsuperscript{114} have also affirmed several I.R.S. rulings stating that a voluntary conveyance of property to the mortgagor in exchange for a discharge of the nonrecourse debt it secured is a "sale or exchange" giving rise to a capital loss.\textsuperscript{115} In summary, the Tax Court and the I.R.S. appear to have made the correct determination in disregarding the formal differences between the foreclosure sale and the deed in lieu of foreclosure. Because both have the necessary elements of a "sale or exchange," both will now result in a capital loss to the mortgagor in a loss situation.

IV. Proposed Alternatives

The judicial trend is currently toward capital treatment of losses incurred in voluntarily conveying deeds in lieu of foreclosure. The amount realized on the transfer for tax purposes is likely to be the full amount of the nonrecourse indebtedness encumbering the property, pending the Supreme Court resolution of \textit{Tufts v. Commissioner}.\textsuperscript{116}

Judicial analysis in this area is still not settled, and none of the adopted judicial approaches seems to adequately handle the issue, as the lack of consensus among the courts illustrates. The courts have justifiably discarded the distinction between involuntary foreclosure sales and voluntary transfers of deeds in lieu of foreclosure by holding that both are "sales or exchanges" that produce capital gains or losses.\textsuperscript{117} Courts have not yet, however, examined the theoretical support for including in the amount realized the entire amount of nonrecourse debt discharged pursuant to a reconveyance agreement.

A theoretical problem exists in stating that the mortgagor realizes the entire amount of the debt when he reconveys the property to

\textsuperscript{114} Winston F.C. Guest, 77 T.C. 9 (1981); Arkin v. Commissioner, 76 T.C. 1048 (1981); John E. DeGennaro, 49 P-H Memo T.C. ¶ 80,486 (1980). In DeGennaro, the court relied on Freeland to hold, on nearly identical facts, that the loss incurred was capital in nature. In Arkin, the taxpayer abandoned his interest in a land trust holding property subject to a nonrecourse mortgage. Although the land trust interest was personally under state law, the court judged the abandonment to be the equivalent of a sale or exchange; thus, the taxpayer incurred a capital loss.

Because Freeland and subsequent Tax Court decisions overruled Commonwealth, Lapsley, Baird, and Jamison, see notes 100 & 103 supra, its holding indicates that whether the mortgagor returned consideration to the mortgagor will no longer be a prerequisite to finding a "sale or exchange."


\textsuperscript{116} See notes 60-66 and accompanying text supra.

\textsuperscript{117} See notes 107-15 and accompanying text supra.
the mortgagee. The mortgagor actually received the entire amount of the benefit when he obtained the purchase-money mortgage or when he subsequently financed the property, not at the time of the sale. There are several alternatives that should be examined in an attempt to resolve this theoretical dilemma.

The first alternative is to maintain the judicial status quo—include in the amount realized the entire amount of the debt upon disposition of the asset. The present treatment of sales of appreciated property supports this alternative; that is, though the amount ultimately realized upon the sale is attributable to appreciation in value over a period of time, the entire amount is taxed at the time of the sale. The primary rationale for this treatment is its administrative ease. The taxpayer need not maintain records of accretion or conduct annual appraisals, and all parties involved save time and expenses.

A second alternative is to dissect the conveyance into its components. If the conveyance is similar to selling the property for an amount of cash equal to the amount of the obligation, then there appear to be two separate components of the "amount realized." The fair market value of the property is the amount actually "realized" on the transfer, and the transfer is treated as a sale or exchange. The excess of the indebtedness over the fair market value, on the other hand, is actually a cancellation of indebtedness, albeit an involuntary one due to the decline in the property's value. This analysis treats the difference between the adjusted basis and fair market value of the property as a capital loss, and the difference between the amount of the debt and the property's fair market value as ordinary income from the discharge of indebtedness. This approach has the advantage of being adaptable, and perhaps better suited, to gain situations. The stumbling block, however, may be that section 61(a)(12) as interpreted requires liability on the part of the mortgagor in order to qualify as discharge-of-indebtedness income. Since the property is the "debtor" in a nonrecourse indebtedness, section 61(a)(12) would not technically apply. An application of this section at the present time, therefore, appears to require a judicial

118 See text accompanying notes 54-55 supra.
119 I.R.C. § 61(a)(12) provides that "[e]xcept as otherwise provided . . . gross income means all income from whatever source derived, including . . . income from discharge of indebtedness."
120 See note 119 supra.
extension of discharge-of-indebtedness rules to bring the amount by which the debt exceeds the property's value within section 61(a)(12).

The third alternative calls for the extension of the section 465 "at-risk" provisions to real estate investments. In this manner, real estate investors would be limited in their loss deductions to the amounts they personally have at risk in the venture; those amounts exclude nonrecourse debt. However, in view of the strong Congressional real estate lobby, the implementation of this alternative is unlikely.

The fourth alternative, which appears to be the most workable, is an extension of the tax benefit rule. The mortgagor receives a benefit, either through tax-free borrowing on the property's value, or through the depreciation deductions that the taxpayer has taken on a debt-inflated basis. Under section 111 of the Code, when a taxpayer "recovers" that which had given him a tax benefit in a prior year, the taxpayer recognizes income to the extent of that tax benefit. Revenue Ruling 74-396 holds that, for the purposes of the

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122 See notes 11-18 and accompanying text supra.
123 See note 14 and accompanying text supra.
124 Courts have defined the tax benefit rule both positively and negatively. Some courts have interpreted the tax benefit rule as requiring income recognition upon the recovery of an item that had produced an income tax benefit in a prior year to the extent of that tax benefit. See, e.g., Nash v. United States, 398 U.S. 1, 3 (1970); Dynamics Corp. of America v. United States, 449 F.2d 402, 412 (Ct. Cl. 1971). Other courts have interpreted the rule to operate as a limitation upon the "general rule" that the taxpayer must recognize as income in the year of recovery the recovery of property that was once the subject of an income tax deduction. The tax benefit rule would thus allow exclusion of the recovered item from income if its initial use as a deduction provided no tax saving. See Alice Phelan Sullivan Corp. v. United States, 381 F.2d 399, 401-02 (Ct. Cl. 1967).

Regardless of how it is defined, the rule has developed as a judicial attempt to prevent a taxpayer from obtaining the benefit of a deduction that subsequent occurrences have shown to be unjustified.

125 I.R.C. § 111 is the Congressional codification of the tax benefit principle, and provides:

(a) General Rule. — Gross income does not include income attributable to the recovery during the taxable year of a bad debt, prior tax, or delinquency amount, to the extent of the amount of the recovery exclusion with respect to such debt, tax, or amount.
(b) Definitions. — For purposes of subsection (a) —

(4) Recovery exclusion. — The term "recovery exclusion" . . . means the amount . . . of the deductions or credits allowed . . . which did not result in a reduction of the taxpayer's tax . . . , reduced by the amount excludable in previous taxable years

I.R.C. § 111 (emphasis added).

126 Although I.R.C. § 111 expressly allows tax-benefit treatment only for the recovery of bad debts, prior taxes, and delinquency amounts, see note 125 supra, the Supreme Court has interpreted section 111 as having been designed not to limit the application of the tax benefit rule, but to prevent its demise. Dobson v. Commissioner, 320 U.S. 489, 505-06 (1943) (construing § 111's predecessor, § 116 of the Revenue Act of 1942, 56 Stat. 798, 812). The Regu-
tax benefit rule, a "recovery" is an event that is inconsistent with a past deduction, and that section 111 does not require that the taxpayer receive or become entitled to receive money or property.

The Sixth Circuit, in *Tennessee Carolina Transportation, Inc. v. Commissioner*, affirmed a divided Tax Court in holding that the tax benefit rule required the inclusion of the fair market value of tires and tubes previously expensed by a corporation then liquidating. Since the tires and tubes were still valuable, this was "inconsistent with [the] prior deduction," and gave rise to gross income upon liquidation of the corporation. Though the tax benefit rule has broad potential applicability, the proscription against applying the rule to past depreciation deductions in Code section 111(b)(4) prevents courts from applying the doctrine to deeds in lieu of foreclosure on depreciable property. Further limitations are the *Tennessee Carolina* court's limitation of its holding to a distribution in liquidation of property the cost of which the taxpayer has previously expensed, the difficulty of identifying a recovery during the taxable year in question, and the peculiar fact situation in the *Tennessee Carolina* case.

Since the tax benefit rule is generally directed at deductions or credits previously allowed, which generally offset ordinary income or tax liability, the subsequent recovery is also expressed in terms of...
ordinary income. The inclusion in gross income, if due to depreciation deductions taken in prior years, should be ordinary income under the "Arrowsmith principle." In Arrowsmith v. United States, the Supreme Court held that a prior year transaction may be examined in order that a subsequent event may be accorded consistent treatment. Because the assumption that a nonrecourse debt would be paid off in its entirety led to the debt's original inclusion in the basis for depreciation, the Arrowsmith principle holds that the voluntary reconveyance of the deed in lieu of foreclosure should give rise to ordinary income, offsetting the previous deductions from ordinary income.

On the other hand, if the property in question were nondepreciable, no depreciation deductions would result, and the assumption would have been that the capital asset was worth the amount of the nonrecourse debt obtained. When later events discredit this assumption, the tax benefit would qualify as capital gain, leaving Freeland and its progeny to prescribe the correct treatment for the deed in lieu of foreclosure. Thus, the tax benefit rule should be able to accommodate both capital and ordinary gains and appears to be an ideal solution; however, an appraisal at the time of reconveyance would be necessary.

V. Conclusion

The law has finally come to realize that the functional distinctions between a deed in lieu of foreclosure and a foreclosure sale are not great enough to justify different tax treatment. A capital transaction takes place, and the relieved mortgagor receives the full benefit of the debt under tax benefit principles. A Supreme Court decision reversing Tufts would be a step in the direction of ending the guessing game between judges, the practicing bar, and the taxpaying public.

Michael P. Ripp

134 344 U.S. 6 (1952).
135 See Part III supra.