

SUPERIOR COURT OF THE DISTRICT OF COLUMBIA

TAX DIVISION

GLOVER PARK TERRACE, :
ANNE FREEDMAN, ET AL., :

Petitioner :

v. :

Docket No. 2062

DISTRICT OF COLUMBIA, :

Respondent :

JOSEPH M. BURTON
CLERK OF
SUPERIOR COURT OF THE
DISTRICT OF COLUMBIA
TAX DIVISION

APR 19 1977

FILED

ANNE FREEDMAN, :

Petitioner :

v. :

Docket No. 2063

DISTRICT OF COLUMBIA, :

Respondent :

GLOVER PARK TERRACE, :
ANNE FREEDMAN, ET AL., :

Petitioner :

v. :

Docket No. 2260

DISTRICT OF COLUMBIA, :

Respondent :

MEMORANDUM ORDER

These matters, having been consolidated for all purposes by Order dated September 16, 1974, come before the Court, pursuant to Rule 10 of the Superior Court Rules for the Tax Division, solely for the determination of the legal issue involved.

*Opinion
No. 1145*

The question which this Court must resolve is the proper basis for depreciation to be used by petitioner Glover Park Terrace for purposes of computing deductions in taxable years 1964-1968 relative to certain apartment units which, along with other assets, had been received by the shareholders (in the term shareholders, we include the owners of Glover Park Terrace and petitioner Anne Freedman; see Stipulation of Facts, para. 1, infra) in complete liquidation of Glover Park Terrace, Inc., in 1963. The shareholders received substantially all the shares of the corporation as legatees under the will of Maurice Korman in 1961, or by gift shortly before his death, and then upon liquidation of the corporation more than two years later, contributed the apartment units to petitioner Glover Park Terrace, operating as an unincorporated business. For the taxable years 1964 through 1966, petitioner Anne Freedman (Docket 2063) reported on her individual income tax return her distributable share of the income from Glover Park Terrace, computed with reference to the depreciation base used by petitioner Glover Park Terrace for the apartment units. The Court's resolution of the question of the proper basis for depreciation of the apartment units, resulting perhaps in either an increase or decrease in the unincorporated business franchise tax for Glover Park Terrace, would cause this petitioner's distributable share to increase or decrease proportionately, which would in turn increase or decrease her tax liability.

The parties have agreed that, upon the Court's finding with respect to the legal issue, petitioners may present such evidence as is required to establish the proportionate values of the apartment units and land on which they are situated, respectively. In view of our decision, it appears that this will be necessary.

A stipulation setting forth the relevant facts which the Court must consider in reaching its decision was filed by the parties on May 4, 1976. That stipulation is as follows:

STIPULATION OF FACTS

It is hereby stipulated and agreed by and between counsel for petitioners and counsel for respondent in the above-entitled proceedings that the following facts may be accepted as true for the purposes of the disposition of these proceedings:

1. The petitioners in these consolidated proceedings are:

(a) Dockets 2062 and 2260.

(i) GLOVER PARK TERRACE, which during the years in question, 1964 through 1968, was an unincorporated business in the District of Columbia with its principal office at 2806 Chesterfield Place, N.W., Washington, D.C. 20008.

(11) THE OWNERS OF GLOVER PARK TERRACE, who during the years in question were: Anne Freedman, individually; Anne Freedman, Sylvia Knie and Rose Jacobs, Trustees (or successor trustees) u/w Maurice Korman, deceased, for the benefit of Susan Abra Korman; Anne Freedman, Sylvia Knie and Rose Jacobs, Trustees (or successor trustees) u/w Maurice Korman, deceased, for the benefit of David J. Korman; Anne Freedman; Sylvia Knie and Rose Jacobs, Trustees (or successor trustees) under an inter vivos Trust for the benefit of Susan Abra Korman; and Anne Freedman, Sylvia Knie and Rose Jacobs, Trustees (or successor trustees) under an inter vivos Trust for the benefit of David J. Korman.

(b) Docket 2063. ANNE FREEDMAN, individually, who during the years in question, 1964 through 1966, owned a 50% interest in Glover Park Terrace and resided at 2806 Chesterfield Place, N.W., Washington, D.C. 20008.

2. In controversy in the case of petitioner Glover Park Terrace and its owners (Dockets 2062 and 2260) are assessments of unincorporated business franchise tax (including assessments of statutory interest) for the years 1964, 1965, 1966, 1967 and 1968 in the aggregate amount of \$5,061.16 computed as follows:

TAXABLE YEAR	TAX	INTEREST	TOTAL
1964	\$1,025.38	\$184.59	\$1,209.97
1965	963.86	115.66	1,079.52
1966	906.02	54.36	960.38
1967	818.77	307.04	1,125.81
1968	521.28	164.20	685.48
TOTAL ADDITIONAL ASSESSMENTS			<u>\$5,061.16</u>

For the year 1967, the tax assessment period began on January 1, 1967, and ended on September 30, 1967, and for the year 1968 the period began on October 1, 1967, and ended on March 31, 1968. (On October 1, 1967, the business changed to a fiscal year.)

3. In controversy in the case of petitioner Anne Freedman (Docket 2063) are assessments of additional individual income tax (including the assessment of statutory interest) for the years 1967, 1965 and 1966, in the aggregate amount of \$1,062.11 as follows:

TAXABLE YEAR	TAX	INTEREST	TOTAL
1964	\$319.30	\$57.47	\$ 376.77
1965	372.75	44.73	417.48
1966	252.70	15.16	267.86
			\$1,062.11

4. The amounts in controversy represent assessments of tax plus interest by respondent District of Columbia, resulting from its determination to reduce the basis of the depreciable property owned by Glover Park Terrace during the years in question. This determination caused in the case of Glover Park Terrace the District's reduction of depreciation claimed by that petitioner resulting in an increase of the unincorporated business taxable income. In the case of petitioner Anne Freedman, the increase of the unincorporated business taxable income caused her distributable share of income from that unincorporated business to increase, thereby increasing her individual taxable income.

5. The principal asset of Glover Park Terrace during the years in question (1964-1968) was 96 garden-type apartment units located on Lots 21, 22, 23, 24 and 25 in Square W. 1317, in the District of Columbia.

6. Prior to Glover Park Terrace acquiring ownership of these apartments, that property was owned by Glover Park Terrace, Inc., a corporation (hereinafter called the "Corporation").

7. Until August, 1963, when the Corporation was liquidated, it had 400 shares of capital stock issued and outstanding.

8. Maurice Korman died April 6, 1961, owning 332 shares of the issued and outstanding 400 shares of capital stock of the Corporation. One hundred and ninety-two (192) of these shares were acquired by petitioner Anne Freedman under Mr. Korman's will. One hundred and forty (140)

shares were acquired by the petitioners designated in paragraph 1(a)(ii) as Trustees under Maurice Korman's will. Sixty (60) additional shares of the Corporation's capital stock were acquired by the petitioners designated in paragraph 1(a)(ii) as Trustees under inter vivos trusts by gift from Maurice Korman, 50 of said shares being gifts made on December 31, 1959, and 10 of said shares being the subject of gifts on January 26, 1960. The remaining 8 outstanding and issued shares were owned by Anne Freedman, having been acquired when the Corporation was organized.

9. The 392 of the 400 shares described in paragraph 8 (the 332 shares distributed under Mr. Korman's will and the 60 shares owned by the inter vivos trusts) were subject to federal estate tax and District of Columbia inheritance tax. For estate and inheritance tax purposes, the 392 shares were valued and subject to tax at \$638,070.16 (\$1,627.73 per share).

10. On or about August, 1963, the Corporation was liquidated and its assets were distributed to the stockholders. On September 1, 1963, petitioners joined in forming Glover Park Terrace, an unincorporated business, and contributed for its use the aforementioned apartment property. (See paragraph 5, supra.)

11. At its liquidation, the Corporation's financial condition, as indicated from the figures attached to the 1963 Corporation Franchise Tax Return, was as follows:

<u>Balance Sheet</u>	
<u>ASSETS</u>	
Cash	\$ 76,793.45
Apartment units (book value net of depreciation)	161,876.79
Land (book value)	<u>44,281.70</u>
Total Assets	<u><u>\$282,951.94</u></u>
<u>LIABILITIES</u>	
Real Estate Taxes	1,876.80
Income Taxes	7,048.52
Capital Stock	1,000.00
Earned Surplus	<u>273,026.62</u>
Total	<u><u>\$282,951.94</u></u>

12. Upon liquidation of Glover Park Terrace, Inc., the shareholders realized and reported receipt of a taxable dividend in the aggregate amount of \$273,026.62 on their 1963 District of Columbia income tax returns (individual income tax and fiduciary income tax return (D-41)). The shareholders also reported for District of Columbia tax purposes on their 1963 income tax returns a non-taxable liquidating gain of \$212,291.77.

13. (a) On its District of Columbia Unincorporated Business Franchise Tax Returns for 1963 through 1968, the business in computing depreciation on the apartment building (see paragraph 5, supra) used the value of \$685,000.00 as the cost or other basis of the apartment units and land, with \$600,000.00 allocable to the apartment units and \$85,000.00 allocable to the land.

(b) Respondent has no objections to petitioners reserving the right (and petitioners hereby reserve such right) to present such evidence as may be required to establish what petitioners purport to be the value of the land and apartment units, and the allocation between the land and apartment units.

14. For each taxable year in question, petitioner Glover Park Terrace timely filed a District of Columbia Unincorporated Business Franchise Tax Return. On each return, petitioner claimed a deduction for depreciation with respect to the apartment units, utilizing \$600,000.00 as its original cost or other basis. Respondent has challenged the use of \$600,000.00 as the basis for depreciation of the apartment units; the District has not challenged the method of computing depreciation or the rate of depreciation or useful life of the property.

15. For each taxable year in question, petitioner Anne Freedman timely filed a District of Columbia Individual Income Tax Return. On each return petitioner reported as

her distributable share of the income from Glover Park Terrace an amount computed with reference to depreciation based on an original cost basis of \$600,000.00 for the apartment units received on liquidation of the Corporation and then contributed to Glover Park Terrace.

16. (a) With respect to petitioner Glover Park Terrace (Docket 2062), the respondent mailed a notice of tax deficiency to petitioner on March 11, 1968, proposing adjustments for 1964, 1965 and 1966. On April 10, 1968, petitioner, through its counsel, mailed a letter of protest of said deficiency to respondent. On April 12, 1968, respondent assessed said deficiency, which amount was paid by petitioner on April 15, 1968. On July 9, 1968, petitioner filed in this Court in Docket 2062 a petition for redetermination of the tax deficiency assessment.

(b) With respect to petitioner Glover Park Terrace (Docket 2262), the respondent mailed a notice of tax deficiency to petitioner on March 5, 1974, proposing the adjustments listed for 1967 and 1968. Respondent subsequently assessed said deficiency, which amount was paid by petitioner on or about April 20, 1974. On August 30, 1974, petitioner filed in this Court in Docket 2262 a petition for redetermination of the tax assessment.

(c) With respect to petitioner Anne Freedman (Docket 2063), the respondent mailed a notice of tax deficiency to petitioner on March 11, 1968, proposing

the adjustments listed for 1964, 1965 and 1966. On April 10, 1968, petitioner, through her counsel, mailed a letter of protest of said deficiency to respondent. On April 12, 1968, respondent assessed said deficiency, which amount was paid by petitioner on April 15, 1968. On July 9, 1968, petitioner filed in this Court in Docket 2063 a petition for redetermination of the tax assessment.

17. The District determined for each of the years here in question that petitioner's computation of depreciation was improperly based on \$600,000.00 as the cost or other basis of the apartment units. Respondent determined that the proper cost or other (allowable) basis for depreciation was computed as follows:

For the Years 1964, 1965 and 1966:

Total Earned Surplus and Capitalization	\$274,026.62
Less Cash Distribution	<u>-76,793.45</u>
Balance Attributable to Buildings and Land	197,233.17
Basis for Depreciation	<u>172,758.90</u>

The District used the same ratio of the building to the total cost or other basis as was used by the taxpayer in determining the value allocated to the building (\$600,000.00 building divided by \$685,000.00 building and land, equals 87.5912%). That ratio determines the balance attributable to the building (87.5912% x \$197,233.17 = \$172,758.90).

For the Years or Periods 1967 and 1968:

Capital Stock		\$ 1,000.00
Earned Surplus		273,026.62
Plus: Corporate Liabilities (taxes)		<u>8,925.32</u>
Total		\$282,951.94

Less: Other Assets Received on Liquidation

Cash	\$76,793.45	
Land	44,281.70	= (\$121,075.15)

Respondent's Determination of the Depreciable Basis of the Apartment Units		<u>\$161,876.79</u>
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[End of Stipulation]

Since the taxable years in question are 1964-1968, inclusive, the provisions of the District of Columbia Income and Franchise Tax Act of July 16, 1947^{1/} (sometimes referred to herein as "Act"), then in effect, govern the disposition of this case.^{2/} Section 47-1557b(a) (7) provided at that time, and still provides, for the deduction from gross income when computing net income of "[a] reasonable allowance for exhaustion, wear, and tear of property used in the trade or business, including a reasonable allowance for obsolescence; * * *." That section further provided that "[t]he basis upon which

^{1/} 61 Stat. 328, Art. I (codified at D.C. Code §47-1551 et seq. (1967)).

^{2/} The District of Columbia Revenue Act of 1969, Pub. L. No. 91-106, §601(c) (4), 83 Stat. 177 (codified at D.C. Code §47-1583e (Supp. IV 1971)) which was made applicable to taxable years beginning after December 31, 1968, changed the law in this area to conform to I.R.C. §167(g). See Lenkin v. District of Columbia, 149 U.S. App. D.C. 129, 131, 461 F. 2d 1215 (1972).

such allowances are to be computed is the basis provided for in section 47-1583e."^{3/} Section 47-1583e specified the basis for depreciation used in determining the amount to be permitted as a deduction in four instances.^{4/} The present case arose due to the fact that §47-1583e did not, nor did any other section of the Act, specifically provide for a depreciation base in the situation where assets are received in the complete liquidation of a corporation.

^{3/} D.C. Code §47-1557b(a) (7) (1967) (amended Supp. IV 1971).

^{4/} In relevant part that section provided:

The bases used in determining the amount allowable as a deduction from gross income under the provisions of section 47-1557b(a) (7) shall be--

(a) where the property was acquired after December 31, 1938, by purchase, the basis shall be the cost thereof to the taxpayer;

(b) where the property was received in exchange for other property after December 31, 1938, the basis shall be the market value thereof at the time of such exchange;

(c) where the property was inherited or acquired by gift after December 31, 1938, the basis shall be that defined in subsection 47-1583(b) (3);

(d) if the property was acquired prior to January 1, 1937, the appropriate basis set forth in subsection (a), (b), or (c) of this section shall be used: Provided, however, That the taxpayer may, at his option, use as the basis the market value of such property as of January 1, 1939.

D.C. Code §47-1583e (1967) (amended Supp. IV 1971).

The question of the proper depreciation base for purposes of calculating deductions from gross income under §47-1557b(a)(7) on the Unincorporated Business Franchise Tax Returns of a business where assets, and particularly an apartment building, are distributed to stockholders in a liquidation was squarely dealt with in Lenkin v. District of Columbia, 149 U.S. App. D.C. 129, 461 F. 2d 1215 (1972).^{5/} In Lenkin-Pollin the assets of a dissolved corporation, consisting mainly of an apartment building, were distributed, subject to outstanding corporate liabilities, to the stockholders who paid off the liabilities and continued the operation of the building in the form of a partnership. In each case, the deductions for depreciation taken by the businesses on their Unincorporated Franchise Tax Returns were disallowed by the District of Columbia, as resting upon an improper basis for the depreciation. The depreciation base which was substituted in each case excluded the amount of corporate indebtedness existing at the time of liquidation.^{6/}

The petitioners in Lenkin invoked the second category under §47-1583e,^{7/} contending that they received their apartment property "in exchange for" the shares of stock

^{5/} Pollin v. District of Columbia, 149 U.S. App. D.C. 129, 461 F. 2d 1215 (1972), consolidated with Lenkin v. District of Columbia, also resolved the same issue. These cases will be referred to herein as Lenkin-Pollin.

^{6/} 149 U.S. App. D.C. at 131, 461 F. 2d at 1217.

^{7/} See note 4, supra.

which they formerly owned in the dissolved corporation.^{8/}
The petitioners in Pollin, on the other hand, argued that
the first statutory category applied and urged the court
to treat the transaction by which they became the owners
of the apartment house as a "purchase" or sale.^{9/} In the
former situation, the basis for depreciation would have
been the market value at the time of the exchange, and
in the latter it would have been the cost.^{10/}

The court in Lenkin-Pollin concluded initially
that the liquidating distributions did not fall within
any of the four categories for which §47-1583e specified
a basis upon which depreciation deductions were to be
taken.^{11/} With respect to the first two categories in
§47-1583e, the court referred to its previous decisions
which "maintained undeviatingly" that distributions of
a corporation's property to its stockholders are neither
sales nor exchanges, even if the distributees' shares
are cancelled as part of the transaction.^{12/} It reaffirmed

8/ 149 U.S. App. D.C. at 137, 461 F. 2d at 1223.

9/ Id., at 138, 461 F. 2d at 1223.

10/ See note 4, supra. What was essentially the book
value of the assets was rejected as a proper basis in
Pollin, 149 U.S. App. D.C. at 131, 461 F. 2d at 1217.

11/ 149 U.S. App. D.C. at 138, 461 F. 2d at 1224.

12/ Id., at 137, 461 F. 2d at 1223. See Verkouteren v. District of Columbia, 139 U.S. App. D.C. 303, 308, 433 F. 2d 461, 466 (1970); Oppenheimer v. District of Columbia (Oppenheimer II), 124 U.S. App. D.C. 221, 224, 363 F. 2d 708, 711 (1966); Doyle v. District of Columbia, 124 U.S. App. D.C. 207, 363 F. 2d 694 (1966); Estate of Uline v. District of Columbia, 124 U.S. App. D.C. 5, 7, 360 F. 2d 820, 822 (1966); Berliner v. District of Columbia, 103 U.S. App. D.C. 351, 353-356, 258 F. 2d 651, 653-656, cert. denied, 357 U.S. 937 (1958).

these decisions and stated with particular reference to the market value basis for depreciation deductions where there is an "exchange," that it would not reconsider its ruling in Oppenheimer II^{13/} and recognize market value as an appropriate basis for depreciation when to do so would result in a step-up in the transferee's depreciation base.^{14/}

The parties in the present case agree that Lenkin-Pollin establishes the proper rule to be applied by the Court in deciding the issue before it. However, they disagree as to the formula to be utilized in applying that rule to the particular facts of this case. To the extent, however, that the petitioners contend that the proper basis for depreciation of the apartment units is their market value at the time of liquidation because of the fact that there was an "exchange" of stock for assets on that date, this Court, based on Lenkin-Pollin and the other cases cited^{15/} previously, must disagree.

The court in Lenkin-Pollin concluded the fact that the situation presented where assets are received in liquidation did not fit into one of the specific categories setting out the appropriate base for depreciation in §47-1583e did not bar completely any deduction for depreciation. It found the entitlement for such

^{13/} 124 U.S. App. D.C. 221, 363 F. 2d 708 (1966). See text accompanying note 12, supra.

^{14/} 149 U.S. App. D.C. at 144, 461 F. 2d at 1230.

^{15/} See note 12, supra.

deductions under §47-1557b(a) (7), which provides in general for "[a] reasonable allowance for" depreciation. It's task then was to find the basis upon which that "reasonable allowance for" depreciation was to be determined in the situation where a taxpayer's business property was acquired in a corporate liquidation.^{16/} It believed that "fundamental considerations" dictated what the basis to the stockholders of the assets received upon dissolution of a corporation should be and stated that:

[W]hen the legislature leaves for the courts the definition of basis for "reasonable" depreciation allowances, their polestar is a basis that will enable the taxpayer to recover his investment in the asset -- no more, but certainly no less. ^{17/}

In determining what made up the stockholders' investment in the depreciable assets, which were obtained in a corporate liquidation, the court in Lenkin-Pollin had little difficulty including two items -- the sum paid for the corporate stock, reflected in the corporation's paid-in surplus, which is the stockholders' cost of achieving that status, and the stockholders' proportionate share of the earned surplus being their vested interest in previously undistributed corporate profits.^{18/} Upon receipt of that share of earned surplus by the stockholders at the time of liquidation, it is taxable as a dividend and includable in gross income.^{19/} The court held that

^{16/} 149 U.S. App. D.C. at 139-142, 461 F. 2d at 1228-1231.

^{17/} Id., at 143, 461 F. 2d at 1229.

^{18/} Id., at 143-144, 461 F. 2d at 1229-1230.

^{19/} Id., at 144, 461 F. 2d at 1230 (footnote omitted).

also included as part of cost of the stockholders-distributees, and thus properly a part of their base for computing deductions for depreciation of the apartment house, were the unsatisfied debts of the dissolved corporation at the time of the liquidation which were assumed by the stockholders.^{20/} Deducted from the investment of the stockholders in the depreciable asset received upon liquidation, however, were other assets received in the liquidation for which no depreciable basis was sought and which comprised a return of their investment in the corporation.^{21/}

Turning to the application of the Lenkin-Pollin investment formula to the present factual situation, the Court finds no clear analogy between the two. The assumption of corporate liabilities by the shareholders upon liquidation, which was an important factor in that decision, has minimal significance, if any, here. More important is the fact that, in Lenkin-Pollin, as well as in Oppenheimer II, the stockholders who acquired the assets upon liquidation were apparently the original stockholders of the corporation. In such circumstances, these stockholders conceivably might receive in liquidation properties which, because of unrealized appreciation over

^{20/} Id., at 148, 461 F. 2d at 1234. In Lenkin, however, the court limited the inclusion of the assumed liabilities in the depreciation base to the amount which the dissolved corporation had not itself already recovered through depreciation deductions. Id.

^{21/} Id., at 144, 461 F. 2d at 1230.

their original cost to the corporation, had a market value at the time of liquidation greatly in excess of the stockholders' capital investment and their proportionate share of the corporation's earned surplus combined.^{22/}

This concerned the Lenkin-Pollin court, since in many instances corporate liquidations precede a continuation of the corporate business by some or all of the stockholders merely in a different form. Such transformation usually occurs absent any change in the stockholders' investment in the transferred assets.^{23/}

The court in Lenkin-Pollin refused to allow any tax advantage by reasserting its previous holding in Oppenheimer II that a stockholder-distributee cannot receive a step-up in the depreciation base to the market value of the assets at the time of the liquidation.^{24/}

To do so would permit the stockholder to acquire a depreciation base "consisting of a book write-up of a value on which, very properly, no tax need be paid upon its receipt by the stockholder."^{25/} Although the

^{22/} See, e.g., 124 U.S. App. D.C. at 222, 363 F. 2d at 709. In District of Columbia v. Oppenheimer (Oppenheimer I), 112 U.S. App. D.C. 239, 240, 301 F. 2d 563, 564 (1962), the court held that the unrealized appreciation in value of the distributed property was not taxable as a "dividend" to the stockholder, but only his share of the earned surplus was so taxable. See text accompanying note 19, supra.

^{23/} 149 U.S. App. D.C. at 143, 461 F. 2d at 1229.

^{24/} Id.

^{25/} 124 U.S. App. D.C. at 223, 363 F. 2d at 710. It is not clear to this Court how the court in the Lenkin case applied the theory set forth in Oppenheimer II to preclude the petitioner there from including any amount of the assumed liabilities over the net depreciation remaining to the corporation in the depreciation base. See note 20, supra.

petitioners in this case in August, 1963, effected the same transformation that concerned the court in Lenkin-Pollin when they liquidated the Corporation and contributed the apartment units and land to Glover Park Terrace, an unincorporated business, there is no evidence that the market value of the depreciable assets, primarily the apartment units, received in the liquidation exceeded what we have determined the investment or cost of the petitioners to be in those assets. Since, as we previously stated, we follow the rule that there is no "exchange" or "purchase" within the meaning of §47-1583e when assets are received in liquidation, and thus petitioners are not permitted to employ the market value of those assets at the time of liquidation as a depreciation base, to the extent that that value exceeded petitioners' investment, we would avoid the concerns expressed by the court in Lenkin-Pollin and Oppenheimer II by not allowing the step-up in basis.

Applying the rule announced in Lenkin-Pollin for the determination of the "reasonable allowance for" depreciation under §47-1557b(a)(7) we find that the petitioners' investment in the assets received in the liquidation of Glover Park Terrace, Inc., or their cost for those assets, must be viewed in terms of the basis in the stock which the shareholders received through, and which was valued in, the estate of Maurice Korman.

The receipt of this stock in 1961, by inheritance, was an intervening event, not present in either Lenkin-Pollin or Oppenheimer II, having consequences for tax purposes which cannot be overlooked. Under the District of Columbia Income and Franchise Tax Act of 1947,^{26/} the stock received by the shareholders in 1961 through inheritance was to be valued, for example, for purposes of determining gain or loss upon sale at the highest valuation placed upon the property by the United States or by the District of Columbia.^{27/} Under federal law at that time, the basis for the stock received was its fair market value on the date of decedent's death.^{28/}

Based upon the Stipulation of Facts filed by the parties, the shares of stock received through the estate of the decedent were valued for purposes of the federal estate tax and District of Columbia inheritance taxes at a value of \$638,070.16.^{29/} To find then, as the District of Columbia contends, that the basis of the apartment units for purposes of depreciation in taxable years 1967

^{26/} See note 1, supra.

^{27/} D.C. Code §1583(b)(3) (1967) (amended Supp. IV 1971). If the inherited property were other than stock, such as, for example, apartment units, the basis of that property for purposes of determining the deduction allowed for depreciation would be the same. D.C. Code §1583e(c) (1967) (amended Supp. IV 1971).

^{28/} I.R.C. §1014. The Tax Reform Act of 1976, in §2205, however, has altered this rule substantially for property acquired from a decedent dying after December 31, 1976.

^{29/} Stipulation of Facts, para. 9 (May 4, 1976).

and 1968 is \$161,876.79, which represents the book value net of depreciation of those units in 1963, and in taxable years 1964 through 1966 is \$172,758.90, would completely disregard the shareholders' basis in the inherited stock under both federal and District of Columbia tax laws, which basis represents under fundamental tax principles their investment or cost. We believe that to view this case in the way respondent presents it, would prevent petitioners from recovering their investment in the depreciable assets as permitted under Lenkin-Pollin.^{30/}

We hold then that the amount at which the stock was valued in the estate for purposes of federal estate tax and the District's inheritance tax, \$638,070.16, which value in turn represented in substantial part the fair market value at that time of the underlying assets of the Corporation, is the upper limit which petitioner Glover Park Terrace could use as a depreciation base for all the assets received on liquidation. Likewise, whatever portion of that amount represented the market value of the apartment units, would constitute the maximum basis for depreciation of those units received in liquidation in 1963. The Court views the fact situation in Snow v. District of Columbia,^{31/} as more

^{30/} Our view is supported by another fundamental tax principle that the corporation and shareholders are separate tax entities and that "[a]ssets demand independent tax treatment -- perhaps differing treatment -- according to whether they belong to the corporation * * * or to the stockholders." Lenkin-Pollin, 149 U.S. App. D.C. at 148 n. 136, 461 F. 2d at 1234, quoting Verkouteren v. District of Columbia, 139 U.S. App. D.C. at 308, 433 F. 2d at 466.

^{31/} 124 U.S. App. D.C. 69, 361 F. 2d 523 (1965).

closely analogous to the fact situation here. In Snow, the taxpayer purchased for \$1,000,000 all of the stock of a corporation which owned assets worth the same amount. He then liquidated the corporation and acquired the assets. One of the taxpayer's claims was for depreciation for an apartment building computed on the basis of its cost to him. The District, on the other hand, contended that the depreciation could be based only on the corporation's book value for the building. The court there held:

[w]e think that in this case a reasonable allowance is the proper proportion of the cost to Snow, which is the value of the stock he turned over for the property. Since he paid cash for that stock so nearly immediately to his acquisition of the depreciable property, no valuation problems seem to arise.^{32/}

The intervening event in Snow which raised the cost or investment of the stockholder from that of the original shareholders was his purchase of the stock. In the instant case, the intervening event which raised the cost or investment of the shareholders in the assets of the Corporation was their inheritance of the stock.^{33/}

^{32/} Id., at 73, 361 F. 2d at 527.

^{33/} Apparently, under the peculiar circumstances of Snow, the court there treated the transaction as a sale or exchange. However, the court in Lenkin-Pollin stated that it did not deem Snow's depreciation ruling, on its facts, at odds with the holding in Oppenheimer II. See 149 U.S. App. D.C. at 144 n. 112, 461 F. 2d at 1230. We state again that we do not hold that there was a sale or exchange in this case which would give petitioners a depreciation base of either the market value of the apartment building on the date of liquidation under §47-1583e(b), or perhaps, the market value of their stock at the time of liquidation, under a fair reading of Snow.

We believe that our holding is supported by considering one of the basic purposes behind the allowance of depreciation deductions, which is, a method whereby a taxpayer recovers his cost for a capital asset. The Supreme Court recently reiterated its belief that "[d]epreciation reflects the cost of an existing capital asset, not the cost of a potential replacement."^{34/} It further stated in Idaho Power Co. that:

Depreciation is an accounting device which recognizes that the physical consumption of a capital asset is a true cost, since the asset is being depleted. As the process of consumption continues, and depreciation is claimed and allowed, the asset's adjusted income tax basis is reduced to reflect the distribution of its cost over the accounting periods affected.^{35/}

The Court also has stated with respect to the determination of the cost of property for purposes of the depreciation basis that the cost

normally means * * * cost to the taxpayer. A property may have a cost history quite different from its cost to the taxpayer. * * * But generally * * * the taxpayer's outlay is the measure of his recoupment through depreciation accruals. ^{36/}

^{34/}Commissioner v. Idaho Power Co., 418 U.S. 1, 11-12 (1974), quoting United States v. Chicago, B. & O. R. Co., 412 U.S. 401, 415 (1973) (citation omitted).

^{35/} 418 U.S. at 10 (footnote omitted) (emphasis supplied).

^{36/} Detroit Edison Co. v. Commissioner, 319 U.S. 98, 102 (1943).

In an earlier case the Court said that a reasonable allowance for depreciation is the sum which should be set aside for the taxable year so that at the end of the useful life of the asset, the aggregate of amounts set aside will equal the original cost or basis to the taxpayer.^{37/} Since we must follow the rule set forth in Lenkin-Pollin that the depreciation basis for depreciable assets must represent the cost of those assets to the taxpayer, the above reasoning convinces this Court that the determination of the proper depreciation basis for the apartment units here must start with the shareholders' basis for the inherited stock immediately after the inheritance.

The amount which we have determined as the proper ceiling for the depreciation base, \$638,070.16, was as we stated, the value of the shares of stock received by the shareholders, which shares passed through the estate of Maurice Korman.^{38/} That value, set for estate and inheritance tax purposes, was petitioners' investment or cost basis for all the corporate assets, depreciable and non-depreciable. In order to determine petitioners' cost for the apartment units, the entire cost must be allocated among all the assets of the Corporation based upon their market value on the date of death, or on the

^{37/} See United States v. Ludey, 274 U.S. 295, 300-301 (1927); Gilmartin v. Commissioner, 32 CCH Tax Ct. Memo. 1158, 1162 (1973).

^{38/} See note 29, supra.

alternate valuation date if used by the executor. It is not clear from this record what the market value of those assets was at that time and thus the proper allocation of cost cannot be made. Petitioners will have the burden of producing evidence to establish the market value of the apartment units on the valuation date and the depreciation basis for the taxable years in question cannot exceed an amount which bears the same proportion to the total investment or cost that the market value of the apartment units bears to the total market value of all the assets.

This Memorandum Order represents the Court's findings of fact and conclusions of law.


FRED B. UGAST
Judge

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