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Atlas' Tax Aspects of Real Estate Transactions. Fifth Edition—Revised and annotated by Orton W. Boyd. (The Bureau of National Affairs, Inc., Washington, D. C. 1971, pp. 394, $15.00).

Reviewed by Donald J. Weidner*

According to the introduction, the book is "intended for the real estate dealer, the investor, the broker, the lawyer, and the accountant," and its purpose is to "state clearly the tax effects of real estate transactions and thus be of assistance to those undertaking these transactions." Since the book is not written primarily for the tax practitioner, I shall evaluate it in terms of the needs of an attorney with no special background in tax, who wants to understand more fully the tax consequences of the real estate transactions he encounters.

The book is not organized as a theoretical development of real estate tax law. Rather, each chapter is an attempt to catalogue the basic tax issues that relate to the chapter title.[1] The only major changes of the Fifth Edition are those that incorporate provisions of the Tax Reform Act of 1969.[2] Given that, and the likelihood that many attorneys will consider purchasing the Fifth Edition to become more familiar with the 1969 Act changes most likely to affect their real estate transactions, it should prove helpful to summarize briefly those changes, and comment on the book's treatment of them.

The basic changes in the 1969 Act that directly affect real estate are aimed at limiting the use of the depreciation deduction as a "tax shelter." Therefore, it is important to understand the nature of this "shelter." Owners of property used

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1. The four longest of the book's fourteen chapters, which together constitute almost half the book, are entitled "How to Organize," "Sales," "Mortgages; Deferred Payment Sales," and "Special Problems on Closely Held Corporations."

2. Hereinafter cited as "1969 Act."

in a trade or business or held for the production of income are allowed annual "depreciation deductions" for the exhaustion, wear and tear of such property.[3] The straight-line method of computing depreciation spreads equal deductions evenly over the estimated useful life of the property. Accelerated depreciation methods, however, allow the taxpayer much greater depreciation deductions in the earlier years of the property's useful life, and smaller deductions in later years. Since a depreciation deduction is subtracted from the taxpayer's gross income, it is used to offset, or "shelter" from tax, ordinary income of that year from the property being depreciated, or from other sources. Before the Revenue Act of 1964,[4] depreciation deductions were taken into account only insofar as they were subtracted from the taxpayer's basis in the property, which is used to compute the gain on the eventual sale or other disposition. Thus, the recognized gain on the sale of the property was increased by the amount of the depreciation deductions previously taken. This, however, did not negate the economic benefit that had been obtained by using the depreciation deduction to shelter ordinary income, because the gain on the sale of depreciable property is generally taxed at the favorable capital gains tax rates. Thus, taxpayers used the depreciation deduction to permanently shelter other income from taxation at the ordinary income tax rates. An example of this classic pre-1964 Act shelter will illustrate the point:

> Taxpayer in the 60% bracket took a depreciation deduction of $10,000. This resulted in a tax savings of $6,000 in the year of the deduction. When taxpayer subsequently sold the depreciated property, the amount of the depreciation deduction that had been taken was subtracted from his basis in the property. Thus, his recognized gain on the sale was $10,000 greater than it would have been had there been no depreciation deduction taken. This gain, however, received capital gains treatment. In a year in which the maximum tax on capital gains was 25%, the tax bill on the additional $10,000 gain was only $2,500. Thus, taxpayer, in effect, "bought" a $6,000 tax saving in the year in which he took his depreciation deduction, for only $2,500.

The 1969 Act is a refinement of the assault on such shelters that began with the 1964 Act. The 1964 Act was the first legislation to require that part or all of the gain on the sale of property that had been depreciated at an accelerated rate be

3. INT. REV. CODE of 1954, §167(a). The Internal Revenue Code of 1954 is hereinafter cited as "Code."

4. Hereinafter cited as "1964 Act."

"recaptured," that is, taxed as ordinary income. The thrust of the real property changes of the 1969 Act is to (1) limit the use of accelerated depreciation methods that permit greater depreciation deductions in the earlier years of the property's useful life; (2) strengthen the provisions of the 1964 Act that recapture some of the ordinary income otherwise sheltered by depreciation deductions; and (3) place a special 10% tax on accelerated depreciation and certain other deductions.

(1) *Limitation on the Use of Accelerated Depreciation Methods.* The general rule of the 1969 Act with respect to depreciation of real property is that new property may be depreciated only by the 150% declining balance or straight line methods,[5] and that used property may be depreciated only by the straight line method.[6] The most important exceptions to this general rule apply to residential rental property and rehabilitation expenditures to low income rental housing. With respect to new residential rental properties, all accelerated depreciation methods previously available are still available.[7] With respect to used residential rental property, the straight-line is the only method available, unless the property has a useful life of 20 years or more, in which case the 125% declining balance method is available.[8] With respect to certain rehabilitation expenditures on low income rental housing, the taxpayer may elect to depreciate such expenditures on a straight-line basis over a 60 month period.[9] Under prior law, such expenditures were capitalized, and depreciable over the property's remaining useful life.

(2) *Recaputre of Ordinary Income.* The "recapture" provisions, introduced by the 1964 Act and strengthened by the 1969 Act, reduce the tax shelter advantages of the depreciation deduction by treating some of the gain on the sale of property that has been the subject of accelerated depreciation, as ordinary income. The amount of depreciation "recaptured," that is, the amount of gain treated as ordinary income, is determined by applying the appropriate "applicable percentage" to the depreciation taken in excess of that allowed by the straight-line method. There are separate rules for determin-

5. Code, §167(j)(1).
6. Code, 167(j)(4).
7. Code, §167(j)(2).
8. Code, §167(j)(5).
9. Code, §167(k).

ing the applicable percentages to be applied to pre-1970 and post-1969 "excess" depreciation. The applicable percentage for pre-1970 excess depreciation is 100% less 1% for each month the property is held beyond 20 months.[10] Thus, if the property is held for more than 120 months, none of the pre-1970 excess depreciation will be recaptured.

The general rule with respect to post-1969 excess depreciation of most real property is that the applicable percentage is 100%.[11] In other words, all of the excess depreciation will be recaptured, regardless of the length of time the property is held. Residential rental properties, however, are not subject to recapture provisions as strict as those that now apply to commercial properties. With respect to residential rental property and certain rehabilitation expenditures on low income rental housing, the applicable percentage is 100% less 1% for each month the property is held beyond 100 months.[12] Thus, if residential rental property is held for more than 200 months, there will be no recapture. With respect to property that is financed under the National Housing Act or similar local programs and subject to certain limitations on the rate of return and profit, the applicable percentage is the same as it would be for pre-1970 excess depreciation.[13]

(3) *The Tax on Preferences.* The 1969 Act imposes a new tax on items of tax preference — certain deductions not used by most taxpayers, but often used to great advantage by others. The tax is 10% of the excess of the year's preferences over the sum of $30,000 plus the taxpayer's regular federal tax.[14] "Excess" depreciation, that is, depreciation taken in excess of the amount allowable under the straight-line method, is an item of tax preference subject to this tax.[15]

A major problem with the book is that certain sections that concern areas affected by the 1969 Act are not written as clearly as they could be. For example, the author bases his discussion of the restricted availability of accelerated depreciation methods on the distinction between section 1245 and section 1250 property. He makes the distinction simply by stat-

10. CODE, §1250(a)(2)(B).
11. CODE, §1250(a)(1)(C)(v).
12. CODE, §1250(a)(1)(C)(iii) and (iv).
13. CODE, §1250(a)(1)(C)(ii).
14. CODE, §56(a).
15. CODE, 57(a)(2).

ing the statutory definitions of these categories — definitions that may have less than certain meaning for the attorney inexperienced in tax. Thus, the reader may have a difficult time trying to determine from the book what depreciation methods are available for a particular piece of property. The most difficult part of the book to read, however, is the section of the chapter on "Sales" that concerns the treatment of gain (or loss) in the event of sale or other disposition — the section that includes, among other things, the author's discussion of depreciation recapture. Here again, the author, perhaps to insure that he is technically accurate and complete, primarily tracks statutory provisions rather than digest and restate them in a way the average lawyer can readily understand.[16]

Nevertheless, most of the book is quite easy to read. Almost every chapter contains numerous examples that illustrate even the most basic of points, and many contain several checklists that summarize the treatment of transactions under discussion. Careful use of the book will enable the attorney inexperienced in tax matters to sensitize himself to the basic tax issues in real estate transactions, even though it may not "state clearly" the tax effects of all the transactions he will encounter.

16. For more of a "plain talk" discussion of these issues, *see* P. Anderson, TAX PLANNING OF REAL ESTATE (6th ed. 1970).