No. 6427

In the United States Circuit Court of Appeals for the Ninth Circuit

MARY C. YOUNG, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

and

MARY YOUNG MOORE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

UPON PETITION TO REVIEW ORDERS OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR RESPONDENT

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BRIEF FOR RESPONDENT

PREVIOUS OPINION

The only previous opinion in the present cases is that of the United States Board of Tax Appeals (R. 54-55), which is reported in 20 B. T. A. 692.

JURISDICTION

The appeal in the above-entitled cases involves deficiencies in income taxes of Mary C. Young for

the years 1924 and 1925 in the amounts of $2,825.63 and $2,091.21, respectively, and deficiencies in income taxes of Mary Young Moore for the years 1924 and 1925 in the amounts of $2,930.06 and $2,117.42, respectively, and is taken from decisions of the United States Board of Tax Appeals entered September 10, 1930. (R. 56–57.) These cases are brought to this court by petitions for review filed January 13, 1931 (R. 58–68), pursuant to the Revenue Act of 1926, c. 27, Sections 1001, 1002, and 1003, 44 Stat. 9, 109, 110.

QUESTIONS PRESENTED

1. Whether petitioners may deduct in 1924 as a loss the net depreciated cost of buildings voluntarily demolished in that year in order to effect a ninety-nine year lease of land on which they stood, or whether the net depreciated cost of such demolished buildings should be treated as a part of the cost of such lease to be amortized over the entire period thereof.

2. Whether petitioners may deduct as ordinary and necessary expenses (a) an amount paid to a real-estate agent as a commission for effecting a ninety-nine year lease, (b) amounts paid to an attorney as fees for legal services in effecting said lease, and (c) amounts paid for a certificate of title necessary to effect said lease, or whether said amounts are capital expenditures to be ratably deducted as the lease is exhausted.

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1924, c. 234, 43 Stat. 253:

SEC. 214. (a) In computing net income there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *.

* * * * *

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *.

* * * * *

(8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence; * * *.

SEC. 215. (a) In computing net income no deduction shall in any case be allowed in respect of—

* * * * *

(2) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;

(3) Any amount expended in restoring property or in making good the exhaustion

> thereof for which an allowance is or has been made; * * *.

Treasury Department Regulations 65, promulgated under the Revenue Act of 1924:

> ART. 141. *Losses.*—Losses sustained during the taxable year and not compensated for by insurance or otherwise are fully deductible * * * if (a) incurred in a taxpayer's trade or business, or (b) incurred in any transaction entered into for profit, or (c) arising from fires, storms, shipwreck, or other casualty, or theft. They must usually be evidenced by closed and completed transactions. The basis for determining the amount of the deduction for losses is the same as is provided in section 204 for determining the gain or loss from the sale or other disposition of property. See articles 1591–1603. Proper adjustment must be made in each case for expenditures properly chargeable to capital account, and for items of loss, depreciation, obsolescence, amortization, or depletion, previously allowed with respect to the property. Moreover, the amount of the loss must be reduced by the amount of any insurance or other compensation received, and by the salvage value, if any, of the property. See articles 1579 and 1580. A loss on the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit. * * *
>
> ART. 142. *Voluntary removal of buildings.*—Loss due to the voluntary removal or

demolition of old buildings, the scrapping of old machinery, equipment, etc., incident to renewals and replacements will be deductible from gross income. When a taxpayer buys real estate upon which is located a building, which he proceeds to raze with a view to erecting thereon another building, it will be considered that the taxpayer has sustained no deductible loss by reason of the demolition of the old building, and no deductible expense on account of the cost of such removal, the value of the real estate, exclusive of old improvements, being presumably equal to the purchase price of the land and building plus the cost of removing the useless building.

ART. 161. *Depreciation.*—A reasonable allowance for exhaustion, wear and tear, and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the property in the business, equal the basis

of the property determined in accordance with section 204 and articles 1591–1603. Due regard must also be given to expenditures for current upkeep.

ART. 162. *Depreciable property.*—The necessity for a depreciation allowance arises from the fact that certain property used in the business gradually approaches a point where its usefulness is exhausted. The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art, as where machinery or other property must be replaced by a new invention, or due to the inadequacy of the property to the growing needs of the business. It does not apply to inventories or to stock in trade, nor to land apart from the improvements or physical development added to it. * * * The deduction of an allowance for depreciation is limited to property used in the taxpayer's trade or business. * * *

ART. 163. *Depreciation of intangible property.*—Intangibles, the use of which in the trade or business is definitely limited in duration, may be the subject of a depreciation allowance. Examples are patents and copyrights, licenses, and franchises. Intangibles, the use of which in the business or trade is not so limited, will not usually be a proper subject of such an allowance. If,

however, an intangible asset acquired through capital outlay is known from experience to be of value in the business for only a limited period, the length of which can be estimated from experience with reasonable certainty, such intangible asset may be the subject of a depreciation allowance, provided the facts are fully shown in the return or prior thereto to the satisfaction of the Commissioner.

ART. 164. *Capital sum recoverable through depreciation allowances.*—The capital sum to be replaced by depreciation allowances is the cost or other basis of the property in respect of which the allowance is made. See article 1602. To this amount should be added from time to time the cost of improvements, additions, and betterments, the cost of which is not deducted as an expense in the taxpayer's return, and from it should be deducted from time to time the amount of any definite loss or damage sustained by the property through casualty, as distinguished from the gradual exhaustion of its utility which is the basis of the depreciation allowance. In the case of the acquisition on or after March 1, 1913, of a combination of depreciable and nondepreciable property for a lump price, as, for example, buildings and land, the capital sum to be replaced is limited to an amount which bears the same proportion to the lump price as the value of the depreciable property at the time of acquisition bears to the value of entire property at that time. Where the lessee of real

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property erects buildings, or makes permanent improvements which become part of the realty and income or loss has been returned by the lessor as a result thereof, as provided in article 48, the capital sum to be replaced by depreciation allowances is held to be the same as though no such buildings had been erected or such improvements made. * * *

Art. 165. *Method of computing depreciation allowance.*—The capital sum to be replaced should be charged off over the useful life of the property, either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and must have due regard to operating conditions during the taxable period. While the burden of proof must rest upon the taxpayer to sustain the deduction taken by him, such deductions must not be disallowed unless shown by clear and convincing evidence to be unreasonable. The reasonableness of any claim for depreciation shall be determined upon the conditions known to exist at the end of the period for which the return is made.

Art. 292. *Capital expenditures.*—Amounts paid for increasing the capital value or for making good the depreciation (for which a deduction has been made) of property are

not deductible from gross income. See section 214 (a) (8) of the statute and article 161. * * * The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architect's services is part of the cost of the building. Commissions paid in purchasing securities are a part of the cost price of such securities. Commissions paid in selling securities are an offset against the selling price. * * *

STATEMENT OF FACTS

Upon motion of petitioners' attorney these cases were consolidated for hearing before the United States Board of Tax Appeals (R. 43), and the facts were stipulated and agreed to by counsel (R. 45–49), from which stipulation the Board found the facts to be as follows (R. 51–54):

Mary Young Moore is the daughter of Mary C. Young. They both reside at 1001 South Hoover Street, Los Angeles, California. They are joint owners of certain land in the City of Los Angeles, California, and located at the Southeast corner of Seventh and Figueroa Streets, extending East on Seventh Street to the Southwest corner of Flower and Seventh Streets. The petitioners are equal owners.

During the years 1917 and 1918 the petitioners erected on this land several brick

store buildings at a cost of $50,000. These buildings were rented or for rent until their demolition.

In 1924 a lease for the term of ninety-nine years was entered into by the petitioners with the Sun Realty Company, whereby the brick buildings erected during 1917 and 1918 should be demolished and a new building erected to be occupied by Barker Brothers. The buildings were demolished in 1924.

The full amount of the depreciation sustained on the brick store buildings, from the time of erection to the time of demolition in 1924, was $7,785, and the undepreciated cost thereof to the petitioners at the time of demolition was $42,215.

The buildings were not salvaged or otherwise disposed of, and the petitioners received no insurance or other compensation on the demolition of the buildings.

Each of the petitioners, in her income-tax return for the year 1924, claimed a deduction in the amount of $21,107.50, representing her one-half of the undepreciated cost. These deductions were disallowed by the respondent and the sum of $21,107.50 was added back to the income of each of the petitioners.

On October 1, 1924, the petitioners granted a ground lease of the premises at Seventh and Figueroa Streets to the Sun Realty Company for a period of ninety-nine years, on the basis of a monthly rental of $10,000 from October 1, 1924, to June 30, 1926, and

of a monthly rental of $20,000 thereafter until the end of the term of the lease. This lease was obtained for the petitioners by a real estate agent who charged as his commission therefor the sum of $50,500, which commission was paid during the years 1924 and 1925. During the year 1924 there was paid $21,500, and the sum of $29,000 was paid during the year 1925. These amounts were paid by the petitioners in equal sums and each paid $10,750 in 1924 and $14,500 in 1925

Each of the petitioners claimed as a deduction in her income-tax return for 1924 the sum of $10,750, representing the amount actually paid by her to the real estate agent during that year. These deductions were disallowed by the Commissioner.

In addition to the commission paid to the real estate agent, the petitioners were required to pay attorneys' fees in the amount of $5,500, and the expense of obtaining certificate of title in the amount of $4,502.85.

Each petitioner, in her income tax return for 1924, claimed a deduction in the amount of $2,750, being one-half of the attorneys' fees, and a deduction in the amount of $2,251.43, being one-half of the cost of obtaining certificate of title. These deductions were disallowed by the respondent.

The respondent considered the loss sustained on the demolition of the brick buildings to be a capital loss and further considered the sums expended by the petitioners

as commissions, attorneys' fees and cost of obtaining certificate of title, to be capital expenditures to be amortized and deducted over the term of the lease, and as a result thereof allowed a deduction to each of the petitioners for the year 1924 in the amount of $513.59.

In his adjustment of the income of the petitioners for the year 1925, the respondent disallowed the deduction claimed by each in the amount of $14,500, representing the sum paid by each as commission to the real estate agent in 1925, and allowed a deduction for amortization of the cost of the lease in the amount of $513.59.

Each of the petitioners kept her books and rendered her income tax returns for the years 1924 and 1925 on the basis of cash receipts and disbursements.

The Board held that the petitioners were not entitled to deduct the unextinguished cost of the buildings demolished in order to obtain a ninety-nine year lease upon the land upon which they were erected, and that such extinguished cost should be exhausted over the term of the lease. The Board also held that the amount paid as a commission to a real estate agent for his services in effecting a ninety-nine year lease of the property, amounts paid to an attorney as fees for legal services in connection with said lease, and amounts paid for a certificate of title which was necessary to effect

said lease were capital expenditures, to be ratably deducted as the lease is exhausted. (R. 54–55.)

The Board entered separate orders of redetermination against the petitioners (R. 56–58), from which orders of redetermination this petition for review has been filed (R. 58–68).

SUMMARY OF ARGUMENT

Petitioners owned land with brick buildings thereon and in 1924 demolished the buildings as a necessary incident to the acquisition of a long-term lease. Under these circumstances, the undepreciated cost of the demolished buildings is not a deductible loss. The result of the transaction was merely that the taxpayers had a new building on their land in lieu of the old buildings and in addition had secured a valuable lease on terms which otherwise would have been impossible. There was merely a substitution of assets and no loss has been shown, because of such substitution. The undepreciated cost of the old building constitutes a part of the cost of securing the lease; that is, a capital expenditure which should be recovered through annual deductions spread over the term of the lease.

The various amounts expended by the petitioners were paid in connection with the procuring of a ninety-nine year lease, which is a capital asset, and, therefore, are not deductible in computing net income.

ARGUMENT

I

No deductible loss was sustained by reason of the destruction of the petitioners' buildings, demolished in order to secure a ninety-nine year lease of the land on which they stood; their undepreciated cost became a part of the cost of securing the lease and may be recovered through annual deductions for exhaustion

The petitioners were the owners of certain real estate in the City of Los Angeles, California, and during 1917 and 1918 they erected thereon several brick store buildings at a cost of $50,000. (R. 51.) In 1924 they entered into an agreement with the Sun Realty Company wherein it was agreed that these buildings were to be demolished and a new building was to be erected which was to be leased to Barker Brothers for ninety-nine years at an agreed rental. The brick store buildings were demolished in 1924 and each petitioner claims one-half of the depreciated cost, which in 1924 amounted to $42,215. In other words, each petitioner claims a loss of $21,107.50 in 1924 on account of the demolition of the brick store buildings.

Respondent urges that the removal of the buildings was a part of the cost of acquiring a lease and that the cost of acquiring an asset cannot be regarded as a loss. The statute expressly provides that in computing net income no deduction shall in any case be allowed in respect of any amount paid out for new buildings or for permanent im-

provements or betterments made to increase the value of any property or estate. Section 215, *supra.*

The case of *Anahma Realty Corporation* v. *Commissioner* (C. C. A. 2nd), 42 F. (2d) 128, certiorari denied, 282 U. S. 854, is directly in point. The court said (p. 130):

> Under the provisions of the lease, appellant's lessee, at its own expense, was obliged to replace the buildings demolished with a new office building which became the property of the appellant at the end of the term. While section 234 (a) of the Revenue Act of 1918 permits the deduction of losses sustained during the taxable years, the appellant did not sustain a loss. *Pelican Bay Lumber Co.* v. *Blair* (C. C. A. 1929), 31 F. (2d) 15. The removal of the buildings was a part of the cost of acquiring the lease, and with it came the obligation of the tenant to pay the rent. The cost of acquiring an asset can not be regarded as deductible as a loss or business expense for the year in which it is paid or incurred. Moreover, section 215 (b) of the Revenue Act of 1918 provides that there may be no deduction for any amount paid out for new buildings or for permanent improvements or betterments to increase the value of any property or estate, and, as the asset acquired was a long-term lease, which provided an obligation to pay stipulated rentals and erect a new building in

> place of the building demolished, there may be no deduction allowed. There was necessarily contained in the lease permission on the part of the appellant to permit the lessee to destroy the old buildings. The acquisition of something from which income will be derived in the future has a value in money's worth in the same sense as something which will produce income in praesenti; there was a compensating value for the loss of the buildings which must be recognized as having money's worth. There was a substitution of assets rather than a loss sustained in the destruction of the buildings.

The case of *Pelican Bay Lumber Co.* v. *Blair,* cited by the Circuit Court of Appeals for the Second Circuit, was decided by this Court. The situation in that case, while not identical, is analogous in principle to the instant case. This Court held that where an amount of the taxpayer's lumbering plant constructed at a cost of $124,641.25 was destroyed by fire, and the taxpayer collected insurance in the sum of $164,832.64, realized salvage in the sum of $1,267.68, and constructed a new unit substantially a duplication of the old at a cost of $315,816.95, there was no deductible loss sustained but that the difference between the insurance received and the cost of the new mill should be capitalized.

Had petitioners voluntarily demolished the buildings without obtaining in substitution a

valuable asset, they undoubtedly would have sustained a deductible loss. Article 142, Regulations 65, *supra; Citrus Soap Co. of California* v. *Lucas* (C. C. A. 9th), 42 F. (2d) 372; *Appeal of First National Bank of Goodland, Kansas,* 5 B. T. A. 1174. Of course if land and buildings thereon are purchased with the purpose of demolishing the buildings to erect in their place another building, no loss is sustained on account of the demolition of the old buildings. *Liberty Banking Co.* v. *Heiner* (C. C. A. 3d), 37 F. (2d) 703; *Lansburgh & Brother, Inc.,* v. *Commissioner,* 23 B. T. A. 66. In such cases the true test is the intention of the taxpayer. *Union Bed & Spring Co.* v. *Commissioner* (C. C. A. 7th), 39 F. (2d) 383; *Watson* v. *Commissioner,* 15 B. T. A. 422; *Southern Amusement Co., Inc.* v. *Commissioner,* 14 B. T. A. 300; *Louis Pizitz Dry Goods Co.* v. *Commissioner,* 22 B. T. A. 161. Here the result of the transactions was that the petitioners had erected on their land a new office building, and that they leased the property for a ninety-nine year lease on terms which could not have been made so long as the old brick store buildings remained thereon. In other words, the demolition and removal of the buildings were a part of the cost of acquiring the ninety-nine year lease and with it the obligation of the tenant to pay the rent provided in the lease. The removal of the old buildings and the erection of a new building was made a

part of the lease agreement. (R. 46.) Before the new building was to be erected and the tenant was to assume the obligation to pay rent, there was an obligation upon these petitioners to demolish the old buildings, and, therefore, the unextinguished cost of the old buildings at the time of their destruction constituted a part of the cost of securing a tenant on advantageous terms, and is not deductible as a loss sustained. The Board of Tax Appeals has consistently so held. In *Manning* v. *Commissioner,* 7 B. T. A. 286, the Board said (pp. 289–290):

> While no provision was made in the lease as to the buildings then on the land, the very nature of the building to be erected made it necessary for the existing structures to be torn down. The razing of the buildings was agreed upon at the time of the execution of the lease. The petitioners gave the lessee the option of tearing down the old buildings and retaining the salvage as compensation for its work in their destruction, or the petitioners agreed to demolish them and keep the salvage. The lessee agreed to demolish and remove the buildings on the terms offered. The cost to petitioners allocable to these structures which were demolished was $26,000. The question is whether a deductible loss of this cost less depreciation was sustained through demolition.
>
> Prior to the execution of the lease the petitioners had land and buildings from which

they were deriving income in the form of rent, and also land. After the execution of the lease, they had only the land and were lessors under a more advantageous lease than they formerly had. Did they part with the buildings, without receiving compensation therefore, *quid pro quo?* That the lease in question was a favorable one is admitted by the petitioners and that they improved their position thereby is shown by the fact that their rentals were substantially greater under the new lease than those being received prior to October 31, 1921, from the old buildings. But the petitioners say that they could not have been compensated in 1921 under the lease for the loss since they did not begin to receive rentals thereunder until 1922. We are not impressed by the logic of this argument. The acquisition of something from which income will be derived *in futuro* has a value in money's worth in the same sense as something which will produce income *in praesenti.* The value may differ on this account, but this does not alter the fact that each has a compensating value which may be recognized as having money's worth.

Taken by itself, the petitioners undoubtedly would be said to have sustained a loss in the demolition of their buildings, but when considered in connection with the entire transaction entered into on October 31, 1921, the Board is of the opinion that the removal of the buildings was fully

> compensated for in the rights acquired under the lease and that the cost of the buildings, less sustained depreciation, is properly allocable to the cost of securing the lease. In other words, there was in this instance what amounted to a substitution of assets; instead of an asset in the form of buildings, the petitioners now have another asset, viz, a lease, the giving up or voluntary destruction of the buildings being a necessary incident to the acquisition of the lease.

See also *Ward* v. *Commissioner,* 7 B. T. A. 1107; *Eysenbach* v. *Commissioner,* 10 B. T. A. 716; *Pig & Whistle Co.* v. *Commissioner,* 9 B. T. A. 668; *Spinks Realty Co.* v. *Commissioner,* 21 B. T. A. 674.

The contention that there was an exchange of the demolished buildings for the lease is without merit. No exchange occurred. The buildings were demolished to clear the land so as to enable the petitioners to grant a ground-lease of the premises to the Sun Realty Company. The demolition of the buildings was a necessary incident in this transaction and whatever value remained in the buildings represented what petitioners were willing to pay to secure the lease.

In view of the foregoing, it is our contention that these petitioners sustained no deductible loss when the old buildings were removed.

II

A commission paid to a real-estate broker, a fee paid to an attorney, and an expenditure made for a certificate of title, all made in connection with the effecting of a ninety-nine year lease, are not deductible in the year when made as ordinary and necessary business expenses, but such expenditures should be treated as a part of the cost of securing said lease, to be deducted ratably over the life of the lease, and, in any event, these items are not deductible as ordinary and necessary expenses since these petitioners have failed to show they were made in connection with the carrying on of a trade or business

The petitioners advance the argument that since they kept their books and rendered their income-tax returns for the years 1924 and 1925 on the basis of cash receipts and disbursements, these expenditures are deductible in the years when paid as ordinary and necessary business expenses.

It is obvious that while Section 212 (b) recognizes different systems of accounting and provides that the tax shall be computed in accordance with the method of accounting regularly employed by the taxpayer in keeping its books, if such method clearly reflects the income, that provision does not authorize a taxpayer to take any deductions not authorized by law. This section does not undertake to provide the deductions which may be allowed, but simply prescribes generally the method to be used in taking deductions which are allowable from gross income. The deductions allowable in computing net income are enumerated elsewhere in

the statute and Section 212 (b) merely provides the method of computation. If a taxpayer deducts from gross income items which are not allowable deductions under the Act, even though his doing so may be in accordance with his method of accounting regularly employed in keeping books, the net income would not be clearly reflected, and in accordance with the provisions of Section 212 (b) the Commissioner would be required to determine it in accordance with a method which does clearly reflect income. Bookkeeping entries are not conclusive. *Douglas* v. *Edwards,* 298 Fed. 229; *Southern Pac. R. Co.* v. *Muenter,* 260 Fed. 837; *United States* v. *Block & Kohner Mercantile Co.,* 33 F. (2d) 196.

In the instant case the right to claim a deduction for a commission paid to a real-estate broker, attorney fees and fees for securing a certificate of title, all made to secure a ninety-nine year lease, is predicated upon the claim that they constitute "ordinary and necessary expenses paid * * * in carrying on * * * business" within the meaning of Section 214 (a) (1) of the Revenue Act of 1924, *supra.* This particular section makes specific provisions for the deduction of ordinary and necessary expenses paid or incurred in carrying on a business, but makes no provision for the deduction of capital expenditures. These taxpayers do not prove their right to deduct these expenditures merely by showing that they kept their books and

made their income-tax returns upon the basis of cash received and disbursements made during the taxable years in question. That fact is not relevant for the method of keeping accounts does not go to the question whether an outlay is an expense or a capital item.

Article 292 of Regulations 65, *supra,* adopted for the enforcement of the Revenue Act of 1924, enumerates several examples where specific expenditures are not deductible since they represent capital expenditures. It being practically impossible to set forth the entire field of capital expenditures in a Treasury Regulation, yet a sufficient number are enumerated to show that any expenditure made in connection with the acquisition of a capital asset is not deductible. For instance, this Article provides that "amounts expended for securing a copyright and plates, which remain the property of the person making the payments, are investments of capital. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architect's services is part of the cost of the building. Commissions paid in purchasing securities are a part of the cost price of such securities." This same construction of the statute with reference to the deduction of such items from gross income has been given by the Commissioner in the Regulations promulgated under each revenue act since the adoption

of the income tax amendment. See Paragraph 108, Regulations 33; Article 293, Regulations 45; Article 292, Regulations 65; Article 292, Regulations 69; Article 282, Regulations 74. And again, attention is called to the well-settled rule of statutory construction that where a statute has been construed for a long period of time as having a certain meaning, a reenactment of that statute without change indicates legislative sanction of such construction. It is equally well settled that the construction of a doubtful statute adopted and long enforced by the officers charged with its administration will be given great weight by the courts. *Maryland Casualty Co.* v. *United States,* 251 U. S. 342; *National Lead Co.* v. *United States,* 252 U. S. 140.

The distinction drawn by the Treasury Regulations between business expenses and expenditures incurred in the acquisition of a capital asset has been upheld in the Federal courts. A case directly in point is *Bonwit-Teller & Co.* v. *Commissioner* (C. C. A. 2nd), decided August 25, 1931, in which it was held that a $20,000 fee paid as a commission to a real estate broker for securing a sub-tenant for a long term was a capital expenditure. The court said:

> In effect the lessor exchanges the leasehold estate for the lessee's obligations, and pays a broker a fee for negotiating the exchange. Whether the fee be deemed part of the cost of acquiring an exhaustible capital asset, or

> be deemed a business "expense" to be allocated to the appropriate year (the taxpayer keeping its books on the accrual basis) it would seem that truly to reflect annual income such a fee should be spread over the term of the lease rather than charged against the first year's income.

By payment of the commission petitioners acquired a new productive asset in the form of a lease, an income-producing asset. It is settled law that any expenditure to acquire an asset which is income-producing over a number of years is a capital expenditure.

The payments here are very similar to commissions paid to brokers in connection with the purchase of securities, and attention is called to the case of *Hutton* v. *Commissioner* (C. C. A. 5th), 39 F. (2d) 459. The court said (p. 460):

> The petitioner can derive no right to charge the commissions to expenses from her method of keeping books, unless they clearly reflect the income. It has been a settled rule of the Treasury Department that commissions paid in purchasing securities are a capital expenditure as part of the cost price of the securities. This ruling has uniformly been approved by the Board of Tax Appeals. We are not referred to any controlling decision to the contrary nor to any decision that is persuasive. The rule is fair and reasonable. It is clear that the taxpayer suffers no hardship by the rule, as the com-

mission paid in purchasing the securities may be deducted from the profits or added to the losses when the securities are eventually sold.

See also *Simmons Co.* v. *Commissioner* (C. C. A. 1st), 33 F. (2d) 75, certiorari denied, 280 U. S. 588; *Corning Glass Works* v. *Lucas,* 37 F. (2d) 798; *Duffy* v. *Central R. R.,* 268 U. S. 55; *George H. Bowman Co.* v. *Commissioner* (App. D. C.), 32 F. (2d) 404; *Laemmle* v. *Eisner,* 275 Fed. 504; *National City Bank of Seattle* v. *United States,* 64 Ct. Cls. 236, certiorari denied, 276 U. S. 620.

The Board has not been consistent in its decisions but it has recently in a number of cases adhered to the position contended for by the respondent. See cases cited in *Bonwit-Teller & Co., supra,* and *Central Bank Block Association* v. *Commissioner,* 19 B. T. A. 1183; *Pembroke* v. *Commissioner,* 23 B. T. A. 1175.

Respondent concedes that the decision of the District Court in *Daly* v. *Anderson,* 37 F. (2d) 728, is to the contrary. The court decided the case on the authority of *McNeill* v. *Commissioner,* 16 B. T. A. 479, and *Howard* v. *Commissioner,* 19 B. T. A. 865. But these cases the Board subsequently overruled. Furthermore the *Daly case* was referred to by the Circuit Court of Appeals for the Second Circuit in the *Bonwit-Teller case* and was there disregarded. Aside from this reference it has not been cited in any other Federal court decision.

Finally, these amounts are not deductible in any event under the provisions of Section 214 (a) (1) of the Revenue Act of 1924, since they were not made in connection with the carrying on of a trade or business. The Board of Tax Appeals made no finding that these petitioners were engaged in a trade or business, these petitioners do not allege they were carrying on a trade or business, the answers filed do not admit this essential fact, the stipulation of facts make no reference to it, and no error set forth in this petition that the Board failed to find they were carrying on a trade or business. The record only shows that these petitioners in 1917 or 1918 erected several brick store buildings on the land, and in 1924 entered into a lease agreement which called for the demolition of these buildings and the erection of a new building to be leased for ninety-nine years. These events are isolated transactions and are not sufficient to base a finding that these petitioners were engaged in a trade or business. *United States* v. *Emery,* 237 U. S. 28; *McCoach* v. *Minehill Railway Co.,* 228 U. S. 295; *Von Baumbach* v. *Sargent Land Co.,* 242 U. S. 503; *White* v. *Hornblower* (C. C. A. 1st), 27 F, (2d) 777; *United States* v. *Nipissing Mines Co.* (C. C. A. 2nd), 206 Fed. 431; *Lane Timber Co.* v. *Hynson* (C. C. A. 5th), 4 F. (2d) 666.

As the court pointed out in the *Hutton case,* these petitioners suffer no hardship and the amounts ex-

pended will be amortized over the life of the lease, or in case of a sale of the property will be added to the cost of the property. Each year as the lease is exhausted these amounts will be ratably deducted, or in case of sale, the amount of profit will be lessened or a deductible loss will be increased since these amounts would be added to the basic cost of the property.

CONCLUSION

In view of the fact that the determination of the Board of Tax Appeals is in accord with regulations of the Treasury Department which are based upon a reasonable construction of the statute and have received the implied approval of Congress, it is submitted the decision of the Board should be affirmed.

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