representative of the State of Iowa and who is serving presently under an appointment as a reporter in the district court. It was the feeling of the committee that it would not be safe for you to rely upon the thought that anyone who is a certified shorthand reporter, although presently in private employment, is embraced within that term. It is only important to alert you in your own practice not to use someone who is a certified shorthand reporter, but not serving as an official under appointment, without complying with the same formalities as if the deposition was taken before someone who is not a certified shorthand reporter.

JUDGE PRALL: Suppose somebody comes in and wants to use my reporter, who would classify as an official court reporter. We are busy trying a lawsuit and I cannot spare him from the work we are doing. Could I name one of these free-lance reporters as a temporary court reporter so as to bring him within this classification?

MR. INGERSOLL: I would say that we have been confronted with a good many problems of the law of Iowa relating to evidence, and to other matters of law not strictly within the purview of the rule, and, Your Honor, I don't know what the construction of the statute with reference to your power to make such an appointment would be.

MR. LEWIS: I have heard lawyers discussing the discovery techniques and the pre-trial conference, and I would like to ask you what you think about some of the statements to the effect that the discovery procedure is a tool for the plaintiff, or that it is a tool for the defendant?

MR. DAVIS: From what experience I have had with it in the federal courts, I am very firmly of the opinion that it is not a special tool for either side. It is equally helpful to both sides, and it cannot be characterized as an exclusive weapon or exclusive advantage to either the plaintiff or defendant.

MR. WILMARTH: I don't think it is an advantage to either side in any particular. It just depends on the case; in one, it is better for the plaintiff; in another, it is better for the defendant.

USEFUL LIFE AND SALVAGE VALUE: CHANGING CONCEPTS

One of the most common issues in present day tax controversies concerns the deduction of a "reasonable allowance" for depreciation. There can be but little doubt that depreciation is a highly complex and technical subject, and when an attempt is made to place it within the already complicated framework of the income tax laws, it is not difficult to understand why the confusion exists.

Mr. Justice Brandeis discussed this "reasonable allowance" in *United States v. Ludey*,[1] and in that case announced this now classical statement:

> "The amount of the allowance for depreciation is the sum which should be set aside for the taxable year, in order that, at the end of the useful life of the plant in the business, the aggregate of the sums set aside will (with the salvage value) suffice to provide an amount equal to the original cost."

While this statement innocently appears to be simple and complete, it contains several elements which give rise to many depreciation problems. Two of these elements are useful life and salvage value.

The Treasury Department has recently developed new concepts of useful life and salvage value and it has placed these new definitions in the depreciation regulations issued under the Internal Revenue Code of 1954[2] (hereinafter referred to as the 1954 Code). The Internal Revenue Service[3] has indicated that taxpayers will be expected to adhere to the new interpretation of these terms. It is felt that this change in the administration of the tax laws is of such timely importance as to warrant the undertaking of this article. Therefore, an attempt will be made to discuss the nature of this new policy of the Treasury Department and to sketch generally some of the background developments in the light of which the taxpayer may wish to re-evaluate his present depreciation practices.

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[1] 274 U.S. 295 (1927).

[2] U.S. Treas. Reg., § 1.167, published in tentative form, 20 Fed. Reg. 8454 (November 11, 1955) and promulgated, T.D. 6182, approved June 7, 1956. Previously, tentative regulations had been issued as U.S. Treas. Reg., § 1.167 and published 19 Fed. Reg. 6229 (September 28, 1954) but were later withdrawn. This early regulation seemed to indicate that the Treasury Department intended to administer § 167(a) of the 1954 Code in the same manner as the corresponding provision under the 1939 Code, inasmuch as the provisions relating to useful life and salvage value were similar to those under Regulations 118.

[3] As a matter of convenience the Internal Revenue Service (or the Bureau of Internal Revenue as that agency was formerly designated) will be identified by its present name.

CHANGING ADMINISTRATIVE CONCEPTS

Until the adoption of the new depreciation regulations in 1956, there had never been an official definition of either useful life or salvage value. Therefore, taxpayers developed their own meanings for these terms from accounting principles. As a general rule the useful life was said to be the period of time over which the asset was capable of performing the task for which it was created; in other words, its physically useful life. Salvage value usually meant scrap value, or the residual value left in the asset when it was completely worn out. Under these definitions taxpayers deducted the scrap value, if any, from the cost or other basis of the asset before spreading the depreciation over its physical life.

The depreciation regulations adopted by the Treasury Department in 1956 prescribe definitions which are a radical departure from the established custom. Subsection 1.167(a)-1(b) of the regulations describes useful life as:

> ". . . not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of his income."[4]

This period is to be determined by reference to the experience of the taxpayer in using similar property, taking into account present conditions and probable future developments. The taxpayer may rely upon the experience of the industry as a whole in the event he has not developed an experience pattern of his own. Regardless of the method of computing depreciation, the remaining useful life of an asset may be changed because of the existence of some condition known to the taxpayer by the end of the taxable year. But unless the change in the estimated life is significant and the reason for the change is clear and convincing, no redetermination shall be made.

Subsection 1.167(a)-1(c) of the regulations defines salvage value as:

> ". . . the amount (determined at the time of acquisition) which is estimated will be realizable upon sale or other disposition of an asset when it is no longer useful in the taxpayer's trade or business or in the production of his income and is to be retired from service by the taxpayer."

The taxpayer may use "net salvage" (ordinary salvage less the cost of removal) in computing depreciation, but he must consistantly use whatever figure he chooses. Salvage value, once determined, does not fluctuate with changes in market conditions; it may be changed only to correspond to a change in useful life. It may be accounted for by either reducing the basis to be

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[4] It is interesting to note that the definition describes useful life as "not necessarily the useful life inherent in the asset," as though it were necessary to negatively phrase the term in order to dispel a previous understanding to the contrary.

depreciated, or by reducing the rate of depreciation.[5] The salvage subsection also makes the following observation:

> "If the taxpayer's policy is to dispose of assets which are still in good operating condition, the salvage value may represent a relatively large portion of the original basis of the asset. However, if the taxpayer customarily uses an asset until its inherent useful life has been substantially exhausted, salvage value may represent no more than junk value."

Throughout the depreciation regulations are statements which warn that in no event, under any method of computing depreciation, shall an asset be depreciated "below a reasonable salvage value."[6] The taxpayer must determine whether an allowance is reasonable by considering the conditions known to exist at the end of the taxable period.[7] This would seem to mean that in determining the taxpayer's disposal experience, the retirements of the current year should also be considered. Where a given method of depreciation produced a reasonable allowance under the Internal Revenue Code of 1939 (hereinafter referred to as the 1939 Code), that same method may be continued under the 1954 Code.[8]

The new depreciation regulations have not been warmly received by all taxpayers. Perhaps this is to be expected since they tend to restrict the amount of the deduction when compared to past practices. The new definitions will have the greatest impact on taxpayers having a rapid turnover of assets which are sold while they are still fairly new. This type of asset normally has a substantial market value which will thus decrease the

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[5] Under the straight line and sum of the years-digits method of depreciation the cost or other basis to be spread over the useful life, is first reduced by estimated salvage value. U.S. Treas. Reg., § 1.167(b)-1 and § 1.167(b)-3. Under these methods, the basis may be depreciated to zero as the salvage has previously been removed. Under the declining balance method the computation is made without first reducing basis by estimated salvage. However, the regulations provide that no asset or account shall be depreciated below a reasonable salvage value. U.S. Treas. Reg., § 1.167(b)-2.

[6] A problem has arisen in the salvage value area under the declining balance method of depreciation. Some taxpayers have taken issue with the regulations which provide that an asset may not be depreciated below a reasonable salvage value under the declining balance method. They claim that a "built-in" salvage value is inherent in the declining balance system, and that it was the intention of Congress to provide only this residual balance as salvage value. In this respect the congressional committees considering the 1954 Code referred to the declining balance method as follows: "Under this method a uniform rate is applied to the unrecovered basis of the asset. Since the basis is always reduced by prior depreciation, the rate is applied to a constantly declining basis. The salvage value is not deducted from the basis prior to applying the rate, since under this method at the expiration of useful life there remains an undepreciated balance which represents salvage value." H. R. REP. No. 1337, 83rd Cong., 2d Sess. A48; S. REP. No. 1622, 83rd Cong., 2d Sess. 201. Whether the courts will be impressed by this argument remains to be seen.

[7] U.S. Treas. Reg., § 1.167(b)-0(a).

[8] *Id.* at § 1.167(b)-0(b).

depreciable basis of the asset. Therefore, in the application of these regulations, the Internal Revenue Service is likely to be met with various degrees of resistance. So far, there has been no case under the 1954 Code in which a court has considered the effect of these new regulations.

THE DEVELOPMENT OF THE NEW CONCEPTS

The current Internal Revenue Code was enacted into law on August 16, 1954. While the bill was before Congress, there was no statutory modification which revealed that there was any congressional dissatisfaction with the treatment of useful life and salvage value in the past.[9] Section 167,[10] relating to depreciation, contained several new subsections in addition to the basic provision[11] carried over from the 1939 Code. Among these new subsections are subsections 167(b) and 167(c) which prescribe the allowable methods and rates for computing depreciation, as well as certain limitations on the use of these methods. The methods set out in subsection 167(b) are the straight line method, the declining balance method, the sum of the years-digits method and any other method productive of an annual allowance which does not, during the first two-thirds of the useful life of the property, exceed the allowance computed under the declining balance method. However, if an allowance is reasonable under subsection 167(a), it shall not be limited or reduced by any provision of subsection 167(b). Subsection 167(c) restricts the accelerated methods of depreciation contained in subsection 167(b), to new construction and to new tangible property with a useful life of three years or more. While the new depreciation provisions do provide that the taxpayer may enter into a binding agreement with the government concerning the useful life of property,[12] there is nothing in the wording of section 167 which in any manner defines useful life; nor is there any express reference to salvage value.

On September 28, 1954, the Treasury Department published the proposed depreciation regulations in the *Federal Register*.[13] The reference to the terms useful life and salvage value was the same as that found in Regulations 118[14] under the 1939 Code. There was no hint of the definitions of useful life and salvage value that are found in the subsequent regulations. These early regulations were later withdrawn.

Perhaps the first public notice of the coming change in policy, resulted from a letter from Laurens Williams, Assistant to the Sec-

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[9] H. R. REP. No. 1337, 83rd Cong., 2d Sess.; S. REP. No. 1622, 83rd Cong., 2d Sess.

[10] All code sections relate to the Internal Revenue Code of 1954 unless otherwise identified.

[11] INT. REV. CODE OF 1939, § 23(*l*).

[12] INT. REV. CODE OF 1954, § 167(d).

[13] U.S. Treas. Reg., § 1.167, 19 FED. REG. 6229 (September 28, 1954), later withdrawn.

[14] U.S. Treas. Reg. 118, § 39.23(*l*)-1 (1953).

retary of the Treasury, to Representative Thomas B. Curtis of Missouri, appearing in the *Congressional Record* on June 16, 1955.[15] This letter stressed the requirement for a "realistic salvage value" and stated that:

> ". . . useful life . . . is not the full, normally inherent useful life of the property. It is rather, the useful life of the property determined in accordance with the practice of the particular taxpayer in his trade or business or in the production of income. If a taxpayer has no consistent practice regarding the disposition of depreciable property, the estimated useful life of his depreciable assets should be determined in the light of experience in the taxpayer's business or industry."

These statements were an accurate preview of the regulations on depreciation which were to come at a later date.

The present depreciation regulations were published in tentative form on November 11, 1955 and finalized on June 7, 1956.[16] Contained in these regulations are the Treasury Department's detailed interpretation of the useful life and salvage value elements.

It can be seen from a study of the actions of the Treasury Department in this respect, that an all out effort was being made to combat the revenue losses occurring by virtue of section 1231,[17] which provides capital gains treatment for gains resulting from the sale of depreciable property used in the trade or business. Because of a relatively high market demand for used assets, taxpayers found that such assets usually brought a price substantially higher than the junk or scrap value. Thus in failing to take into account any salvage value, the taxpayer may have deducted the entire cost of an item over a period of years and still have sold it for a substantial price. In the case of property used in the trade or business, the sales price could be reported as a capital gain.[18] The net effect of such a practice, in the case of a corporation, could be to convert a portion of income taxable at 52 percent to a capital gain taxable at 25 percent. To illustrate, assume the *A* Company bought an automobile in 1951 at a cost of $1,500. The basis used for depreciation was cost without any reduction for salvage value. Although the useful physical life was determined to be four years the practice of the *A* Company was to operate its autos for about fifteen months before replacing them. At the end of fifteen months, $468.75 had been deducted from income taxable at 52 percent and the auto had been sold for $1,400. The sales price, less the adjusted basis, resulted in a capital gain of $368.75 taxable at 25 percent.[19] In this example it can be seen that the

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[15] 101 CONG. REC. 8569 (1955). This letter was reprinted in 4 P-H 1955 FED. TAX SERV. ¶77278.

[16] See note 2, *supra*.

[17] INT. REV. CODE OF 1954, § 1231.

[18] *Ibid.*

[19] Robley H. Evans, 16 CCH Tax Ct. Mem. 156 (July 31, 1957).

market value of the used auto did not decline as fast as the remaining undepreciated balance and thus the basis for determining gain or loss was less than the sales price. For many years accountants were plagued by the efforts of management to produce maximum net profits. Management argued against taking full depreciation for the reason that depreciation had been offset by a rise in the market value of the asset, and that the asset was still worth its cost in spite of the reduction of its remaining life.[20] Apparently the position of the Treasury Department is that while it realizes as a practical matter that depreciation deductions cannot be tied exactly to the market, there nevertheless should be a closer balance maintained between the market value at a time of disposal and the basis for gain or loss. The method prescribed by the new regulations to effectuate this balance requires the taxpayer to make a reasonable estimate of the market value of the asset at the anticipated time of disposal, and to reduce the cost of the asset by this amount prior to computing depreciation.[21] Thus, in the view of the Treasury Department, the selling price of the used asset should result in a negligible amount of gain or loss.[22] Such a theory has been criticized from an accounting viewpoint in that it ignores the fact that fixed assets wear out regardless of fluctuation of market values, and the resulting cost expiration is an operating expense.[23]

The government has attempted to reduce capital gains by several methods. In several cases it has alleged that capital gains treatment was not available to the taxpayer because the assets disposed of were held primarily for sale to customers in the ordinary course of his trade or business.[24] The Commissioner has generally

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[20] FINNEY & MILLER, PRINCIPLES OF ACCOUNTING (Intermediate) 440-441 (4th ed. 1951).

[21] U. S. Treas. Reg., § 1.167(a)-1(c).

[22] It has not been uncommon for a revenue agent, while auditing a return, to simply subtract the sales price of a used asset from the taxpayer's cost, and if the resulting figure exceeds the total depreciation deducted, the excess is disallowed. For example: Assume the purchase of an asset on January 2, 1950 for $4,100. The taxpayer set up a salvage value of $100 and a useful life of 5 years. From 1950 through 1954 the taxpayer deducted $800 per year and on December 31, 1954 the asset was sold for $450. $350 was reported as a capital gain. The revenue agent might then reduce capital gains by $350 and disallow depreciation deductions of $116.66 in each of the years 1952 through 1954.

[23] See note 20, *supra*.

[24] The Commissioner has used a two pronged attack on those taxpayers in businesses which have a rapid turnover of assets, particularly when there is a substantial amount of use left in the property at the time of disposal. In addition to the approach discussed in this article, there are cases in which he has asserted that the sale of the assets results in ordinary income rather than capital gain. The reason given for disallowing treatment under section 117(j) of the 1939 Code is that the taxpayer holds the assets not only for use in his business but also "primarily for sale to customers in the ordinary course of his trade or business." This approach of the Commissioner received a set back in the case of Philber Equipment Co. v. Commissioner, 237 F. 2d 129 (3rd Cir. 1956). See also Massey Motors, Inc. v. United States, CCH 57-2 U.S.T.C. ¶9957 (D. Fla. October 7, 1957). In the *Evans* case, note 19, *supra*, the Commissioner initially took the same position. When the

met with defeat on this theory. The decision to require more exacting accounting for depreciation under the new regulations can also be traced to this drive against capital gains.

An interesting inconsistency which may bear on the validity of these new concepts is found in examining section 1231 which provides for capital gains treatment upon the sale of depreciable property used in the trade or business. If it had been the intention of Congress to eliminate gains from the sale of such property by authorizing the restrictive depreciation regulations now adopted by the Treasury Department, it would seem indeed inconsistent that Congress also found it necessary and desirable to enact a special section to provide favorable treatment for gains and losses resulting from the sale of such assets. There would be no need for section 1231 if there were to be no gains realized.

THE POSITION OF THE TAXPAYER

There will probably be some taxpayers who will not accept the new concepts of useful life and salvage value without making some effort to either have them declared invalid by the courts, or to somehow prevent their retroactive application.

The broadest attack will probably claim that under the 1939 Code useful life meant physical life and salvage value meant scrap value; that Congress also understood those definitions to be correct; that since Congress made no change in this respect in the 1954 Code, it contemplated the continued use of the former meanings; and that any change in such fundamental concepts are changes in policy and can only result from congressional action. This argument by the taxpayer assumes that useful life under the 1939 Code properly means the period over which the property is physically and functionally useful. A further complicating factor is the fact that the proper meaning of the term under the 1939 Code is very much in doubt. At the time the Treasury Department launched its new drive against capital gains through its new depreciation regulations, the statute of limitations had not yet run on several of the taxable years under the 1939 Code. This resulted in the Internal Revenue Service challenging depreciation deductions under the 1939 Code for failing to account for depreciation in accordance with the theories found in the regulations under the 1954 Code. In this respect the government contends that the new regulations simply define in more detail, the terms useful life and salvage value as they were used under the 1939 Code. In other words, it contends that there has really been no change of definition by the new regulations. Even if the taxpayer should prevail in the determination of this underlying issue, it is still possible that the courts would hold that Congress exercised its policy defining power in providing for the deduction of a "reasonable

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court of appeals struck down this theory in the *Philber* case, the *Evans* case was tried only on the useful life and salvage value issues.

allowance" for depreciation, and that it is not an improper delegation of legislative power to permit an administrative agency to prescribe the rules which will best define what is reasonable.

A point of friction has developed in applying the new definition of useful life to the restriction found in section 167(c). This section restricts the use of accelerated depreciation methods to assets having a useful life of at least three years. Many taxpayers switched to the accelerated depreciation methods when they first became available under section 167(b) of the 1954 Code. Since it was commonly believed that useful life as it was used in section 167(c) meant inherent physical life, the accelerated depreciation methods were also applied in some instances to assets which were held less than three years in the business. On June 7, 1956 when the new regulations were adopted, it became definitely apparent to these taxpayers that they had taken accelerated depreciation on some assets where the use of accelerated depreciation was prohibited. Thus if the new useful life regulation is to be applied retroactively to the years prior to the final adoption of the new regulations, these taxpayers could be liable for tax deficiencies resulting from taking excessive depreciation deductions. These taxpayers are likely to resist any retroactive application of the new regulations. Once again the validity of the taxpayer's position is based upon the correctness of his belief that under the 1939 Code useful life meant inherent physical life rather than useful life in the taxpayer's business. The argument of these taxpayers is that when an interpretive regulation has become seasoned from long continued acceptance, and when its underlying statute is reenacted by Congress without change, the taxpayer has a right to rely on such interpretation; and if administrative changes are made, they may not legally be applied retroactively. There appears to be substantial judicial warrant for this proposition.[25] While this may be a valid defense to deficiencies assessed in the first few years under the 1954 Code, it does not deny the power of the Treasury Department to make these changes in its regulations, which may then be enforced prospectively.

In each of the possible arguments which might be raised as a defense against the new regulations, it has been pointed out that the taxpayer relys on the interpretation of useful life which was commonly ascribed to it under the 1939 Code. It has also been pointed out that there is at present a considerable difference of opinion between the government and the taxpayer, over the proper interpretation of this term as it has been used under the 1939 Code. In an attempt to resolve this dispute, we must now turn

[25] Helvering v. R. J. Reynolds Tobacco Co., 306 U.S. 117 (1939); Commissioner v. Clark, 202 F. 2d 94 (7th Cir. 1953); Shearer v. Anderson, 16 F. 2d 995 (2d Cir. 1927); St. Louis Co. v. United States, 134 F. Supp. 411 (C.D. Del. 1955); United Fruit Co. v. Hassett, 61 F. Supp. 1013 (C.D. Mass. 1945). See also Griswold, *A Summary of the Regulations Problem*, 54 HARV. L. REV. 398, 411 (1941).

back to the 1939 Code and view useful life and salvage value as these terms were developed by the taxpayers, the Treasury Department and the courts.

TREATMENT OF USEFUL LIFE AND SALVAGE VALUE UNDER THE 1939 CODE

Perhaps one of the most significant reasons for the absence of more complete and authoritative clarification of the tax laws with respect to depreciation has been the apparent reluctance of Congress to become involved in the minute details of the law. Instead, Congress has placed broad limitations on allowable depreciation deductions[26] and has delegated the detailed administration to the Secretary of the Treasury or his delegate, the Commissioner of Internal Revenue.

In the early years of the income tax laws, the Treasury Department declared that salvage value should be considered in computing allowable depreciation deductions.[27] However, while recognizing the need for including salvage value and while using the term useful life in its regulations, the Treasury Department did not announce an official definition of either term.[28]

The first appearance of the term useful life in the regulations was at Article 161 of Regulations 45.[29] That article provided in part, as follows:

> ". . . 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 consistent plan by which the aggregate of such amounts for the *useful life of the property in the business* will suffice, with the salvage value, at the end of such useful life to provide in place of the property its cost . . ." (Emphasis added.)

The words "in the business" continued to appear in subsequent regulations until the issuance of Regulations 111 effective in 1942, which provided in part, as follows:

> "The proper allowance for such depreciation 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 salvage value, will, at the end of the *useful life of the depreciable property*, equal the cost or other basis of the property . . ."[30] (Emphasis added.)

[26] The broad statutory limitation on the allowable deduction was defined in the Revenue Act of 1918 and in successive revenue acts as "a reasonable allowance for the exhaustion, wear and tear of property used in the trade or business including a reasonable allowance for obsolescence." The Revenue Act of 1942 and acts subsequent thereto, have extended the deduction to property held for the production of income.

[27] U.S. Treas. Reg. 45, Art. 161 (1919); S.M.1217, 1 Cum. Bull. 120, 122 (1919).

[28] See U.S. Treas. Reg. 111, § 29.23(*l*)-1 (1942) and U.S. Treas. Reg. 118, § 39.23(*l*)-1(1953).

[29] U.S. Treas. Reg. 45, Art. 161 (1919).

[30] U.S. Treas. Reg. 111, § 29.23(*l*)-1(1942).

This identical wording was found in Regulations 118.[31] It is possibly significant to note that prior to 1942 the regulations specified the "useful life of the property in the business," but from 1942 through 1953 the reference was merely to the "useful life of the depreciable property."

The most positive position that was taken by the government was the issuance of Bulletin "F",[32] which was published solely as an informational guide to what was considered to be a reasonably normal period of useful life for various assets. The factors bearing on useful life were set forth in Bulletin "F" as follows:

> ". . . The factors which determine the useful life of property in a trade or business have already been discussed briefly in the Introduction. These factors are wear and tear and decay or decline from natural causes, and also various forms of obsolescence attributable to the normal progress of the art, economic changes, inventions, and inadequacy to the growing needs of the trade or business . . ."

There does not appear to be included in these factors, any mention of the taxpayer's intended disposal or retirement plans; nor is there any indication elsewhere in Bulletin "F" that useful life meant the period of use "in the business."

In the text of Bulletin "F" there appears the following comment on salvage value:

> "Salvage value is the amount realizable from the sale or other disposition of items recovered when property has become no longer useful in the taxpayer's business and is demolished, dismantled or retired from service. When reduced by the cost of demolishing, dismantling, and removal, it is referred to as net salvage. In principle, the estimated net salvage should serve to reduce depreciation, either through a reduction in the basis on which depreciation is computed or a reduction in the rate. In either instance the amount of net salvage should actually, or in effect, be a credit to the depreciation reserve. Where the basis or rate for depreciation is not reduced for estimated salvage, all net receipts from salvage should be considered income."

With no clear official ruling as a guide, the meanings of useful life and salvage value quite naturally evolved from the definitions commonly ascribed to them by taxpayers in the business community. The useful life was commonly understood to be that period of time over which the asset was functionally usable in the task for which it was created. For accounting purposes most tax-

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[31] U.S. Treas. Reg. 118, § 39.23(*l*)-1 (1953).

[32] INT. REV. BULL. F. (1920, revised 1942), republished as INT. REV. SER. Pub. No. 173 (1955). The Treasury Department has announced that it is revising Bulletin "F" once again to provide more complete coverage and to provide a more accurate guide for those assets previously listed. Although Bulletin "F" has been withdrawn by the Treasury Department as an official guide to useful life, it may still be used as an indication of the past views of the government. See INT. REV. BULL. 1955-8, 53 and INT. REV. BULL. 1956-8, 53.

payers traditionally understood "salvage" value to be synonymous with "residual" or "scrap" value; that value which remained in the asset after its inherent functional and economic life was exhausted. Because of the widespread acceptance of these definitions among taxpayers, and in the absence of any official ruling to the contrary, it would seem to be a fair assumption that the Treasury Department had acquiesced in the propriety of such practices. Moreover, due to the paucity of cases dealing with these issues in some forty years of income taxation, it would appear that the federal government had no organized intention of challenging these meanings.[33] It appears for the most part that the practice of reducing the basis for salvage value had been virtually ignored by taxpayers, their attorneys and accountants; and assets had been completely depreciated.[34] Furthermore, it was a common practice for revenue agents to disregard salvage value in auditing tax returns.[35] Thus, with few exceptions, the custom had become fixed. Even if a taxpayer was at all mindful of the salvage requirement, he first deducted from cost or other basis only the scrap value of the asset before determining annual depreciation. He estimated scrap value as of the end of the physically useful life of the asset rather than at the end of any shorter period for which he intended to use it in his business.

Bearing in mind the differences of opinion between the taxpayer and the government, we now must turn to the decisions of the courts in an attempt to develop the extent of judicial participation in this controversy.

There are several things which should be kept in mind while considering the decisions rendered in the 1939 Code cases. In the first place, there have been some cases which have only determined a proper useful life and there have been others which have only determined a proper salvage value. Salvage value is determinable

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[33] There have been a few scattered cases in which the courts have made a determination of either useful life or salvage value; but it does not appear that any concerted effort was made to carry out any particular policy. See Wier Long Leaf Lumber Co. v. Commissioner, 9 T.C. 990 (1947), *rev'd on other issues,* 173 F. 2d 549 (5th Cir. 1949); Yellow Cab Co. v. Driscoll, 24 F. Supp. 993 (W.D. Pa. 1938); Dorothy Caruso, 23 T.C. 836 (1955); Otis Beall Kent, 12 CCH Tax Ct. Mem. 1491 (1953); Lewis E. Whitham, 10 CCH Tax Ct. Mem. 250 (1951); Norris Lumber Co., 7 CCH Tax Ct. Mem. 728 (1948); The Bolta Co., 4 CCH Tax Ct. Mem. 1067 (1945);Terminal Realty Corp., 32 B.T.A. 623 (1935); American Refrigerator Transit Co., 31 B.T.A. 465 (1934).

[34] In keeping himself informed on the status of the tax laws, the taxpayer has probably relied more on the various tax services than on any other source of information. When the new definitions were issued in the new regulations, these services reacted by issuing comments which are largely expressive of the thoughts shared by the public generally. See R.I.A. TAX REP. (November 17, 1955); R.I.A. TAX REP. (October 18, 1956); P-H FED. TAX REP. BULL. (April 18, 1957). See also 4 MERTENS FED. INC. TAX § 23.28 (1954), which states that "[a]s a matter of practice, salvage value is sometimes ignored."

[35] Koelling v. United States, 4 P-H 1957 FED. TAX SERV. ¶72529, 57-1 U.S.T.C. ¶9453 (D. Nebr. 1957).

only after a finding of useful life is made. If salvage value is held to be merely scrap value, it is necessarily implied that the court has found that useful life corresponds to inherent physical life; as only at the end of the physical life of an asset has its value been reduced to scrap value. On the other hand, if useful life is determined to correspond to inherent physical life, it is necessarily implied that the court has found that salvage value will exist to the extent that some residual value will remain in the property when it is completely worn out.

Secondly, it should be remembered that in only a few of the most recent cases decided under the 1939 Code does it appear that the government has stressed the new concepts of useful life and salvage value which are contained in the new depreciation regulations.[36]

It is difficult to develop a consistent pattern from the cases since the majority of the cases involve several different tax questions and the proper depreciation deduction is quite often a small part of the total picture. The usual pattern of litigation stems from the disallowance by the Commissioner of that part of the depreciation allowance which results from alleged improper computation. Once in court the burden is placed on the taxpayer to overcome the presumptive correctness of the findings of the Commissioner.[37] When the taxpayer fails to convince the court of the correctness of his position, the court, in its opinion often mentions that fact only and seldom includes any evidentiary detail.[38]

The Board of Tax Appeals, in *Sanford Cotton Mills*,[39] found that the taxpayer customarily used trucks for about two and one-half years and then traded them in on new trucks. Notwithstanding this finding, the Board upheld the Commissioner's determination that the proper rate of depreciation was 20 percent, thus indicating that useful life did not mean useful life *to the taxpayer*.

In the case of *General Securities Co.*,[40] the Board of Tax Appeals made the following finding of fact:

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[36] Koelling v. United States, 4 P-H 1957 FED. TAX SERV. ¶72529, 57-1 U.S.T.C. ¶9453 (D. Nebr. 1957); Robley H. Evans, 16 CCH Tax Ct. Mem. 156 (1957); Pilot Freight Carriers, Inc., 15 CCH Tax Ct. Mem. 1027 (1956).

[37] Taylor v. Helvering, 293 U. S. 507(1934); United States v. Anderson, 269 U. S. 422 (1926); Gibb Instrument Co., 1 B.T.A. 278 (1925). See also TAX CT. RULE No. 32.

[38] Cases in which the court determined useful life or salvage value with little comment include: Goldberg v. Commissioner, 239 F. 2d 316 (5th Cir. 1956); Yellow Cab Co. v. Driscoll, 24 F. Supp. 993 (W.D. Pa. 1938); Dorothy Caruso, 23 T.C. 836 (1955); Otis Beall Kent, 12 CCH Tax Ct. Mem. 1491 (1953); Lewis E. Whitham, 10 CCH Tax Ct. Mem. 250 (1951); Norris Lumber Co., 7 CCH Tax Ct. Mem. 728 (1948); Terminal Realty Corp., 32 B.T.A. 623 (1935).

[39] 14 B.T.A. 1210 (1929).

[40] CCH B.T.A. Mem. Dec 12,500-D (1942); *aff'd on other issues* 137 F. 2d 201 (6th Cir. 1943).

"... The petitioner kept his automobiles from one to two years. When the petitioner traded its cars after one year, from a value standpoint, they had a third to a half of their original value left. The normal useful life of automobiles used by petitioner in its business was three years."

In *Max Kurtz*,[41] the Board found that the taxpayer traded in its cars after two or three years of use, and held that the Commissioner's allowance for exhaustion, wear and tear of automobiles at the rate of 20 percent per annum was reasonable.[42]

In *Pilot Freight Carriers, Inc.*,[43] the Commissioner contended that the period of useful life of certain assets was understated for the reason that upon disposition thereof, both by sale and upon exchange for new equipment, the taxpayer received amounts largely in excess of the depreciated cost of the assets. The Tax Court failed to agree. The Commissioner was in a difficult position because the issue of salvage value had not been properly raised in the pleadings. Therefore, the issue of useful life took on greater importance. The court found that the taxpayer disposed of its tractors after an average use of 38 months, and disposed of its trailers after an average use of 32.6 months. The court then held that the useful lives of the taxpayer's tractors and trailers was four years and five years respectively.

In *Philber Equipment Co. v. Commissioner*,[44] while useful life was not in issue, both the court and the Commissioner made reference to it. The taxpayer was in the auto leasing business. It normally leased new autos to customers for one year and then sold the autos when the lease terminated. The Commissioner disallowed capital gains treatment, contending that the taxpayer held the autos primarily for sale. In its findings of fact the court stated:

"Because of existing conditions [taxpayer] was aware, when it purchased equipment, that it was likely that it would be able to rent any vehicle only for a period that was *substantially less than its useful life* . . ." (Emphasis added.)

The Commissioner also employed the term in this manner when he stated:

"Because of existing conditions taxpayer knew when it purchased equipment that it would likely be able to rent such equipment only for a period that was *substantially less than its useful life*."[45] (Emphasis added.)

Thus it can be seen that both the court and the Commissioner indicated that it was the common practice of the taxpayer to use

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[41] 8 B.T.A. 679 (1927).

[42] See also Merkle Broom Co., 3 B.T.A. 1084 (1926). In Holmes-Darst Coal Co., 11 CCH Tax Ct. Mem. 122 (1952), *aff'd* 209 F. 2d 957 (6th Cir. 1953), the Tax Court apparently allowed a shorter useful life because the taxpayer reported all gains on disposal of assets as ordinary income.

[43] 15 CCH Tax Ct. Mem. 1027 (1956).

[44] 237 F. 2d 129 (3rd Cir. 1956). See also note 24, *supra*.

[45] Brief for Respondent, p. 5, Philber Equipment Corporation v. Commissioner, 237 F. 2d 129 (3rd Cir. 1956).

an auto for a period which was shorter than the period which each referred to as the useful life.[46]

It has been pointed out that the taxpayer who stands to lose the most under the new concepts of depreciation, is not the one that always uses his property until it is completely worn out; but is the one that has developed a retirement history in which assets are normally disposed of while they still have substantial value. The cases that have been referred to seem to indicate that in the past the courts have not been concerned with the taxpayer's intended time of retirement in determining the useful life of an asset.

In 1934, the Board of Tax Appeals decided the *American Refrigerator Transit Co.* case,[47] one of the earliest cases in this area. The taxpayer, in depreciating its refrigerator cars, attempted to reduce salvage value from 40 percent to 12 percent of cost. The Board permitted the reduction after finding that the interchangeability of parts had been largely lost and that scrap prices had materially declined.[48]

The Tax Court, in the case of *Wier Long Leaf Lumber Co.*,[49] had occasion to determine the proper depreciation deduction to be allowed in the year of sale, on a Texas sawmill which had greatly appreciated during World War II.[50] The case apparently stands for the proposition that salvage value must be adjusted upward,

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[46] Rev. Rul. 108, 1953-1 CUM BULL. 185, *as modified by* Rev. Rul. 229, 1954-1 CUM. BULL. 124.

[47] 31 B.T.A. 465 (1934).

[48] The Board in upholding the taxpayer's action stated: "A further factor to be considered in fixing the depreciation base is the estimated salvage value of cars at the end of useful life. Consistently since 1912, the petitioner has carried 40 percent of cost on the books as representing estimated salvage value. However, the facts set forth in the findings indisputably show that while 40 percent of cost was a fair estimate of salvage in 1912, when petitioner first adopted a depreciation policy, it is much too high under the circumstances existing in the taxable years in controversy. Interchangeability of parts and high scrap prices gave high values to salvaged materials in the years immediately following 1912. In the taxable years in controversy that interchangeability of parts had been largely lost, while scrap prices had materially declined from the high levels of earlier years. . . . [W]e conclude that 12 percent of cost is the maximum salvage value . . ."

[49] 9 T.C. 990 (1947) *aff'd and rev'd other grounds* 173 F. 2d 549 (5th Cir. 1949).

[50] The useful life of the sawmill was controlled by the quantity of available standing timber on which it could operate. The depreciation rate was computed by estimating the available supply of timber and prorating the mill cost over this supply, deducting each year that portion of the mill cost which was determined by the number of board feet produced. Salvage value was set at $15,000. At the end of the year 1942, the taxpayer sold the saw mill and deducted the remaining undepreciated cost of the mill, which amount was less than the normal annual depreciation deduction. Thus, the basis used for gain was $15,000. The property was sold for $75,000, its value having greatly appreciated during the war. The Commissioner contended that the property would be fully depreciated at the beginning of the present tax year if salvage were correctly stated. The court held that the taxpayer had not met the burden of showing the Commissioner to be in error.

thus decreasing allowable depreciation, if the asset is sold during the year for more than the amount set aside for salvage value.[51] In this respect the court stated:

> ". . . It has long been the rule that depreciation deductions are to be corrected in any year when it is apparent that the factor involving the extent of useful life is erroneous . . . and that the reasonableness of a deduction for depreciation is to be determined upon conditions known to exist at the end of the period for which the return is made . . . *An adjustment to correct for mistaken salvage value is no different from an adjustment of a mistaken estimate of years of use* . . ."[52] (Emphasis added.)

The case also seems to point out that appreciation in market values will not in itself change the *rate* of depreciation; but it may have the resulting effect of reducing the depreciable balance by increasing salvage value, thus eliminating further deductions in whole or in part.[53]

In the *Bolta Co.*,[54] the assets under discussion were machines used to make combs. The Tax Court held that salvage value should be measured by the proceeds received from the sale of machines which were held and used by the taxpayer for their full useful life, rather than by the proceeds from the sale of defective machines which were held less than their full useful life.[55]

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[51] The taxable year in question was 1942, the first year in which gains from the sale of property used in the trade or business were treated as capital gains. Previously the question of deducting depreciation in the year of the sale was immaterial, as the sale resulted in the same amount of ordinary income under either computation. Of course, under the 1942 law it was advantageous to deduct the depreciation expense even at the cost of a reduced basis for gain.

[52] 9 T.C. at 998. It should be noted that under the 1954 Regulations, salvage value is not to be altered to reflect current market values unless the useful life is redetermined. U.S. Treas. Reg. 1.167(a)-1(c).

[53] *Ibid.*

[54] 4 CCH Tax Ct. Mem. 1067 (1945).

[55] The Company had sold twelve machines. The total sales price of eleven of the machines on disposal was about three percent of the total original cost and about 4.73% of the cost was recovered on the twelfth machine. Therefore, the Company contended its disposal history indicated a maximum salvage value of five percent. The Commissioner pointed to the fact that nine of the machines had not been held their full useful life of five years and had to be sold because they were defective, thus lowering the average sales price. The other three machines were held five years and averaged 25% of cost upon sale. The Commissioner claimed that salvage must be determined upon the basis of what a non-defective machine would be worth at the end of five years. The following language of the court with reference to war time prices and useful life is of interest: ". . . Petitioner offered testimony to show that when these three machines [those sold for 25 percent of cost] were sold on October 20, 1941, equipment was becoming scarce and that in 'normal times' they could not be sold for that high a price. We think the world situation at the end of 1941 was such that one could reasonably expect that the manufacture of civilian goods and the production of machinery therefore would be more and more seriously curtailed over the years to follow. Experience has fully justified such expectations. The injection machines had only five years of *useful life for petitioner's purposes,* but they could be used and were used in other businesses. . ." (Emphasis added.)

In *Louis E. Whitham,*[56] the Tax Court held the taxpayer was entitled to compute depreciation without regard for salvage value. In its findings of fact the court held:

> "Generally, the partnership used its equipment until it was completely exhausted and had no remaining value *except for salvage.*" (Emphasis added.)

Thereafter, the court in its opinion stated:

> "The evidence of record supports the petitioner's [taxpayer's] contention as to salvage value . . . the evidence is that the partnership made a practice of using its equipment as long as it was of any service and then abandoning or selling it for junk for whatever price could be had."

L. A. Davidson,[57] is a case in which the Tax Court held that salvage value of 20 percent was proper on trucks and autos used by the taxpayer, but that salvage value need not be deducted in depreciating road paving machinery which was normally disposed of only as junk. However, the court indicated that where no salvage value has been deducted from cost, the net proceeds of the sale of the used item should be treated as ordinary income.

In *Warren H. Brown,*[58] the issue of proper depreciation was raised on certain assets used in a logging operation. The Tax Court held:

> ". . . The sawmill and sawmilling equipment and the automotive and logging equipment used by the corporation in its logging operations had no salvage value because of their distance from market at the time of the expiration of their useful life."

In a recent federal district court case in Louisiana, the court held that the salvage value of a barge, at various times during the year 1950, ranged from zero to $30,000, fluctuating with the price of and demand for scrap. The court then held $30,000 to be a "fair and reasonable salvage value." It is interesting to note that this court had also found that in the year 1950 (the year in which the taxpayer took over the barge from its predecessor), the barge had a remaining useful life of ten years. Thus, the court measured the salvage value ten years in the future by the maximum current *scrap* value.[59]

It was held in *Transoceanic Terminal Corporation*[60] that trade-in value is not a realistic measure of salvage value. In this respect the court stated:

> ". . . Respondent [Commissioner] treats the average amount received as a trade-in allowance as salvage value in reducing average cost. The trade-in allowance is not,

[56] 10 CCH Tax Ct. Mem. 250 (1951).

[57] 12 CCH Tax Ct. Mem. 1080 (1953). See also Universal Mills, 7 CCH Tax Ct. Mem. 886 (1948); Cohn v. United States, CCH 57-1 U.S.T.C. ¶9457 (D. Tenn. February 25, 1957).

[58] 27 T.C. No. 3 (October 18, 1956).

[59] W. Horace Williams Co. Inc. v. Lambert, 56-2 U.S.T.C. ¶9839 (E.D. La. 1956) *aff'd other issues sub nom* Williams v. United States, 245 F.2d 559 (5th Cir. 1957).

[60] 13 CCH Tax Ct. Mem. 227 (1954).

in our opinion, a reliable or even realistic measure of the actual value of the equipment traded in."[61]

It would be a difficult task to attempt to reconcile each of these cases with the others, and to draw from them some clear concept of useful life or some common method of determining salvage value. The primary consideration of the courts was to determine whether under the peculiar facts and circumstances of the case, the taxpayer was including in the cost of his operations a fair and reasonable amount for depreciation. Useful life and salvage value were approved or disapproved under various circumstances in order to reach a desirable result. In any event, no conclusive test of the Treasury Department's new attitude toward higher salvage value and reduced capital gains was made in the foregoing cases.

CHANGING CONCEPTS UNDER THE 1939 CODE

During the period of formulation of the new concepts adopted by the new regulations, the Internal Revenue Service continued its examination of the depreciation deductions claimed by taxpayers under the Internal Revenue Code of 1939. The new zeal of the Treasury Department for changing the method of accounting for depreciation under the new regulations, simply overflowed into those years remaining open under the 1939 Code and revenue agents began to examine returns in this new light. Several cases have been tried since this change of policy went into effect.

In the case of *Koelling v. United States*,[62] the issue of salvage value on livestock was considered. The taxpayers had not reduced cost by estimated salvage value prior to computing depreciation. Unquestionably the common practice of the taxpayer's community was to omit salvage value. The tax returns in this case had been prepared by a revenue agent. The largest part of the taxpayer's herd was used for breeding purposes. After an animal had lost its value for further breeding in the taxpayer's herd, it was either sold on the livestock market or sold to another breeder. If it was sold to another breeder it usually brought a higher price than if it was sold on the livestock market. The Internal Revenue Service assessed a deficiency for having taken excessive depreciation deductions. The taxpayer paid the additional tax and sued for a refund in the district court. The court denied the recovery of the additional tax, holding that there was definitely some residual value left upon sale by the taxpayer and that fact should have been apparent to the taxpayer during the taxable year. The taxpayer and the government stipulated that on December 31, 1951 (the year in question), livestock sold at the Omaha Livestock Market, brought an average net price of $136 for cows and $257.50 for bulls, for animals of about the same weight

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[61] *Cf.* Thos. Grogan & Bros., 45 B.T.A. 218 (1941).
[62] See note 35, *supra*. See also Rewrite Bulletin, 5 CCH 1957 STAND. FED. TAX. REP. ¶8721 (April 25, 1957).

as the taxpayer's. Therefore, at any time the taxpayer could determine the minimum cash recovery he could expect upon sale of an animal. The government had set up salvage value by deducting from the cost of each animal, the comparable average sales price on the market as of December 31, 1951. The court approved this method of establishing salvage value, notwithstanding the fact that the actual sale of all animals owned on December 31, 1951, brought less than the government's salvage figure. In so doing the court held that the salvage value must be based on facts known to exist during the taxable year, and should not be based on the hindsight acquired by actual sales made as late as 1955.

The government in this case based its determination of salvage value on an estimate of the market price for "cutters and canners" and "slaughter bulls" or "sausage bulls." This adoption of the lowest grade of meat as a basis for the estimates would seem to support the use of scrap or junk value in setting up salvage value.

The court described as "immaterial" the taxpayer's defense that it was the common practice of the locality to ignore the reduction of cost by salvage value. The essential inquiry was to determine whether the taxpayer had complied with the law.

The first real test of the validity of the Treasury Department's new concepts resulted in a complete victory for the government. In *Robley H. Evans*,[63] the Tax Court completely accepted the idea that salvage value should be based on the estimated proceeds of the disposition of the asset at the end of the period of use to the taxpayer.

During the years 1950 and 1951 Evans was engaged in the auto leasing business. He entered into an agreement with Evans U-Drive, Inc., an auto rental corporation, to furnish autos to the corporation. The outstanding stock of U-Drive was owned by Evans' son until near the end of 1951 when Evans acquired part of the stock. Evans was the manager of U-Drive. U-Drive rented 30 to 40 percent of its autos for periods of from 18 to 36 months. The remainder were rented for a few hours or days. When autos were returned from use under extended term leases they were sold by Evans. The short term rental autos were normally sold after about 15 months of use. Evans depreciated all autos over a four year life and made no provision for salvage value. The tax returns filed for 1950 and 1951 disclose that he sold 140 and 147 autos, respectively, in those years. The average cost, sales price, depreciation claimed, and gain per auto, were approximately as follows:

Year	Cost	Sales Price	Depreciation Claimed	Gain
1950	$1,650	$1,380	$515	$245
1951	$1,495	$1,395	$450	$350

[63] See note 19, *supra*.

The Commissioner redetermined depreciation on all autos to reflect a useful life of 17 months and a salvage value of $1,325. On those autos having less than $1,325 remaining undepreciated cost on January 1, 1950, salvage value was set at whatever undepreciated cost remained at that date. The Tax Court held:

> "We have made a finding, and we so hold, that the automobiles which Robley [Evans] leased to U-Drive during the taxable years for use under the extended term leases, had a useful life of 3 years and a salvage value of $600, and that the automobiles which it leased to U-Drive for short-term rental, had a useful life of 15 months and a salvage value of $1,375. If the undepreciated cost of the automobiles in service at January 1, 1950 is less than $600 and $1,375 for the respective classes of automobiles, then that amount will be the salvage value of those automobiles."

It thus appears that the Tax Court determined these issues on the basis of two classes of use, *i.e.*, long term rental autos and short term rental autos. It further appears that the Tax Court was more severe on the taxpayer than the Commissioner was, inasmuch as it reduced the useful life from 17 months to 15 months and increased the salvage value from $1,325 to $1,375 on the short term rental autos.

Whether one agrees or disagrees with the court's ruling in this case, no one can deny that it is certainly the most extreme decision that has been handed down. It is not only meaningful to Mr. Evans and other auto lessors, but it will affect the depreciation of a great many assets which are disposed of by taxpayers before they are ready for the scrap heap. Because of its significance, a few more observations concerning this case might be made.

The actual selling prices of these autos were known to the court at the time salvage values were adjudicated. Also the length of time the taxpayer held them was known to the court. Having this information available at the time of the trial, it seems probable that it had some influence on the computation of useful life and salvage value. In determining these elements the court should disregard its present knowledge and base its finding only upon those facts and circumstances that were available for the taxpayer to consider at the time he was supposed to have made an estimate.[64] The court recognized that this is the rule.[65] However, its findings of salvage value and useful life so closely approximated the actual facts, that it is difficult to believe that the taxpayer could have estimated his turnover so accurately and could have foreseen future market conditions within a few dollars. In addition, the court failed to mention any of the facts and conditions existing at the time

[64] U. S. Treas. Reg. 118, § 39.23 (*l*)-5(a) (1953), Commissioner v. Mutual Fertilizer Co., 159 F. 2d 470 (5th Cir. 1947).

[65] The court stated: "The reasonableness of the depreciation claimed is to be determined in the light of conditions known to exist at the end of the period for which the return is made." Citing: Leonard Refineries, Inc., 11 T.C. 1000 (1948).

the taxpayer should have estimated salvage value. The conditions then existing may or may not have justified the finding that the court made.[66]

The *Evans* case appears to be the first case in which the taxpayer has met the new policy of the government head-on. The basis of Evans' argument was that useful life and salvage value have attained definite and fixed meanings; that the term useful life means the "physical or inherent functional life";[67] and that salvage value means the "residual, scrap or junk value of an asset after its inherent functional useful life has been exhausted."[68] In its opinion the Tax Court wholly ignored the position of the taxpayer, failing even to mention the interpretation of the law upon which he relied. Thus there has as yet been no direct expression by a court upon this interpretation.

CONCLUSION

The Treasury Department has adopted the general policy of accepting the judgment of the taxpayer on depreciation matters unless the facts in the case furnish a clear and convincing basis for adjustment.[69] However, the fact that the same method of depreciation was unchallenged in previous years shall not preclude the Commissioner's adjustment in the present year if the facts so warrant.[70]

One commentator on the tax scene has predicted that the Treasury Department will not attempt to retroactively apply the new regulations, but that it will instead select some date, after which it will expect all taxpayers to comply with its requirements.[71] While this approach would seem to be the most desirable

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[66] In the proposed findings of fact submitted by Evans in his brief, he alleged that at the time he acquired a new auto, he could not estimate the time of disposal of the auto due to the uncertainty inherent in the auto leasing business. This uncertainty was accentuated by the Korean Conflict during 1950 and 1951, the taxable years in question. Evans stated that the respective ages of the oldest autos sold in the years prior to 1950 were: 1946, 27 months; 1947, 76 months; 1948, 24 months; 1949, 32 months. Evans also asserted that he settled his income tax liability for 1947 on the basis of $150 salvage value and a four year useful life. He sold his autos at wholesale to other auto dealers, and he contends that with rare exceptions, the wholesale price received was some $200 less than the retail price of the same auto. There is no indication by the court that these factors were considered.

[67] Brief for Petitioner, Robley H. Evans, 16 CCH Tax Ct. Mem. 156 (July 31, 1957).

[68] *Ibid.*

[69] Rev. Rul. 90, 1953-1 Cum Bull. 43; Rev. Rul. 91, 1953-1 Cum Bull. 44. It might well be argued that the government is taking inconsistent positions at the same time. On the one hand, it has reversed tradition in prescribing new definitions for established terms, thereby finding new grounds upon which to challenge depreciation deductions; while on the other hand, it has announced via Revenue Rulings 90 and 91 that the judgment of the taxpayer will be accepted in the absence of clear and convincing reasons to the contrary.

[70] Rev. Proc. 57-18, Int. Rev. Bull. 1957-18, 27.

[71] R.I.A. Tax Rep. (July 3, 1957).

from the taxpayer's standpoint, the Tax Court decision in the *Evans* case may possibly have forestalled any chance of compromise by the government.[72]

Present indications are that the taxpayer in the *Evans* case intends to appeal to the United States Court of Appeals for the Ninth Circuit. It seems probable that the appellate court will take a definite stand on the validity of the taxpayer's position. Such a decision would be a big step forward in resolving this controversy.

For many years under the tax laws the terms useful life and salvage value were peacefully applied without serious conflict over their meanings. It was not until the 1954 Regulations on depreciation defined those terms that there came to light the fact that an obvious difference of opinion existed. The confusion is compounded under the 1954 Code by the fact that the proper interpretation of the law under the 1939 Code is still not firmly established. To answer most of the questions under our present law we must first back up and find out what the law used to be. The *Evans* case has put this question in issue. In that case the Tax Court in effect decided that the Treasury Department was correct, but in so deciding the court side stepped the taxpayer's argument. Certainly, a broad and all-inclusive study of these opposing views should be made at the appellate level. Only then can the taxpayer and the government return to their normal ways, each secure in the knowledge that they stand on common ground with respect to determining useful life and salvage value.

L. CALL DICKINSON, JR. (June 1958)

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[72] There has been a recent hint that Congress is considering an amendment which would eliminate the need to subtract estimated salvage from basis before depreciation is computed; however, the bill would require that the proceeds from the sale of a used asset would be reported as ordinary income to the extent that the proceeds exceed the adjusted basis for gain or loss. 3 P-H 1957 FED. TAX REP. BULL ¶34559 (October 31, 1957).