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decisions which have denied retrospective application of *Mapp v. Ohio*,¹⁰⁴ or limited its application to appeals pending at the time of the Supreme Court decision.

VII. CONCLUSION

The prisoner who has been deprived of his liberty through state action which has failed to meet the requirements of fairness and justice must be given an adequate forum in which to question such illegal confinement. Today, there is virtually no bar to securing a hearing in the state courts if the prisoner's claim has the least merit. Where the state courts do not or can not, because of inadequate procedural remedies, give the relief sought, the prisoner may come into federal court where his claim is almost assured of careful scrutiny under the new guidelines laid down by the Supreme Court.

CHANGING THE COMPUTATION OF DEPRECIATION

One of the fundamental concepts in the computation of taxable income is the allowance to the taxpayer of a tax-free return of his capital costs.¹ Perhaps the most significant method of achieving this return is through the allowance for depreciation.² Broadly characterized, this allowance amounts to a spreading of the cost³ of an asset used in the trade or business over the period of years during which the asset will remain in use. This results in an annual deduction from the taxpayer's gross income.⁴

The theory underlying this allowance for depreciation is that by using up the [asset] . . . a gradual sale is made of it. The depreciation charged is the measure of the cost of the part which has been sold. When the [asset] . . . is disposed of after years of use, the thing then sold is not the whole thing originally acquired.⁵

The resale value will therefore represent the unsold portion of the asset, and upon receipt of this amount the taxpayer is, in effect, fully compensated for his investment.

Gaitan v. United States, 317 F.2d 494 (10th Cir. 1963). *Contra*, *Hall v. Warden*, 313 F.2d 483 (4th Cir.) (en banc) (retrospective application given), cert. denied, 374 U.S. 809 (1963); *Hurst v. California*, 211 F. Supp. 387 (N.D. Cal. 1962).

194. 367 U.S. 643 (1961).

1. See *Doyle v. Mitchell Bros. Co.*, 247 U.S. 179, 185 (1918).

2. Int. Rev. Code of 1954, § 167 (a), provides:

"There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)

(1) of property used in the trade or business, or
 (2) of property held for the production of income."

3. "Cost" is used here in a broad sense since the basis for depreciation may be otherwise determined in extraordinary circumstances. See Int. Rev. Code of 1954, § 1012; *Treas. Reg.* § 1.1012 (1957), as amended, T.D. 6311, 1958-2 Cum. Bull. 394.

4. Int. Rev. Code of 1954, §§ 161, 167.

5. *United States v. Ludey*, 274 U.S. 295, 301 (1927).

The computation of depreciation essentially involves four factors: the cost basis, the salvage value, the useful life and the method of computation. The annual deduction is arrived at by taking the basis (cost) less the salvage value,⁶ allocating this figure over the useful life of the asset and applying an accounting method to allot a portion to each taxable year. This yearly amount of depreciation must then be consistently deducted from the basis of the depreciable asset⁷ whether or not the deduction is taken⁸ or tax benefit in fact received.⁹

The purpose of this comment is to explore the considerations involved in changing the manner in which depreciation is computed. After a brief description, each of the four factors of depreciation will be examined to point out the problems involved in making a change in computation under the present Code provisions. A basic problem is whether the prior consent of the Commissioner is needed to make such a change. This will be dealt with at the beginning of each section. At the end of the discussions the impact of the new depreciation guidelines and rules will be considered.

I. BASIS

A. Description

"In general, the basis of property is the cost thereof. The cost is the amount paid for such property in cash or other property."¹⁰ The cost basis, once determined, will be adjusted for additions or deductions to the capital account¹¹ and reduced by a systematic annual deduction for depreciation. The resulting figure is the adjusted basis, from which the depreciation deduction is determined for each year.

B. Redetermination

The first consideration is the redetermination of the cost basis. Such an adjustment may be made by the taxpayer without prior application to and consent from the Commissioner whenever the cost is misallocated between depreciable and nondepreciable property.¹² In *Commissioner v. Superior Yarn Mills, Inc.*,¹³ the taxpayer was allowed to recompute the cost basis of certain depreciable assets to reflect the value of property improperly designated as

6. In the declining balance method, however, salvage value is ignored in computation.

7. Treas. Reg. § 1.167(a)-10(a) (1956), as amended, T.D. 6507, 1960-2 Cum. Bull. 91.

8. "A taxpayer is not permitted to take advantage in a later year of his prior failure to take any such allowance or his taking an allowance plainly inadequate under the known facts in prior years." Treas. Reg. § 1.1016-3(a)(1)(ii) (1957). See *Fidelity-Philadelphia Trust Co. v. Commissioner*, 47 F.2d 36 (3d Cir. 1931).

9. *Virginian Hotel Corp. v. Helvering*, 319 U.S. 523 (1943).

10. Treas. Reg. § 1.1012-1(a) (1957). For the purpose of this article the basis will be assumed to be the cost. It should be noted, however, that there are several exceptions to this general rule. For a good discussion of these exceptions, see 3A Mertens, *Law of Federal Income Taxation* §§ 21.02-21.213 (1958) [hereinafter cited as Mertens].

11. See note 26 infra and accompanying text.

12. For the manner in which a lump sum is divided among depreciable and nondepreciable property, see Treas. Reg. § 1.167(a)-5 (1956).

13. 228 F.2d 736 (4th Cir. 1955).

nondepreciable. The Commissioner did not contest the adjustment, but did contend that the recomputed cost basis must be retroactively applied, with the adjusted basis¹⁴ being reduced by the amount actually allowed plus the amount allowable under the new cost basis. The court, holding that "the very nature of original cost renders any subsequent change in it a retroactive change,"¹⁵ arrived at the present value of the assets by deducting the depreciation that would have been allowable under the new cost basis in years prior to the recomputation, plus the depreciation actually allowed.

The Commissioner may also recompute the cost basis to correct an improper inclusion of nondepreciable property in the computation of the depreciation.¹⁶ In *Hoboken Land & Improvement Co. v. Commissioner*,¹⁷ the cost basis of the taxpayer's depreciable property mistakenly included nondepreciable realty. The Commissioner deducted the value of the realty from the cost basis and recomputed the adjusted basis of the property. This recomputation resulted in a complete exhaustion of the cost basis, and the taxpayer was accordingly entitled to no further depreciation deductions.¹⁸ The court approved the Commissioner's calculations, holding that since "the taxpayer received a tax benefit from the allowance,"¹⁹ he was not entitled to a retroactive application of the new basis to the depreciation previously taken. A similar recalculation was refused by the Eighth Circuit in *Blackhawk-Perry Corp. v. Commissioner*.²⁰ In that case, a reorganized hotel corporation overestimated the basis for depreciation on its building and equipment. The court refused to apply the taxpayer's method retroactively to the redetermined cost basis, holding that the case was governed by the decision of the Supreme Court in *Virginian Hotel Corp. v. Helvering*.²¹

14. See note 26 *infra* and accompanying text.

15. 228 F.2d at 742. But see *Blackstone Theatre Co. v. Commissioner*, 12 T.C. 801 (1949), in which the court stated: "[R]etroactive adjustment of [adjusted] basis . . . finds no warrant in the Internal Revenue Code." *Id.* at 805.

16. *Hoboken Land & Improvement Co. v. Commissioner*, 138 F.2d 104 (3d Cir. 1943). See *Blackhawk-Perry Corp. v. Commissioner*, 182 F.2d 319 (8th Cir. 1950).

17. 138 F.2d 104 (3d Cir. 1943).

18. See *Treas. Reg. § 1.167(a)-1(a)* (1956), as amended, T.D. 6507, 1960-2 Cum. Bull. 91.

19. 138 F.2d at 107.

20. 182 F.2d 319 (8th Cir. 1950).

21. In *Virginian Hotel*, 319 U.S. 523 (1943), the Supreme Court construed Int. Rev. Code of 1939, ch. 1, § 113(b)(1)(B), 53 Stat. 44, which read as follows: "Proper adjustment in respect of the property shall in all cases be made— . . . (B) . . . for [depreciation] . . . to the extent allowed (but not less than the amount allowable) under this chapter or prior income tax laws" in conjunction with § 23 (*l*), 53 Stat. 14, which provides for an allowance for depreciation. The Court held that the cost basis must be reduced by the "amount 'allowable' each year whether or not it is claimed [and] . . . even though no tax benefit results . . ." 319 U.S. at 525. The Court went on to hold that the amount allowed by the Commissioner "plainly has the effect of requiring a reduction of the depreciation basis [even if the] . . . amount . . . is in excess of depreciation properly deductible." *Id.* at 526. This case is clearly applicable to the 1954 Code since these provisions of sections 113(b)(1)(B) (now 1016) and 23(*l*) (now 167(a)) have been substantially incorporated into the 1954 Code. The rationale of the *Virginian Hotel* case has been incorporated into *Treas. Reg. § 1.1016-3* (1957).

Cost basis, then, may be adjusted by the Commissioner or the taxpayer, if there was a miscalculation at the time of determination. Retroactive application of the taxpayer's method of accounting to the recomputed cost basis will depend upon whether the recalculation results in a raising or lowering of the original cost basis. If the cost basis is raised, the Commissioner will apply the *Virginian Hotel* rationale²² and recompute the basis for depreciation to reflect the adjustments in the cost basis. The Treasury Regulations are not clear, but it can be assumed from their manifest intent²³ that if the taxpayer has employed a consistent method of depreciation, it will be retroactively applied in the recomputation. If the taxpayer has not consistently made use of such a method, it is reasonable to assume that the Commissioner would apply the straight-line method.²⁴ If, however, the original cost basis is reduced, the Commissioner will apply the rationale of *Virginian Hotel*²⁵ to justify his refusal to recompute the basis for depreciation, thereby not allowing the taxpayer to recover excess depreciation deducted as a result of the use of mistaken cost basis.

The effect of an adjustment, other than the regular depreciation deduction, upon the adjusted basis must also be considered. The Internal Revenue Code provides for the first such adjustment: "Proper adjustment in respect of the property shall in all cases be made—(1) for . . . items, properly chargeable to capital account"²⁶ The amount of this adjustment includes: "[T]he cost of improvements and betterments made to the property,"²⁷ expenditures upon the property which add to its value,²⁸ and "carrying charges such as taxes and interest, with respect to the property . . . which the taxpayer elects to treat as chargeable to the capital account under section 266"²⁹ Whenever such an addition or reduction is made to the capital account, the basis for depreciation must be adjusted accordingly before the annual deduction for depreciation is taken.³⁰

The second instance in which the adjusted basis is affected, other than by the regular deduction for depreciation, is when there is accelerated depreciation on the asset. In *Copiflyer Lithograph Corp.*,³¹ the Tax Court held that a taxpayer, employing the straight-line method of computing depreciation, could not deduct accelerated depreciation on its machinery for periods of abnormal use and insufficient repair in the absence of a showing that the useful life was actually shortened. This prerequisite has been applied in several cases³²

22. See note 21 *supra*.

23. See Treas. Reg. §§ 1.1016-3(a)(2)(ii), (f) (1957).

24. *Ibid*.

25. See note 21 *supra*.

26. Int. Rev. Code of 1954, § 1016(a)(1).

27. Treas. Reg. § 1.1016-2(a) (1957).

28. 3A Mertens § 21.221, at 555 (1958).

29. Treas. Reg. § 1.1016-2(c) (1957). For a complete discussion on the adjustment to basis for capital expenditure, see 3A Mertens §§ 21.218-26.

30. Int. Rev. Code of 1954, § 167 (g).

31. 12 T.C. 728 (1949).

32. *Gounares Bros. & Co. v. United States*, 292 F.2d 79 (5th Cir. 1961); *Bradley v.*

and it is reasonable to assume that a showing of a reduced useful life will be required in order to take accelerated depreciation under any method. A consideration to be examined is whether the use of an accelerated method³³ would preclude the deduction of accelerated depreciation.³⁴ It is probable, however, that such a deduction would be reasonable and allowable under Code Section 167(a).³⁵ Consequently, an allowance for accelerated depreciation may be made when abnormal use of assets³⁶ or other considerations³⁷ would result in a shortening of useful life. The adjusted basis is then reduced by the abnormal deduction taken, and the annual depreciation computed therefrom.³⁸

C. Effect of the 1962 Changes

The cost basis is unaffected by the 1962 developments in federal taxation. The adjusted basis, however, will be initially affected by the new investment credit³⁹ provided for under the 1962 amendments to the Internal Revenue Code.⁴⁰ Under these provisions, the basis of new or used property acquired after December 31, 1961,⁴¹ which meets the definition of "section 38 property,"⁴² will be "reduced . . . by an amount equal to seven percent of the qualified investment as determined under section 46(c)"⁴³ This means that for all new or used property acquired by the taxpayer after December 31, 1961, an initial deduction of between two and one third and seven per cent⁴⁴ will have to be made from the cost basis before depreciation is taken from the property.

Commissioner, 184 F.2d 860 (7th Cir. 1950); Roundup Coal Mining Co., 20 T.C. 388 (1953); Minkoff, 15 CCH Tax Ct. Mem. 1404 (1956); Kokinoor Coal Co., 15 CCH Tax Ct. Mem. 403 (1956); Southwest Ornamental Iron Co., 12 CCH Tax Ct. Mem. 521 (1953); Accurate Tool Co., 10 CCH Tax Ct. Mem. 354 (1951); Spriesch Tool & Mfg. Co., 9 CCH Tax Ct. Mem. 669 (1950); Owens, 9 CCH Tax Ct. Mem. 281 (1950).

33. See 4 Mertens §§ 23.33, .37a, b (1960). See also Treas. Reg. § 1.167(b)-2 to -3 (1956).

34. Int. Rev. Code of 1954, § 167(b)(4).

35. Int. Rev. Code of 1954. Section 167(b) states: "Nothing in this subsection shall be construed to limit or reduce an allowance otherwise allowable under subsection (a)."

36. Hyatt Roller Bearing Co. v. United States, 70 Ct. Cl. 443, 43 F.2d 1008 (1930); Drayton Mills Co. v. Commissioner, 19 B.T.A. 76 (1930); Witham, 10 CCH Tax Ct. Mem. 250 (1951); Bro-Jeff Theatre Inc., 4 CCH Tax Ct. Mem. 1147 (1945); Homchis, 4 CCH Tax Ct. Mem. 361 (1945).

37. Cosmopolitan Corp., 18 CCH Tax Ct. Mem. 542 (1959).

38. Wilkes-Barre Lace Mfg. Co., 1 B.T.A. 467 (1925).

39. Int. Rev. Code of 1954, § 38(a).

40. 76 Stat. 962 (1962).

41. Int. Rev. Code of 1954, §§ 48(b)-(c).

42. Int. Rev. Code of 1954, § 48(a).

43. Int. Rev. Code of 1954, § 48(g)(1).

44. The amount of the credit is determined by the useful life as estimated at the time of placement in service by the taxpayer as follows: A credit of 7% is computed from—33⅓% of the basis if the useful life is 4 to 6 years, 66⅔% of the basis if the useful life is 6 to 8 years, and the entire basis if the useful life is 8 years or more. Int. Rev. Code of 1954, §§ 46 (a)(1), (c).

In addition, the cost basis may also be initially reduced, at the election of the taxpayer, by twenty per cent of the cost, not to exceed \$10,000.⁴⁵ This "bonus" first year depreciation is set up for depreciable property which has a useful life of at least six years and is acquired after December 31, 1957. Furthermore, there is no limitation placed upon the size of taxpayer who may elect this initial deduction.

II. SALVAGE VALUE

A. Description

The Treasury Regulations define 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.⁴⁶

Salvage value has been further defined by the Supreme Court in *Massey Motors, Inc. v. United States*.⁴⁷ In that case the issues were whether useful life was to be the period for which the taxpayer reasonably would expect to retain the asset or its physical life, and whether the salvage value would always be the scrap value of the asset or its resale value at the time of sale. The Court held that the useful life was to be the estimated period of use by the taxpayer and that salvage value "must include estimated resale or second-hand value."⁴⁸ Thus, the concept of salvage value is no longer tied to the physical life of the asset.

B. Redetermination

The Regulations also set out a general rule respecting changes to be made in the taxpayer's original estimation of depreciation.

Salvage value shall not be changed at any time after the determination made at the time of acquisition merely because of changes in price levels. However, if there is a redetermination of useful life . . . salvage value may be redetermined based upon facts known at the time of such redetermination of useful life.⁴⁹

Such change may be made without prior application to and consent from the Commissioner.

A similar formula was applied, at an early date, by the Tax Court in *Wier Long Leaf Lumber Co.*⁵⁰ In this case, the court held that it was proper for the Commissioner to redetermine the salvage value at the end of the useful life of a taxpayer's assets in order to reflect a sharp increase in the market value. The court further stated, however, that the price received for assets sold prior to the end of their useful life would not justify a change in the salvage

45. Int. Rev. Code of 1954, § 179.

46. Treas. Reg. § 1.167(a)-1(c) (1956), as amended, T.D. 6507, 1960-2 Cum. Bull. 91.

47. 364 U.S. 92 (1960).

48. Id. at 107.

49. Treas. Reg. § 1.167(a)-1(c) (1956), as amended, T.D. 6507, 1960-2 Cum. Bull. 91.

50. 9 T.C. 990 (1947), rev'd on other grounds, 173 F.2d 549 (5th Cir. 1949).

value. The same considerations were presented to a federal court of appeals in *Cohn v. United States*.⁵¹ Citing Section 1.167(a)-1(c) of the Treasury Regulations,⁵² the court held that although salvage value should not be adjusted to reflect "minor fluctuations in market value from year to year,"⁵³ it may properly be redetermined "at or near the end of the useful life of the asset when it is shown by an actual sale of the asset that there is a substantial difference between what was estimated and what it actually is."⁵⁴ The court made it clear that, although such a redetermination would be allowed, it "would not affect prior taxable years."⁵⁵

Shortly after the *Cohn* case, a ruling was requested from the Internal Revenue as to whether the salvage value of an asset would be adjusted in the year of disposition if the salvage value as indicated by sale was greater than the adjusted basis of the property. In Revenue Ruling 62-92,⁵⁶ the Commissioner answered the question in the affirmative, and went on to state that section 1.167(a)-1(c)⁵⁷ "does not preclude adjustment of salvage value where there is a clear and convincing basis therefor even though no adjustment of useful life is required."⁵⁸ The Commissioner also held that this rationale was "of course, applicable for taxable years prior to the year of disposition where there is a clear and convincing basis existing at the end of such prior taxable year for an adjustment in the depreciation deduction."⁵⁹

In *S & A Co. v. United States*,⁶⁰ the court was faced with a situation in which the District Director wished to change the salvage value of an asset, sold before the end of its useful life, to reflect its sale price. The court severely criticized Revenue Ruling 62-92⁶¹ by reviving the distinction in *Wier Long Leaf Lumber*⁶² and limiting the *Cohn*⁶³ case to its facts. The court distinguished *Massey Motors*⁶⁴ by pointing out that the sale was premature when compared with the period of use expected by the taxpayer, and held there were no grounds for redetermining the salvage value of an asset sold prior to the end of its useful life. The court pointed out, in dictum, that since Revenue Ruling 62-92 seemed to go further than the holding in *Cohn*, an extension of that case beyond its facts, by application of the ruling, would be "erroneous as a matter of law."⁶⁵

51. 259 F.2d 371 (6th Cir. 1958).

52. Treas. Reg. § 1.167(a)-1(c) (1956), as amended, T.D. 6507, 1960-2 Cum. Bull. 91.

53. 259 F.2d at 379.

54. *Id.* at 378.

55. *Ibid.*

56. 1962-1 Cum. Bull. 29.

57. Treas. Reg. § 1.167(a)-1(c) (1956), as amended, T.D. 6507, 1960-2 Cum. Bull. 91.

58. Rev. Rul. 62-92, 1962-1 Cum. Bull. 30.

59. 1962-1 Cum. Bull. 31.

60. 218 F. Supp. 677 (D. Minn. 1963).

61. 1962-1 Cum. Bull. 29.

62. 9 T.C. 990 (1947), rev'd on other grounds, 173 F.2d 549 (5th Cir. 1949).

63. 259 F.2d 371 (6th Cir. 1958).

64. 364 U.S. 92 (1960).

65. 218 F. Supp. at 685.

In the present state of the law, we are faced with an apparent conflict between Revenue Ruling 62-92 and these cases. It would seem that the better reasoning, if not the better authority, stands behind the rationale in *Wier Long Leaf Lumber*.⁶⁶ Since salvage value is the value of the asset at the end of its useful life, the price at a sale prior to that time is an estimation which is no better than ordinary market fluctuations. Therefore, redetermination should not be made in the absence of a change in useful life.

One question remains, that is, whether the taxpayer is precluded from revising his estimation of salvage value under proper circumstances. There is no prohibition on this point in the regulations or cases. Absent a decision to the contrary, it may be presumed that the taxpayer may redetermine the salvage value if at or near the end of the useful life of his asset a sale manifests a discrepancy, or if he makes a redetermination of the useful life and the facts warrant a change in salvage value.

C. *Effect of the 1962 Changes*

There has been only one development that directly affects salvage value. Under the new Section 167(f)⁶⁷ of the 1954 Code, salvage value of up to ten per cent of the basis, determined after deduction of the tax credit and/or the discretionary twenty per cent initial deduction,⁶⁸ may be disregarded.⁶⁹ The result of this section is that a salvage value of less than ten thousand dollars may be disregarded completely, or a greater salvage value may be reduced by that amount.

III. USEFUL LIFE

A. *Description*

The most essential factor in the determination of the depreciation deduction is useful life. It is defined in the Treasury Regulations as "not necessarily the useful life inherent in the asset, but . . . 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."⁷⁰ The factors to be considered in determining useful life are listed in four groups: (1) decline in value from natural causes, (2) industrial innovations, (3) effect of abnormal conditions, and (4) replacement and repair. Salvage value is expressly excluded from consideration.⁷¹ The four categories, together with the taxpayer's previous experience with similar property, are applied, at the time when the taxpayer places the asset in use, to calculate its probable useful life.

B. *Redetermination*

The general rule applicable to changing useful life is set forth in the Treasury Regulations as follows:

66. 9 T.C. 990 (1947), rev'd on other grounds, 173 F.2d 549 (5th Cir. 1949).

67. 76 Stat. 1034 (1962).

68. Proposed Treas. Reg. § 1.167(f)-1, 28 Fed. Reg. 12825 (1963).

69. Int. Rev. Code of 1954, § 167(f)(1).

70. Treas. Reg. § 1.167(a)-1(b) (1956).

71. *Ibid.*

The estimated remaining useful life may be subject to modification by reason of conditions known to exist at the end of the taxable year [but] . . . only when the change in the useful life is significant and there is a clear and convincing basis for the redetermination.⁷²

If such a basis exists, a redetermination may be made by the Commissioner⁷³ or the taxpayer,⁷⁴ without prior application to and consent from the Commissioner.

If facts available to the Commissioner at the end of the tax year indicate that the taxpayer is employing too short a useful life, the period will be extended. Such facts were presented in *Virginian Hotel Corp. v. Helvering*,⁷⁵ where the Commissioner extended the useful life of the taxpayer's assets to a figure approximately twice the former estimation. The taxpayer contended that the lower rate of depreciation invoked by the extension of the useful life under the taxpayer's straight-line method should be retroactively applied. If it had been, the taxpayer would have the advantage of the lower rate in determining his adjusted basis. He supported his contention with the fact that he had received no tax benefit. The Commissioner, on the other hand, contended that the rate under the former useful life should be applied, as it was allowed as a deduction during prior years. The Supreme Court held that a regular depreciation deduction is allowed whether or not a tax benefit results, and must, therefore, be deducted from the adjusted basis of the asset. A redetermination of the useful life normally does not affect the amount allowed in previous years.⁷⁶

The rationale of *Virginian Hotel* was extended, in *Southwest Ornamental Iron Co.*,⁷⁷ to encompass a reduction in useful life. In this case, however, its application led to the conclusion that the newly calculated useful life would be

72. *Ibid.* The exception to this general rule occurs when the composite or classified group accounts are used. In this case, the useful life "shall be redetermined whenever additions, retirements or replacements substantially alter the relative proportions of types of assets in the account." Treas. Reg. § 1.167(a)-7(d) (1956).

73. *Virginian Hotel Corp. v. Helvering*, 319 U.S. 523 (1943); *Commissioner v. Mutual Fertilizer Co.*, 159 F.2d 470 (5th Cir. 1947); *Southwest Ornamental Iron Co.*, 12 CCH Tax Ct. Mem. 521 (1953). Such a redetermination by the Commissioner, once made, is presumed correct. This presumption has the effect of shifting the burden of proof to the taxpayer, *Southwest Ornamental Iron Co.*, *supra*, and must be overcome by substantial evidence to the contrary. *M. Pauline Casey*, 38 T.C. 357 (1962).

74. *Commissioner v. Cleveland Adolph Mayer Realty Corp.*, 160 F.2d 1012 (6th Cir. 1947); *Washburn Wire Co. v. Commissioner*, 67 F.2d 658 (1st Cir. 1933); *Goss & DeLeeuw Mach. Co. v. United States*, 53 F. Supp. 853 (D. Conn. 1943); *New York City Omnibus Corp.*, 7 CCH Tax Ct. Mem. 899 (1948).

75. 319 U.S. 523 (1943).

76. The decision of the Supreme Court in this case was based on an interpretation of the Int. Rev. Code of 1939, ch. 1, § 113(b), 53 Stat. 44. Since this provision of the 1939 Code was substantially incorporated into § 1016 of the 1954 Code, the rule of the case would be applicable today. See also *Commissioner v. Mutual Fertilizer Co.*, 159 F.2d 470 (5th Cir. 1947).

77. 12 CCH Tax Ct. Mem. 521 (1953).

retroactively applied, with the resulting allowable depreciation deducted from the adjusted basis of the asset. It should be noted, however, that the Commissioner's redetermination was prompted by a change in useful life made by the taxpayer himself and involving a contention that the taxpayer's original estimate was erroneous. The decision in this case, therefore, should be treated as an exception to the rule that a change in useful life will not be retroactively applied, and confined to the case where the Commissioner contends that the original estimate of the taxpayer was mistaken. It cannot be logically extended to the case where a redetermination is made in light of facts which did not exist at the time of original estimation.

The taxpayer also may redetermine useful life. He must, however, overcome a presumption that the former life is correct by introducing facts sufficient to justify the change.⁷⁸ Upon proof of such facts, the taxpayer will be allowed to extend his useful life⁷⁹ where the assets in question are not fully depreciated.⁸⁰ If the basis of the asset⁸¹ has been completely reduced, however, extension of the useful life will not be allowed.⁸² When redetermination is allowed, the same rules apply as in an adjustment by the Commissioner, and the redetermined useful life will not be retroactively applied.⁸³

Thus, a redetermination of useful life may be made by either the taxpayer or the Commissioner at the end of the tax year if the facts warrant. With one exception, it will not be applied retroactively and the deduction is calculated as though a new asset were being placed into service.⁸⁴

The right to redetermine is affected, however, if the taxpayer elected, under Section 167(d) of the Internal Revenue Code,⁸⁵ to enter into an agreement with the Commissioner fixing useful life. Such agreement is binding upon both parties unless facts not considered at the time of the agreement are proved to exist by the party seeking to amend.⁸⁶ Amendment will not be proposed by the Commissioner "unless there is a clear and convincing basis for a modifi-

78. Keller Steel Dev. Co., 37 T.C. 559 (1961).

79. New York City Omnibus Corp., 7 CCH Tax Ct. Mem. 899 (1948).

80. Washburn Wire Co. v. Commissioner, 67 F.2d 658 (1st Cir. 1933).

81. Cost less salvage value.

82. Repplier Coal Co. v. Commissioner, 140 F.2d 554 (3d Cir.), cert. denied, 323 U.S. 736 (1944).

83. Commissioner v. Cleveland Adolph Mayer Realty Corp., 160 F.2d 1012 (6th Cir. 1947).

84. Redeterminations under the declining balance (Treas. Reg. § 1.167(b)-2(c) (1956)) and sum of the years-digits (Treas. Reg. § 1.167(b)-3(a)(ii) (1956)) methods are treated similarly. But see Int. Rev. Code of 1954, § 1312(4) and related sections. This, in effect, would provide for a retroactive application of useful life if there has been a prior erroneous determination, e.g., by the Tax Court, of the length of the useful life and the later determination results in a shortening thereof.

85. Int. Rev. Code of 1954, § 167(d). For the form of an agreement see Rev. Proc. 57-10, 1957-1 Cum. Bull. 735.

86. Treas. Reg. § 1.167(d)-1 (1956), as amended, T.D. 6426, 1959-2 Cum. Bull. 90. A letter stating intention to change and facts in justification must be sent by the party proposing the change, by registered or certified mail to the other party. *Ibid.*

cation."⁸⁷ Furthermore, an amendment by either party may only be applied prospectively to the years after the effective date of the amendment.⁸⁸

C. *Effect of the 1962 Changes*

The most significant changes in the depreciation deduction made in 1962 were in the area of useful life. The Commissioner published Revenue Procedure 62-21,⁸⁹ seeking to

provide taxpayers with a greater degree of certainty in determining the amount of their depreciation deductions and to provide greater uniformity in the audit of these deductions by the Internal Revenue Service.⁹⁰

The innovations introduced consisted of new tables to act as a guide for determining useful life⁹¹ and as an objective test by which the taxpayer and the Commissioner can easily calculate whether a depreciation deduction should be redetermined.⁹²

The new guideline lives⁹³ consist of close to one hundred items in four categories: assets used by business generally;⁹⁴ nonmanufacturing assets;⁹⁵ manufacturing assets;⁹⁶ and assets used in transportation, communications and public utilities.⁹⁷ The purpose of the new lives is to facilitate the grouping of assets into the categories set forth, and thereby to provide one easily ascertainable useful life for the entire category. The Commissioner will then use the guideline life as a standard, together with the "reserve ratio test," to determine the reasonableness of the deduction for depreciation. Although the taxpayer need not adopt the new guideline lives, the reasonableness of his deduction for all returns due after July 12, 1962, including assets acquired prior to that date, will normally be determined by a class life involving their use.⁹⁸ Provision is made for calculations to arrive at a comparable class life

87. 1957-1 Cum. Bull. 737.

88. Treas. Reg. § 1.167(d)-1 (1956), as amended, T.D. 6426, 1959-2 Cum. Bull. 90.

89. Rev. Proc. 62-21, 1962-2 Cum. Bull. 418.

90. 1962-2 Cum. Bull. 429.

91. 1962-2 Cum. Bull. 419.

92. 1962-2 Cum. Bull. 435.

93. Bulletin F, the former standard used by the Commissioner, is expressly revoked. 1962-2 Cum. Bull. 430.

94. 1962-2 Cum. Bull. 419.

95. 1962-2 Cum. Bull. 420.

96. 1962-2 Cum. Bull. 422.

97. 1962-2 Cum. Bull. 426.

98. This is true with two exceptions. Where the taxpayer uses a method of depreciation which does not employ the useful life concept, e.g., unit of production (see 4 Mertens §§ 23.34-37 (1960)), the procedure cannot be used. The taxpayer can elect to change this method to a method covered by the procedure, without prior consent, for the first taxable year ending on or after July 12, 1962. Rev. Proc. 62-21, 1962-2 Cum. Bull. 429, n.1. A tax-

for taxpayers who do not choose to group their assets into guideline accounts.⁹⁹ Since salvage value is not considered in the class life, provision is also made for conversion in the majority of cases¹⁰⁰ where salvage value is a factor.¹⁰¹ If the taxpayer uses the guideline classes and has no salvage value, his class life is equal to his guideline life.¹⁰²

The second part of the Commissioner's new test for determining whether the deduction for depreciation is reasonable is the reserve ratio. The purpose of this test is defined as follows:

The reserve ratio test is an objective technique which can be used to demonstrate that the retirement and replacement practices being followed by a taxpayer with respect to a guideline class are consistent with the class life being used.¹⁰³

The reserve ratio is calculated by dividing the total depreciation reserves, *i.e.*, total amount of depreciation claimed for the assets in a guideline class, by the total cost or equivalent basis of the assets.¹⁰⁴ Once the reserve ratio is computed, the rate of growth must be determined in order to apply the test. This determination is made by comparison of the class life period¹⁰⁵ with the

payer employing the useful life method may elect not to have these procedures apply, 1962-2 Cum. Bull. 429-30, and the reasonableness of his deduction will be determined according to Rev. Rul. 90, 1953-1 Cum. Bull. 43, and Rev. Rul. 91, 1953-1 Cum. Bull. 44.

99. This computation involves 3 steps: (1) regrouping of assets into their guideline accounts; (2) computing the depreciation over the taxpayer's estimated useful life as if straight-line depreciation were used; and (3) dividing the sum of the depreciation of the assets in the account into the sum of their cost or comparable bases.

$$\text{Class life} = \frac{\text{sum of bases}}{\text{sum of straight-line depreciation of regrouped assets}}$$

See Rev. Proc. 62-21, 1962-2 Cum. Bull. 434.

100. Salvage value may be disregarded if less than 10% of basis (see Int. Rev. Code of 1954, § 167(f)(1)), salvage is not considered in the computation of depreciation under the declining balance method.

101. In all cases where salvage value is considered in computing depreciation, the total salvage value used by the taxpayer on all assets in the guideline class is added to the total straight-line depreciation and divided into the total basis.

$$\text{Class life} = \frac{\text{total basis}}{\text{total straight-line depreciation} + \text{total salvage value}}$$

See Rev. Proc. 62-21, 1962-2 Cum. Bull. 434.

102. 1962-2 Cum. Bull. 434. The taxpayer need not assign the guideline life to all the assets in the guideline account, as long as the prorated total life is equal to the guideline life for the class.

103. 1962-2 Cum. Bull. 439.

104. *Ibid.*

105. The class life period is the class life of the guideline class under consideration unless records are not available for the base year. (The base year is determined by subtracting from the present tax year a number of years equal to the class life.) In this case, the class life period will be computed from the earliest year, prior to the taxable

asset ratio¹⁰⁶ in a table provided by the Commissioner.¹⁰⁷ The rate of growth thus obtained is compared with the test life¹⁰⁸ for the guideline class in the table provided for the taxpayer's method¹⁰⁹ to arrive at the reserve ratio range. The reserve ratio test consists of a comparison of the reserve ratio with the upper and lower limits of the range.

How does this affect a recomputation of useful life? The answer to this question is that the taxpayer may justify a change in useful life by the reserve ratio test, and the Commissioner will use the test to decide whether he will disturb the taxpayer's determination. During the tax years for which a return is due prior to July 12, 1965, the taxpayer is given leave to experiment with useful lives equal to or greater than the guideline lives, even though he formerly used a longer useful life.¹¹⁰ After 1965, however, the taxpayer will have to justify any change by the reserve ratio test or by all the facts and circumstances. Even the guideline lives will be subject to redetermination if the test is not met.¹¹¹

The consideration for changing to a class life lower than the guideline life, or preventing the Commissioner from disturbing a lower life, are more complex. If the taxpayer uses a class life equal to or greater than that used in the previous year, the Commissioner will not disturb the class life if it is justifiable

year for which returns were due on July 12, 1962, for which records are available, provided that year is at least 3 years prior to the taxable year being considered. The year for which the records are available will also be substituted for the base year. 1962-2 Cum. Bull. 441-42.

106. The asset ratio is the total cost basis of all assets in the class being considered, divided by the total cost basis of the assets in that class at the close of the base year. 1962-2 Cum. Bull. 441.

107. Table 1—Rate of Growth Conversion Table, 1962-2 Cum. Bull. 444-45.

108. The test life is equal to: (1) the guideline life, if the class life is at least as long as the guideline life and it has not been lengthened by the Commissioner; (2) the previously justified life, if it is at least as long as the guideline life and has not been lengthened by the Commissioner; (3) the lengthened life, if lengthened by the Commissioner; (4) the life used in the year under examination, if it is shorter than the guideline life and sought to be justified by reference to prior use; and (5) the life for the previous taxable year, if shorter than the guideline life and sought to be justified by prior retirement and replacement practices. 1962-2 Cum. Bull. 440-41.

109. Tables are provided for: the straight-line method, 1962-2 Cum. Bull. 446-48; the double-declining balance method, 1962-2 Cum. Bull. 449-51; the sum of the years-digits method, 1962-2 Cum. Bull. 452-54; and the 150% declining balance method, 1962-2 Cum. Bull. 455-57. Since no tables are provided for "other consistent method[s]," Int. Rev. Code of 1954, § 167(b)(4), it would seem that adoption of Revenue Procedure 62-2, 1962-1 Cum. Bull. 420, is confined to taxpayers using these four methods. If the taxpayer makes use of more than one method in a guideline class, the reserve ratio range is computed by weighted average. See 1962-2 Cum. Bull. 442.

110. 1962-2 Cum. Bull. 430-31.

111. *Ibid.* The redetermination will be made according to the Adjustment Table for Class Lives which appears at 1962-2 Cum. Bull. 459. 1962-2 Cum. Bull. 437.

under all the facts and circumstances, or if the same class life has been consistently maintained for at least half its duration and the reserve ratio test is met.¹¹² Once again, however, the reserve ratio test is considered met for the first three years to which Revenue Procedure 62-21 applies.¹¹³ If after the three years have elapsed the reserve ratio is still above the upper limit of the appropriate range, the taxpayer will be allowed a transitional period of years equal to the guideline life of the class to bring his reserve ratio below the upper limit, provided the discrepancy is lower than it was during any year of the three-year hands-off period.¹¹⁴ If neither the permanent nor transitional rule is met, the class life will be lengthened by the Commissioner in accordance with the Adjustment Table for Class Lives.¹¹⁵

If the taxpayer wishes to change to a class life shorter than that used in the previous year, he may justify his redetermination by showing that his reserve ratio for the prior year was below the lower limit of the range,¹¹⁶ that he used the prior life for a period of more than one half its length, and by use of the Adjustment Table for Class Lives.¹¹⁷ He may also justify such a change by all the facts and circumstances.¹¹⁸ In the case of a new taxpayer or new asset account where the asset could not have been used for a period of one half the class life, a class life shorter than guideline life may be justified only by all the facts and circumstances as listed in subsection .06.¹¹⁹ If not so justified, the Commissioner may lengthen the class life to conform to the guideline life.¹²⁰

There are no express rules set forth in Revenue Procedure 62-21 for the application of the reserve ratio test to justify the shortening of class lives by the Commissioner or their lengthening by the taxpayer. It is clear, however, that the taxpayer may change to a class life longer than or equal to the guideline life until the first taxable year for which a return must be filed after July 12, 1965.¹²¹ After the hands-off period, however, the Commissioner may be expected to consider redetermination of the useful lives of accounts whose reserve ratios fall below the lower limit of the range. The taxpayer wishing to lengthen his useful life will probably have to justify such a redetermination by the facts and circumstances existing at the end of the

112. 1962-2 Cum. Bull. 431-32.

113. 1962-2 Cum. Bull. 436.

114. *Ibid.*

115. 1962-2 Cum. Bull. 459.

116. The reserve ratio is deemed met for the three-year hands-off period, and the transitional rule would be applicable. However, it should be noted that for the transitional rule to be applied during the hands-off period, the discrepancy for the taxable year must be less than it was for any of the 3 years preceding it. 1962-2 Cum. Bull. 436.

117. 1962-2 Cum. Bull. 432.

118. 1962-2 Cum. Bull. 433.

119. *Ibid.*

120. 1962-2 Cum. Bull. 437.

121. 1962-2 Cum. Bull. 430-31.

taxable year, unless his reserve ratio falls beyond the upper limit of the range in the previous taxable year.

It is important to remember that the reserve ratio test and the guidelines are always subject to the election of the taxpayer to have his useful life determined under prior procedures. These tests are merely procedural and do not supersede any existing regulations or case law. They eliminate only "Bulletin F."

IV. METHODS

A. Description

The final factor to be examined is the method of computation.¹²² The Internal Revenue Code of 1954 expressly sanctions the use of three methods which are commonly used today: the straight-line method;¹²³ the declining balance method¹²⁴ using a rate not exceeding twice the straight-line method; and the sum of the years-digits¹²⁵ method.¹²⁶ The Code sets up a standard by

122. It should be noted at the outset of this discussion that there are other methods of computing depreciation which are not discussed, as their use involves entirely different considerations, their application to tax depreciation is not advantageous, and their use is confined to specialized industries. See 4 Mertens §§ 23.34-37.

123. The straight-line method is computed by dividing the cost basis less salvage value by the useful life, and taking an annual deduction equal to the figure obtained. E.g., X Corporation has an asset which cost \$14,000. Its useful life is 10 years and its salvage

value is \$4,000. The annual depreciation would be $\frac{\$14,000 - \$4,000}{10} = \$1,000$, or 10%

per year. See Treas. Reg. § 1.167(b)-1 (1956); 4 Mertens § 23.32 (1960).

124. The declining balance method is actually two methods, the 150% declining balance method and the double-declining balance method. The former is computed by taking 150% of the straight-line rate and applying it to the adjusted basis to arrive at the annual deduction. Salvage value is not subtracted from the cost basis, but the asset may not be depreciated below it. E.g., X Corporation has an asset which cost \$14,000, with a useful life of 10 years and a salvage value of \$4,000. The depreciation on X's asset for the first year would be $\$14,000 \times (150\% \times 10\%) = \$2,100$, the second year's depreciation would be $(\$14,000 - \$2,100) \times (150\% \times 10\%) = \$1,784$, and so on. The double-declining balance is computed the same way except that 200% of the straight-line rate is used. X's depreciation would be $\$14,000 \times (200\% \times 10\%) = \$2,800$; the second year would be $(\$14,000 - \$2,800) \times (200\% \times 10\%) = \$2,240$. See Treas. Reg. § 1.167(b)-2 (1956); 4 Mertens § 23.33 (1960).

125. There are two manners in which the sum of the years-digits method may be computed. The first is to divide the years of useful life remaining, including the present year, by a denominator consisting of the sum of the years composing the useful life. The resulting fraction is then applied to the cost basis less salvage value to arrive at the annual deduction. E.g., X Corporation has an asset which cost \$14,000, with a useful life of 10 years and a salvage value of \$4,000. X's first-year deduction would be

$$(\$14,000 - \$4,000) \times \frac{10}{1 + 2 + 3 + 4 + 5 + 6 + 7 + 8 + 9 + 10} = \$1,818.18.$$

which the validity of any other method may be judged. The depreciation allowance may also be computed by

any other consistent method^[127] productive of an annual allowance which, when added to all allowances for the period commencing with the taxpayer's use of the property and including the taxable year, does not, during the first two-thirds of the useful life of the property, exceed the total of such allowances which would have been used [under the straight-line method]¹²⁸

These provisions are made subject to "regulations prescribed by the Secretary or his delegate."¹²⁹ The first of these deals with restrictions on the use of a depreciation method. The straight-line method is available to all taxpayers for use initially; but the use of the "accelerated methods"¹³⁰ is confined to tangible property with a useful life of three or more years and which has been either constructed, reconstructed, or created or acquired during or after 1954.¹³¹ The use of all but the 150 per cent declining balance method is further restricted to new¹³² property.¹³³ The 150 per cent declining balance method is applicable to new and used property acquired prior to 1954.¹³⁴

B. Redetermination

Any change in the method of computing the depreciation allowances with respect to a particular account is a change in method of accounting, and such a change will be permitted only with the consent of the Commissioner¹³⁵

The alternate method is to set up a fraction with a numerator of the years of useful life remaining and denominator of the sum of the years in the remaining useful life, and apply it to the adjusted basis less salvage value. E.g., X's first-year depreciation would be the same, but the second year would be

$$(\$12,181.82 - \$4,000) \times \frac{9}{1 + 2 + 3 + 4 + 5 + 6 + 7 + 8 + 9} = \$2,436.36.$$

See Treas. Reg. § 1.167(b)-3 (1956); 4 Mertens § 23.37(a) (1960).

126. Int. Rev. Code of 1954, § 167(b)(1)-(3).

127. See Treas. Reg. § 1.167(b)-4 (1956); 4 Mertens § 23.37(b).

128. Int. Rev. Code of 1954, § 167(b)(4).

129. Int. Rev. Code of 1954, § 167(b).

130. I.e., the double-declining balance method, the sum of the years-digits method, and other consistent methods proscribed by Int. Rev. Code of 1954, § 167(b).

131. Int. Rev. Code of 1954, § 167(c). The property fits this description if the work was done according to the specifications of the taxpayer. The method may only be applied to that portion of the basis affected by the work. Treas. Reg. § 1.167(c)-1(a) (1956).

132. This must be "the first use to which the property is put, whether or not such use corresponds to the use of such property by the taxpayer." Treas. Reg. § 1.167(c)-1(a)(2) (1956).

133. Treas. Reg. § 1.167(c)-1(a) (1956). For the ruling expressly allowing the use of the 150% declining balance method on used property, see Rev. Rul. 57-352, 1957-2 Cum. Bull. 150.

134. Rev. Rul. 57-352, 1957-2 Cum. Bull. 150.

135. Treas. Reg. § 1.167(e)-1(a) (1956).

Prior to the 1962 changes, there was one exception to this general rule which is still in effect.¹³⁶ A taxpayer who employed the double-declining balance method¹³⁷ can switch to the straight-line method at any time prior to the end of the useful life of his asset without the Commissioner's permission.¹³⁸ In all other cases, prior consent of the Commissioner is a prerequisite,¹³⁹ provided there actually is a change in method. The Tax Court has held that a corporation reorganized from two others is a new taxpaying entity and need not continue to depreciate under its predecessors' method.¹⁴⁰ Also, the suspension of the taking of a depreciation deduction does not preclude resumption under the same method without the Commissioner's permission.¹⁴¹

The exercise of the Commissioner's permission to make a change in accounting method is discretionary.¹⁴² As stated by the court in *Chicago & N.W. Ry. v. Commissioner*,¹⁴³ "the taxpayer having elected . . . to employ [one method] . . . cannot now claim as a matter of right the privilege of . . . applying a different method of accounting for depreciation . . ."¹⁴⁴ Furthermore, the Commissioner's determination of the situation is presumptively correct, and the courts will not overturn his refusal to grant permission unless it is arbitrary¹⁴⁵ or the taxpayer can prove¹⁴⁶ a clear abuse of discretion.¹⁴⁷ The court in *M. Pauline Casey*¹⁴⁸ held that a refusal by the Commissioner to grant permission, where the taxpayer had used a method for only one year and the Commissioner had already redetermined the useful life and salvage value, was not an abuse of discretion. Similarly, in *Johnson v. Commissioner*,¹⁴⁹ it was held that the mere fact that the declining balance method was a better indication of rapid actual depreciation in the early years of useful life did not entitle the taxpayer to change his method without permission.

136. The right of a taxpayer to switch from retirement accounting to the straight-line method without prior consent of the Commissioner expired on January 11, 1960. Treas. Reg. § 1.9001-1(b)(3) (1959).

137. The taxpayer was not allowed to switch from the 150% declining balance method without permission from the Commissioner. Rev. Rul. 57-510, 1957-2 Cum. Bull. 152.

138. Int. Rev. Code of 1954, § 167(e)(1). The taxpayer must also comply with Treas. Reg. § 1.167(e)-1(b) (1956), i.e., he must not have entered into any agreement to the contrary under § 167(d) of the Code, and if assets are grouped into an account, all assets therein must be changed. The taxpayer is also required to submit a statement containing: the date of acquisition, the cost basis, total depreciation and other allowances to date, the salvage value, the remaining useful life, the character of the property and other information which may be required.

139. Int. Rev. Code of 1954, § 446(e).

140. *Akron, Canton & Youngstown R.R.*, 22 T.C. 648 (1954).

141. *Guantanamo & W.R.R.*, 31 T.C. 842 (1959).

142. *Brown v. Helvering*, 291 U.S. 193, 204 (1934).

143. 114 F.2d 882 (7th Cir. 1940).

144. *Id.* at 886. See also *Hertz Corp. v. United States*, 364 U.S. 122 (1960).

145. *M. Pauline Casey*, 38 T.C. 357 (1962).

146. *United States Industrial Alcohol Co. v. Helvering*, 137 F.2d 511 (2d Cir. 1943).

147. *Schram v. United States*, 118 F.2d 541 (6th Cir. 1941).

148. 38 T.C. 357 (1962).

149. 302 F.2d 86 (4th Cir.), cert. denied, 371 U.S. 904 (1962).

If the change in method is allowed, it will not be retroactively applied,¹⁵⁰ and the new method will commence as if initially applied to a useful life equivalent to the remaining useful life of the asset in question.¹⁵¹ This general proposition has been expanded to include a change from a nondepreciation method to a depreciation method of accounting. The result is that a taxpayer changing from the retirement method to straight-line depreciation need not reduce the basis of his property by the amount of depreciation which would have been taken under the latter method in prior years.¹⁵² This ruling could be easily applied to a change from any method in which depreciation is not considered to a depreciation method of accounting.

A change in method of depreciation, therefore, generally requires the permission of the Commissioner, which will be granted only if there is a showing of necessitating circumstances. If the change is made, the new method will only be applied prospectively to the remaining life.

C. Effect of the 1962 Changes

The only actual change affecting the redetermination of depreciation method in the 1962 innovations is a provision enabling the taxpayer to elect to change from any accelerated method to the straight-line method without the prior consent of the Commissioner.¹⁵³ This change must be made on or before the last day for filing a return for the first taxable year after December 31, 1962, and is only applicable to property eligible for guideline treatment. On all subsequent returns the normal procedure will apply.

The most important change for the taxpayer in 1962, however, is a change in emphasis. The introduction of the new investment credit and the initial deduction for depreciation,¹⁵⁴ coupled with shorter guideline lives, makes depreciation accounting essential for every taxpayer. A more narrow, but important, emphasis is placed upon the straight-line method of depreciation. Long recognized as the least complicated of the methods to apply,¹⁵⁵ straight-line computation has become a near necessity with the introduction of the guidelines and the reserve ratio test. The main objection to the method, *i.e.*, that it does not allow sufficient initial recapture of cost, is largely assuaged by the investment credit and initial allowance. The taxpayer may now have the advantages of both a quick recovery of cost, through tax reduction, and a substantial deduction in later years. Also, by adopting the straight-line method, at least for tax purposes,¹⁵⁶ the taxpayer will also be better able

150. Washburn Wire Co., 9 P-H B.T.A. Mem. 590 (1940).

151. Treas. Reg. § 1.167(a)-1(b) (1956).

152. Portland Gen. Elec. Co. v. United States, 189 F. Supp. 290 (D. Ore. 1960), *aff'd*, 310 F.2d 877 (9th Cir. 1962); Kansas City Pub. Serv. Co. v. United States, 100 F. Supp. 105 (W.D. Mo. 1951); Los Angeles & Salt Lake R.R., 4 T.C. 634 (1945). See Rev. Rul. 60-390, 1960-2 Cum. Bull. 463.

153. Int. Rev. Code of 1954, § 167(e)(2).

154. See notes 44 & 45, *supra*.

155. 4 Mertens § 23.32 (1960).

156. It has always been permissible to keep two sets of books.

to regulate his depreciation deduction so that it complies with the Commissioner's objective test.

Finally, although much of the prior law has remained unchanged by the 1962 amendments, the standards to be applied in determining the reasonableness of the depreciation deduction, or a change thereof, have achieved a new clarity. For the first time the Commissioner has proffered an objective standard which can be calculated and applied by the Internal Revenue and taxpayer alike to decide when redetermination is necessary or allowable. The objective standard is a welcome innovation in this field, and the taxpayer should avail himself of the chance to know exactly where he stands at all times.