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BASIC MATERIALS ON LIBERALIZED DEPRECIATION ALLOWANCES ANNOUNCED ON JANUARY 11, 1971

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January 25, 1971

BASIC MATERIALS ON LIBERALIZED DEPRECIATION ALLOWANCES
ANNOUNCED ON JANUARY 11, 1971

On January 11, 1971, the President announced that a liberalization and simplification of depreciation allowances for machinery and equipment were being adopted by the Internal Revenue Service. On the same date, various press releases explaining the changes were issued by the White House, Department of the Treasury, and the Council of Economic Advisers. Those press releases (which were issued collectively by the Department of the Treasury) are reproduced in this set of basic materials.

Adoption of the liberalized depreciation by the Administration followed fairly soon after the Report of the President's Task Force on Business Taxation was released publicly. The adopted rules, however, are less liberal than those recommended by the task force. The chapter of the task force report dealing with its depreciation recommendations is also included in this collection of materials. The report describes (in greater detail than the press releases) the reasons for adopting the liberalized depreciation and provides a comparison of depreciation policy in the United States and foreign countries.

Very shortly after the official announcement of the liberalization of depreciation for Federal income tax purposes, both favorable and unfavorable reactions were expressed throughout the country. Several newspaper articles that provide some of these views are included in the collection of materials.

TABLE OF CONTENTS

	Page
*Statement by the President [on depreciation liberalization]. Press Release, January 11, 1971.	1
*Statement by Treasury Secretary David M. Kennedy on Asset Depreciation Range at a News Conference, Washington, D.C., January 11, 1971.	3
*Depreciation Allowances -- Asset Depreciation Ranges. Department of the Treasury News Release, January 11, 1971.	5
*Depreciation Allowances -- Asset Depreciation Ranges: Questions and Answers. Department of the Treasury News Release, January 11, 1971.	19
*Illustrations of the Effect of the New Modified First-Year Convention under the Asset Depreciation Range (ADR) System. Department of the Treasury News Release, January 11, 1971.	30
*Statement of Paul W. McCracken on President's Announcement of Changes in Depreciation Allowances.	32
Report of the President's Task Force on Business Taxation. Washington, D.C., Government Printing Office, September 1970. 82 p. [Only the chapter on "Capital Cost Recovery", p. 3-33, including charts, is reproduced in this collection of material.]	35
Treasury Issues Liberalized Rules on Depreciation. Wall Street Journal, January 12, 1971, p. 2.	73
Easing of Depreciation Rules Won't Spur Capital-Spending Flood, Survey Indicates. Wall Street Journal, January 12, 1971, p. 2.	75
Business Gets U.S. Tax Help. Washington Post, January 12, 1971, p. A1, A4.	76
Depreciation Easing Was Only a Proposal, Administration Says; Effect of Suit Denied. Wall Street Journal, January 13, 1971, p. 4.	78

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*These separately listed documents were issued collectively on January 11, 1971 by the Department of the Treasury.

Page

Depreciation Move Gets Proxmire, Chamber Nod. Washington Post, January 13, 1971, p. D7. 79

Volcker Sees No extremes. Washington Post, January 13, 1971, p. D7. 80

FOR IMMEDIATE RELEASE January 11, 1971

Office of the White House Press Secretary

THE WHITE HOUSE

STATEMENT BY THE PRESIDENT

Today I have approved three important changes in the administration of the depreciation provisions of the tax laws which will --

-- help create jobs for the unemployed as well as young people joining the labor force;

-- promote the economic growth which is essential if this nation is to meet its domestic and international responsibilities;

-- increase the competitiveness of U. S. goods abroad, thus strengthening our balance of payments; and

-- reduce significantly the complexity and uncertainty of the application of an important section of the Internal Revenue Code.

Briefly summarized, these highly technical changes will:

(1) Authorize the Internal Revenue Service to accept depreciation based on lives for business equipment acquired after 1970 that are not more than 20 percent shorter nor 20 percent longer than the present "guideline lives" fixed by Treasury in July 1962.

(2) Terminate the complex "reserve ratio test" for determining limits on depreciation allowances.

(3) Provide an alternative to the present "convention" which permits deduction of half the annual depreciation in the year in which equipment is placed in service. Under the modified "convention," a full year's depreciation for assets acquired after 1970 will be accepted for assets placed in service in the first half of a year; one-half year's for those in the second half of a year.

These actions will reduce business tax payments by $2.6 billion in this calendar year, rising to a peak of about $4 billion in 1976, and thereafter gradually declining. In evaluating the impact of these tax actions on economic activity, it should be remembered that as of January 1, 1971, almost $7 billion in individual income tax cuts had already occurred as a result of the Tax Reform Act of 1969.

I want to emphasize that these short-run revenue deductions announced today are not so large as to prevent us from maintaining balance, now and in fiscal year 1972, between budget spending and the revenues that would be generated in a full employment economy. Most

importantly, they can be expected to have a substantial "feedback" effect. Past experience demonstrates that depreciation liberalization will stimulate the pace of spending on new plant and equipment, which has been levelling off, and thus create jobs. As a result, Federal tax collections in the long run will increase. The estimates of revenue loss may, therefore, be regarded as maximum estimates.

Sound depreciation reform to create jobs and growth has a long history of bipartisan support. In 1961, the first year of the Kennedy Administration, Under Secretary of the Treasury Henry H. Fowler supported the impending program for major depreciation reform as a stimulant to economic recovery (unemployment was then about 6-1/2 percent of the labor force); as a means of increasing competitiveness of U. S. goods in world markets; and as a major force for long-run economic growth.

Several months later, in announcing broad revisions in depreciation guidelines, Secretary of the Treasury Douglas Dillon pointed to the job-creating impact of rising investment. In this respect, economists have long recognized that, in a highly industrialized society such as ours, each productive worker has to be equipped, in effect, with tools and machinery costing many thousands of dollars.

Depreciation reform is especially desirable today when we are requiring the diversion of significant amounts of business capital into the financing of pollution control facilities and away from those investments which would ordinarily go to increasing material productivity.

The specific administrative changes which I have approved are consistent with the recommendations of the President's Task Force on Business Taxation. I appointed this Task Force in September 1969 and asked the members to "concentrate on the role of business taxes in promoting growth, full employment, and a strong progressive economy." The Task Force included leading business men, lawyers and accountants, economists, a former U. S. Senator, and two former Secretaries of the Treasury.

A liberalization of depreciation allowances is essentially a change in the timing of a tax liability. The policy permits business firms to reduce tax payments now, when additional purchasing power is needed, and to make up these payments in later years.

Clearly, therefore, these steps toward meaningful depreciation reform are important for the present -- in light of current economic conditions -- and for the future -- to maintain the growth which has made this nation the strongest and most productive the world has ever known.

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The Department of the TREASURY NEWS

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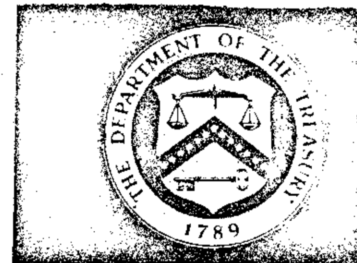

FOR IMMEDIATE RELEASE January 11, 1971

STATEMENT BY TREASURY SECRETARY DAVID M. KENNEDY
ON ASSET DEPRECIATION RANGE
AT A NEWS CONFERENCE
WASHINGTON, D. C.
JANUARY 11, 1971

The changes in tax administration announced today by the President are a major and timely reform of depreciation policy, and will be good for our national economy, all of our citizens, and every American business.

It strengthens every segment of our production team -- workers, managers and investors.

The reform of depreciation policy will encourage business to increase its investment in new machinery and equipment, and by providing significant tax reductions in 1971 and subsequent years, will help business accumulate the capital required for investment. As a result, our economic growth will be stimulated strongly and many new jobs created for those who are now unemployed or who will enter the work force in the future. Every American -- manufacturers, farmers, miners, storeowners, professional and service companies, all others and those who work therein -- will benefit.

By liberalizing and simplifying the depreciation provisions of the tax law, we also have taken a needed step to help U. S. businesses to modernize their productive facilities and keep abreast of rapidly changing technology. New and better equipment in American industry will bring increased productivity, and a strengthening of the competitive position of our country's goods in world markets.

It should be kept in mind that a liberalization of depreciation allowances primarily involves a postponement of the tax payment, and that this payment will eventually be added to government revenues. Furthermore, new business investments and job creation will serve in time to increase the taxable income of business and individuals, thus providing a larger tax return.

Aside from the tax effect, the changes in the depreciation provisions will also simplify and improve the administration of the tax laws. Elimination of the complex "reserve ratio test" for determining limits on depreciation allowance will ease the burden of compliance for business, and help with interpretation and administration of the law by the Internal Revenue Service. Repeal of this test also ends a disadvantage which our businesses have suffered in competing with foreign companies, whose tax systems do not include such a test.

The depreciation policy changes announced by the President were based on an intensive study by the Treasury Department and its Internal Revenue Service of steps needed to provide greater investment incentives and for job creation. Treasury was assisted in this study by the views of other government agencies, of business representatives, and of the President's Task Force on Business Taxation.

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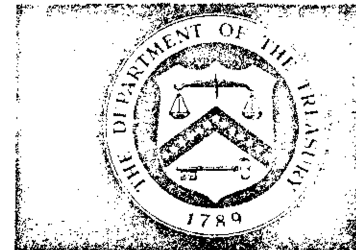

FOR IMMEDIATE RELEASE

January 11, 1971

THE DEPARTMENT OF THE TREASURY
Washington, D.C. 20220

DEPRECIATION ALLOWANCES -- ASSET DEPRECIATION RANGES

The President has announced today that a simplified and modernized system of depreciation allowances for machinery and equipment (the Asset Depreciation Range (ADR) System) is being adopted by the Internal Revenue Service. The reserve ratio test applicable to taxpayers who have elected so-called "Guideline" depreciation will be eliminated for taxable years ending after December 31, 1970.

The new ADR System will provide an election to taxpayers to take as a reasonable allowance for depreciation an amount based on any period of years selected by them within a range specified for designated classes of assets. Having selected the period, the taxpayer will determine his depreciation allowance under one of the methods presently permitted, such as the "straight-line," "double-declining balance," or "sum of the years-digits" method.

The range from which a period may be chosen will be specified for all assets or classes of assets for which Guideline lives are presently provided under Rev. Proc. 62-21, 1962-2 C.B. 418 (as amended and supplemented), except buildings and real estate improvements and certain public utility property.

In general, the range will be from a period of years 20 percent below the present Guideline lives to 20 percent above such lives.

A first year convention will be provided under which the taxpayer will either: treat all assets acquired during the year as acquired at the mid-point in the year, or treat assets acquired in the first half of the year as acquired at the beginning of the year and assets acquired in the second half of the year as acquired at the mid-point in the year (hereinafter referred to as the new modified first year convention).

The income tax regulations will be amended to provide for this system.

The Internal Revenue Service will accept such treatment as providing a reasonable allowance for depreciation purposes in all events if the ADR System is elected. A period selected from within the Asset Depreciation Range cannot be changed either by the taxpayer or the Service during the remaining period of use of the assets.

Assets will be required to be accounted for in item accounts or in group accounts by year placed in service (vintage accounts) according to the basis of classification of such assets in the Asset Depreciation Ranges. The election may be made annually and will apply to all assets placed in service in the year of election in the trade or business for which the election is made.

The ADR System will be made available for assets physically placed in service after December 31, 1970.

These actions are being taken pursuant to the authority contained in section 167(a) of the Internal Revenue Code of 1954 whereby a reasonable allowance for depreciation and obsolescence is to be permitted; in sections 446, 451, and 461 giving the Secretary or his delegate authority to provide for methods of accounting and the period in which income is to be accounted for and deductions are to be taken; and in section 7805 authorizing the Secretary or his delegate to prescribe all needful rules and regulations for administration of the internal revenue laws.

The System will provide simplicity and certainty to taxpayers and will substantially relieve the administrative burden on both taxpayers and the Internal Revenue Service resulting from the rules previously in effect. In the case of assets to which the System applies, it will eliminate controversy

as to the period on the basis of which a reasonable allowance for depreciation is to be determined, and thus will eliminate necessity for making each determination by weighing all the facts and circumstances of each particular taxpayer. Such controversies would otherwise continue to arise, even if Guideline lives have been adopted under Rev. Proc.62-21 where the reserve ratio test has not been satisfied (see sections 3.03, 3.06, and 6.01 of Rev. Proc. 62-21).

The System will also provide greater flexibility to taxpayers in determining the method by which they allocate their costs of capital equipment to the periods in which such equipment is expected to produce income. Thus, the System will in all respects be a more efficient alternative for determining a reasonable allowance for depreciation each year than either the "facts and circumstances" approach or the Guideline lives system under existing law.

The actions recognize that past replacement or retirement experience is not always the best and seldom is the only proper guide for forecasting the future period of economic productivity of assets to which the capital expenditures for such assets should be allocated. The degree of technological change since the 1962 Guideline lives were prepared makes the use of hindsight inappropriate as a guide in predicting the future practices of the 1970's and 1980's. Vigorous competition from producers in other nations, most of which provide similar systems, requires that United States businesses accelerate the modernization of their facilities. The necessity of modifying many of our industrial processes to cope with environmental quality requirements has resulted in an unexpected rapid increase in obsolescence of productive facilities.

All of these forces have caused the taxpayer's past retirement and replacement experience to be an unreliable guide in our modern industrial society in establishing reasonable allowances for future depreciation and obsolescence. Moreover, within the limits of administrative discretion, it is in the best interest of the United States to increase the productivity of our labor force and stimulate employment by encouraging the modernization of machinery and equipment of United States businesses. The ADR System permits taxpayers to select appropriate periods for recovery of their capital expenditures for productive equipment from the revenues which will be produced by such equipment by use of foresight and with proper adaptation to all these changing economic conditions.

The recent indications of a leveling off of investment in equipment makes it important to institute these changes at the present time to stimulate business activity and thereby speed the return of the economy to full employment. This action with respect to depreciation reform is an integral part of the expansionary policies announced by President Nixon to attain these objectives.

It is estimated that, without giving effect to any feedba to revenues resulting from increased employment and business activity, these changes will result in a reduction in Federal revenues of $0.8 billion in the fiscal year ending June 30, 1971, and of $2.7 billion in fiscal 1972, rising annually thereafter to a peak of $4.1 billion in fiscal 1976 and falling thereafter to $2.8 billion by fiscal 1980. It is anticipated, however, that the increase in employment and business activity will provide substantial additional feedback revenues to offset these reductions.

Asset Depreciation Range System

Ranges of years within a bracket from 20 percent below to 20 percent above Guideline lives will be established for all assets or groups or classes of assets for which Guideline lives are now provided under Rev. Proc. 62-21 except as hereinafter provided. The lower and upper limits of each range will be stated in terms of years rounded to the nearest half year in each case. While the basic structure of the ADR System will be adopted by regulations, the specification of Asset Depreciation Ranges will be made in Revenue Procedures.

The System will not extend to buildings or certain other real estate improvements. Further study is being given to the extent to which the System should apply to special purpose structures or enclosures which are so integrally a part of or closely related to machinery or equipment which they house or enclose that their usefulness necessarily terminates with the termination of the usefulness of such machinery or equipment.

At the present time, the ADR System will not be made available for assets which are public ut ity property of the type described in section 167(l)(3)(A) o the Code. The

property so excluded is primarily property of electric, water, gas, and telephone utilities. The ADR System will be available for property of railroads, airlines, and the trucking industry. The exclusion of certain classes of public utility property is made pending further study of the extent to which the ADR System is appropriate for such property, and if appropriate, the Asset Depreciation Ranges which should be provided for such property.

Where Guideline lives are not provided under Rev. Proc. 62-21, for any asset or class of assets, and hence an Asset Depreciation Range is not provided, the Internal Revenue Service will receive information from taxpayers and industry groups from time to time as to additional Asset Depreciation Ranges which should be established. Additional Ranges so established will be published in Revenue Procedures.

Where the taxpayer elects to apply the ADR System for any taxable year for a trade or business, periods must be selected within the specified Asset Depreciation Ranges for each asset or class of assets placed in service in that year for which a range is provided. For this purpose, all property held by the taxpayer for production of income but not held for use in a trade or business must be covered by a single election; the ADR System may not be elected for only part of such property placed in service by the taxpayer during the year; it must be elected for all or none of such property. The taxpayer may not thereafter change the periods so selected for those assets, and the Internal Revenue Service cannot change such periods. Once made for a year, the taxpayer's election of the ADR System may not thereafter be revoked. An election may be made for all assets placed in service in any year in one trade or business of the taxpayer and not for assets placed in service in that year in a different trade or business.

Assets subject to the election will be required to be accounted for in item accounts or in multiple asset accounts by year placed in service (vintage accounts). In the case of multiple asset accounts, normal retirements will be ignored -- the deduction will be computed as if all assets in the account survived for as long as the period selected. In the case of abnormal retirements, however, the unrecovered basis of the asset will be deductible at the time of retirement. The

distinction between normal and abnormal retirements is contained in existing regulations, but it is expected that the distinction will be amplified by amendments to the regulations.

If the ADR System is elected with respect to assets placed in service in a trade or business for a particular year, it will apply to used assets as well as new assets. The depreciation period of the used assets, as well as of the new assets, must be within the Asset Depreciation Range for such assets or classes of assets, but need not be the same if the new and used assets are placed in separate depreciation accounts. An exception will be made where the basis of used assets exceeds 10 percent of the total basis of all assets placed in service in the year; in such a case, lives for used assets may at the taxpayer's election be determined without regard to the Asset Depreciation Ranges.

Similarly, the cost of rebuilding, rehabilitating or repairing an asset, to the extent such cost must be capitalized, must be accounted for in a separate vintage account for the year in which the rebuilding, rehabilitation, or repair is completed and cannot be added to the original vintage account for the asset so rebuilt, rehabilitated, or repaired. Such account must be treated in the same manner as used assets. Further consideration is being given to the extent to which special shorter Asset Depreciation Ranges should be established for such used assets or capitalized expenditures.

The Guideline lives, on the basis of which the Asset Depreciation Ranges are established, were determined so as to make current allowance for salvage value unnecessary. Accordingly, salvage value will not be taken into account under the ADR system in establishing the annual depreciation deduction for an asset or class of assets, but no asset or class of assets may be depreciated below the salvage value after application of section 167(f) of the Code. Thus, the annual depreciation deduction will be determined by applying the appropriate fraction or percentage based on the period selected to the original cost or unadjusted basis of the asset (reduced, in the case of declining balance methods, by cumulative depreciation taken).

The salvage value to be taken into account for this purpose is the salvage value expected to be realized by the particular taxpayer in question (see Reg. section 1.167(a)-1(c)). Provision will be made for specification by the taxpayer of salvage value of depreciation accounts at the time such accounts are first established. Such accounts will not ordinarily thereafter be changed by the Internal Revenue Service unless there is a clear and convincing basis for using a different amount for salvage value based on facts in existence at the time such amount was first established by the taxpayer.

It is expected that the regulations will be clarified as to the determination of salvage value for taxpayers who customarily dispose of assets after periods substantially less than the normal useful life of such assets.

The ADR System will serve only to establish the period on the basis of which the annual depreciation deduction is determined. The appropriate method of depreciation chosen by the taxpayer (declining balance, sum of the years digits, straight line, or other method based on a period of time) will be applied based on such period.

Example. On January 15, 1971, M Company, a manufacturer reporting on the calendar year basis, purchases and places in service various items of production machinery and equipment with a total cost of $50,000. The cost of the various individual items ranges from $150 to $10,000. The anticipated useful lives range from 3 years to 15 years. On August 1, 1971, M also acquires an item of special equipment with a cost of $30,000. M has no other asset acquisitions in 1971.

The range of depreciation periods under the ADR System for equipment used in M's business is 8 to 12 years. M elects to use the ADR System for 1971.

M places all of the various items of machinery and equipment other than the special equipment in a multiple asset vintage account for 1971. M chooses from the ADR Range a depreciable period of 8 years and elects to calculate depreciation on the double declining balance (DDB) method. M expects that the aggregate salvage value of the account will be $4,000, but this amount of salvage is disregarded for all purposes because, as provided in section 167(f) of the Code, it is less than 10 percent of cost of the assets in the account (the basis of the account).

M also decides to set up an item account for the one item of special equipment. This item has an estimated salvage value of $5,000. M selects from the ADR Range of 8 to 12 years a depreciable period of 10 years for the special equipment and decides also to use the double declining balance (DDB) method for this account. The salvage value of such account taken into account for Federal income tax purposes is $2,000 ($5,000 estimated salvage value minus $3,000 [10 percent of $30,000, the cost of the equipment]), and therefore the cumulative depreciation deductions with respect to such account may not exceed $28,000.

M's depreciation deduction on account of assets placed in service in 1971 is $15,500, determined as follows:

Account	Basis	ADR Period	DDB Rate	Depreciation Amount
Group Account-1971 Acquisitions	$50,000	8 yr.	25%	$12,500*
Special Equipment	30,000	10 yr.	20%	3,000*

*Reflects application of the new modified first year convention elected by M which treats assets placed in service in the first half of the year as placed in service at the beginning of the year (thus allowing a full year's depreciation on such assets) and Assets placed in service in the second half of the year as placed in service at the mid-point of the year (thus allowing a half year's depreciation on such assets).

The first year's depreciation allowance for assets subject to the ADR System accounted for in both item and multiple asset vintage accounts will be determined according to one of two conventions, either of which may be selected by the taxpayer:

1. The taxpayer may elect under the half year convention to treat all assets put in service in that trade or business in that taxable year as put in service at the mid-point in the year, so that one-half of a full year's depreciation allowance based on the life selected may be taken; or

2. The taxpayer may elect under a "new modified first year convention" to treat all assets put in service in that trade or business in the first half of the taxable year as put in service at the beginning of the year and all assets put in service in the second half of the taxable year as put in service at the mid-point in the year. Assuming equal amounts of assets are put in service in the first half and second half of the year, and that the lives selected are the same, this will result in three-fourths of a full year's depreciation allowance.

Other methods of achieving the same effect as the above two conventions will be set forth in the regulations. A taxpayer electing the ADR System will be required to elect the same

convention for all assets accounted for in both item and multiple asset vintage accounts for any year for which the ADR System is elected. However, one of the two conventions may be elected for one year of election and the other convention may be elected for another year of election. The conventions will not be permitted to result in depreciating an asset or a multiple asset vintage account below salvage value.

Example. X, a manufacturer reporting on the calendar year basis, placed new equipment in service in 1970 as follows:

Date	Equipment	Cost
June 15, 1970	Lathes	$10,000
October 1, 1970	Drill Press	5,000

X elected to be tested under the Guidelines, which prescribe a single Guideline class for X's factory equipment of 5-years. X elected for 1970 to use the double declining balance method. X grouped his assets in a single factory equipment multiple asset vintage account for 1970. X used a half year convention. The equipment is expected to have no salvage value. X's depreciation allowance for 1970 for his 1970 acquisitions was $1,500, computed as follows:

Account	Basis	Life	DDB Rate	Depreciation Amount
1970 Acquisitions	$15,000	5-year	40%	$3,000

The depreciation amount of $3,000 reflects application of the half year convention for the year of acquisition.

For 1971, X elects the ADR System and the minimum period of 4 years. X also elects the new modified first year convention. X's asset acquisitions for 1971 are exactly the same as for 1970 (dates and amounts). X's depreciation allowance for the assets placed in service in 1971 is $6,250, computed as follows:

Account	Basis	Period	DDB Rate	Depreciation Amount
1971 Acquisitions	$15,000	4-years	50%	$6,250

The depreciation amount of $6,250 reflects application of the new modified first year convention; X obtains a full year's depreciation on $10,000, the cost of the lathes placed in service in the first half of the year and a half year's depreciation on $5,000, the cost of the drill press placed in service in the last half of the year. If X had not placed the lathes in service until July 15, 1971, X's depreciation allowance for 1971 for this multiple asset vintage account would be $3,750.

The ADR System may be elected with respect to assets physically placed in service after December 31, 1970. In the case of fiscal year taxpayers who elect the ADR System for assets placed in service after December 31, 1970, in a taxable year beginning before and ending after December 31, 1970, each asset or class of assets for which an Asset Depreciation Range is provided must be accounted for separately in an item account or in a multiple asset vintage account for that portion of the taxable year after December 31, 1970.

In the event that under a first year convention used by a fiscal year taxpayer assets to which ADR applies are treated

as placed in service in 1970, depreciation for such assets for the fractional part of the year in 1970 shall be determined at the rate applicable before the ADR System was effective. Depreciation for the fractional part of the year after December 31, 1970, shall be computed using the appropriate ADR rate. The new modified first year convention under the ADR System may not be utilized to allow depreciation for any period prior to January 1, 1971, if not otherwise allowable.

Example. Taxpayer A reports on the basis of a fiscal year ending March 31. Taxpayer A has elected to be tested under the present Guidelines and all of his factory equipment falls within a single Guideline class with a life of 10-years. He has previously consistently grouped his assets in annual vintage accounts and used the half year convention. Taxpayer A places in service in his fiscal year ending March 31, 1971, new machinery and equipment having a zero salvage value as follows:

Date	Equipment Item	Cost
April 15, 1970	101	$1,000
Sept. 1, 1970	102	1,500
Dec. 15, 1970	103	500
Jan. 20, 1971	104	2,000
March 10, 1971	105	3,000

A elects the ADR System for assets placed in service after December 31, 1970, and selects the minimum period in the Asset Depreciation Range (8 to 12 years) and the half-year convention. A also elects the double declining balance (DDB) method of depreciation for fiscal 1971 equipment acquisitions. A's depreciation deduction for his fiscal year ending March 31, 1971, would be $862.50 determined as follows:

Account	Basis	Life or Period	DDB Rate	Depreciation Amount
April 1, 1970 to Dec. 31, 1970	$3,000	10 yr.	20%	$300*
Jan. 1, 1971 to March 31, 1971	5,000	8 yr	25%	562.50**

*One-half of 20 percent of $3,000.

** Taxpayer is entitled to one-half year's depreciation for these assets under the half-year convention effective for fiscal 1971. Half of this depreciation is computed at a 20 percent rate (for the portion of the half year preceding January 1, 1971) and half is computed at a 25 percent rate (for the portion of the half year following December 31, 1970). Thus, the depreciation for the period preceding January 1, 1971, is one-fourth of 20 percent of $5,000 ($250) and the depreciation for the period after December 31, 1970, is one-fourth of 25 percent of $5,000 ($312.50).

Reserve Ratio Test

The reserve ratio test under Rev. Proc. 62-21, 1962-2 C.B. 418 (as amended and supplemented), providing for Depreciation Guidelines and Rates, will be eliminated for taxable years ending after December 31, 1970. Thus, a taxpayer who has elected to be examined under Rev. Proc. 62-21 and has satisfied the reserve ratio test for taxable years ending before January 1, 1971, may continue to use the prescribed Guideline lives for all subsequent years without application of the reserve ratio test. Where such Guideline lives test is satisfied, the taxpayer's depreciation deduction for the assets in that Guideline class will not be disturbed. Where a taxpayer has so elected but has not satisfied the reserve ratio test for all such years, adjustments may be made to asset lives as provided in Rev. Proc. 62-21 for taxable years up to and including the taxpayer's last taxable year ending before January 1, 1971. The life as so adjusted for the last taxable year ending before January 1, 1971, will be used for subsequent years, but no further adjustments may be made by application of the reserve ratio test for any subsequent taxable year.

A taxpayer who has not previously elected to be tested under the Guidelines for a taxable year for which a return is required to have been filed (after giving effect to any extensions of time for filing granted pursuant to requests already filed) may not elect on or after the date of this announcement to be so tested for such year. With respect to taxable years ending before January 1, 1971, for which a return was not required to have been filed by December 31, 1970 (after giving effect to any extensions of time for filing granted pursuant to requests already filed), the taxpayer may elect to be tested under the Guidelines for any Guideline class of assets if the taxpayer will satisfy the reserve ratio test for the year in which the election is made.

Taxpayers not electing the ADR System with respect to assets placed in service in any taxable year ending after December 31, 1970, may elect to be tested under the Guidelines for such year. Taxpayers electing the ADR System for a taxable year ending after December 31, 1970, may also elect to be tested under the Guidelines for such year with respect to assets placed in service prior to January 1, 1971. In such cases, the Guidelines will be applied without application of the reserve ratio test. Thus, for example, regulated public utilities of the type described in section 167(1)(3)(A) of the Code for which Guideline lives are provided in Rev. Proc. 62-21 may elect to be tested under that Revenue Procedure. In such case, if the taxpayer's class life is equal to or longer than the Guideline life for a Guideline class, the depreciation deduction claimed by the taxpayer for the assets in that class will not be disturbed, except that no less than a reasonable allowance for depreciation may be taken in any year. Such treatment will not, however, be available unless a specific Guideline class life is provided in the Guidelines. It will not, for example, be available for trees and vines in Guideline Group Two because no specific Guideline class life is provided for such assets.

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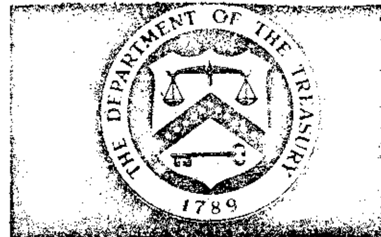

FOR IMMEDIATE RELEASE January 11, 1971

Depreciation Allowances -- Asset Depreciation Ranges

Questions and Answers

A. General

1. Q: The statement places substantial importance on a liberalized system of depreciation. What makes reform so important right now?

A: The reform would be sensible at any point in time, since it will result in simplification, greater certainty for taxpayers, and a more efficient administration of the tax law. It is especially sound in light of current economic conditions. Demand pull inflationary forces have been brought under control, but business activity is below its potential and unemployment is too high. Expansionary policies are needed at this time to foster healthy growth and reduce unemployment.

2. Q: If the ADR System is successful in stimulating business activity, won't that rekindle the inflationary tendencies? And what about the increased deficit? Isn't that inflationary?

A. First, the primary impact of the ADR System will be in the capital equipment industries where spending has sagged and where there are considerable unemployed resources. The ADR System should bring these resources into productive use with little price impact. Second, a deficit is inflationary primarily when resources are fully employed. We do not have that condition now. The ADR System will result in some reduction of tax revenues now, during this period of slack business activity; but later, as we move toward full employment, revenues will rise. Third, we expect business

and labor to recognize that in reaching wage and price decisions, they should no longer anticipate continued inflation. The short term revenue reductions are not so large that the balance between expenditures and revenue collections under the full employment budget concept cannot be maintained.

3. Q: The ADR System is directed toward business expansion. What about the wage earner? Will he get any benefits?

   A: This program will benefit the entire production team. The wage earner benefits when his wages increase and even then only when his wage increase outstrips price increases. The only source for a wage increase in excess of price increases is higher productivity. Except to a very limited extent, wage earners cannot, by themselves, increase their productivity. Their productivity can be increased, however, by the application of larger amounts of capital for investment in productive equipment. This program will increase the amount of capital per wage earner and so raise the productivity that is essential for any real wage increase. Thus, the ADR System will stimulate employment by encouraging the modernization of machinery and equipment of United States businesses.

4. Q: Does the ADR System reduce business taxes by granting larger depreciation deductions?

   A: The ADR System affects only the timing of deductions; it does not increase the total amount of deductions with respect to any individual asset. Prescribing shorter depreciation periods gives greater recognition: to changes in technology; to pressures from foreign competition to modernize our productive facilities; and to obsolescence resulting from such factors as changes in production processes necessitated by environmental quality requirements. Thus, there is a reduction in business taxes now. But any business taxpayer's

taxes in future years will be increased if he does not in fact replace his facilities consistent with the new periods or enlarge his productive capacity.

5. Q: Are taxpayers required to use the ADR System or is it optional?

A: The ADR System is optional. Unless a taxpayer elects the ADR System for the taxable year, it will not apply. However, if elected for the taxable year with respect to a trade or business, all assets placed in service in that trade or business during the taxable year must be depreciated under the ADR System.

B. Basic Application - ADR System

6. Q: Will the ADR System apply to all types of depreciable assets?

A: In general, the ADR System will apply to all types of assets for which a Guideline life has heretofore been provided. The ADR System will not, however, apply to electric, water, gas, telephone and certain other public utility property. (It will apply, however, to property of railroads, airlines, and the trucking industry.) The ADR System will not apply to buildings or real estate improvements except for a narrow category of structures and enclosures which are so integrally a part of or closely related to machinery or equipment which they house or enclose that their usefulness necessarily terminates with the end of usefulness of such machinery or equipment. In the case of such public utility property and in the case of assets for which no Guideline life has heretofore been specified, interested taxpayers are invited to submit data which would assist in determining whether the ADR System should be extended to such assets and in establishing an Asset Depreciation Range for such assets.

7. Q: When will the ADR System become effective?

   A: Taxpayers may elect to apply the ADR System to assets physically placed in service on or after January 1, 1971, but not for assets placed in service prior to that date.

8. Q: To what extent have the Guideline lives been shortened?

   A: In general, the Asset Depreciation Range is from 20 percent shorter to 20 percent longer than the Guideline class life for the asset or class of assets. The ranges so established will be rounded to the nearest half year. In the event an Asset Depreciation Range is established for assets not presently covered by the Guidelines, the policy of the ADR System to accept shorter or longer depreciation periods for business machinery and equipment will be taken into account.

9. Q: Are taxpayers who use the ADR System assured that their depreciation deductions will not be questioned?

   A: Yes. The ADR System establishes ranges of depreciation periods. The deduction based on the depreciation period which the taxpayer has chosen within the applicable range will be accepted for all assets to which he has elected to apply the ADR System.

10. Q: What effect does the ADR System have on depreciation of assets placed in service in a year for which ADR is not elected?

    A: None. The ADR ranges have no significance with respect to assets for which the ADR System is not properly elected.

11\. Q: If a taxpayer has more than one trade or business must his election be the same for each trade or business?

A: No. The purpose is to provide taxpayers the flexibility to take account of the different conditions which may prevail in each trade or business. Therefore, the taxpayer must make a separate election for each year with respect to the assets placed in service for use in each different trade or business during that year which he wishes to depreciate under the ADR System.

12\. Q: May a separate election be made for assets held for the production of income although not used in a trade or business?

A: Yes. However, the taxpayer's election to apply the ADR System to eligible assets held for the production of income although not used in a trade or business, applies to all such property placed in service during the taxable year.

13\. Q: If a taxpayer elects to apply the ADR System to a trade or business for a taxable year, does the election apply to assets placed in service in prior years but still used in the trade or business?

A: No. The election applies only to assets placed in service during the taxable year and does not apply to assets placed in service in any prior or subsequent taxable year for which no election was made.

14. Q: Once having elected to use the ADR System, may a taxpayer revoke the election?

A: The election is made for each taxable year and once made cannot be revoked that year. However, an election for one taxable year does not require an election in any subsequent taxable year.

15. Q: How does a taxpayer elect to apply the ADR System to assets placed in service during the taxable year?

A: The ADR System is elected on the return for the taxable year. The election is not treated as a change in a method of accounting for which consent must be obtained.

16. Q: May an election to apply the ADR System for the taxable year be made on an amended return for the taxable year?

A: The election may be made on an amended return only where it is filed prior to the due date of the return (after giving effect to any extensions of time for filing). If a timely election to apply the ADR System is not made for a taxable year, the taxpayer may not thereafter elect the ADR System for assets placed in service during that taxable year.

17. Q: What is the meaning of a "vintage" account under the ADR System? Does this term refer both to multiple asset accounts and item accounts?

A: Item accounts as well as multiple asset accounts may be used under the ADR System. Assets must be identified by and placed in separate accounts by the taxable year in which placed in service. The "vintage" of an account, whether an item account or a multiple asset account, refers to the year in which the assets in that account were placed in service.

18. Q: Does this mean that a taxpayer using the ADR System must have separate accounts for each taxable year, and will not be permitted to maintain composite accounts for assets acquired on a continuing basis over a period of several years?

A: Generally, yes. A taxpayer may use the ADR System for one year and not use it for another year, and may use different depreciable periods within the ADR range and different first-year conventions for acquisitions in one year as compared to acquisitions in another year, even though he continues under the ADR System. Hence, it is necessary to be able to compute depreciation separately for assets placed in service in each year and to identify assets on the basis of vintage accounts.

19. Q: If a taxpayer elects the ADR System and selects a period of depreciation for an asset which is less than three years, may he determine depreciation under the double declining balance method or the sum of the years-digits method for such asset?

A: No. A taxpayer may not use any of the methods of accelerated depreciation described in section 167 (b)(2), (3) or (4) for an asset if a period of less than three years is selected for such asset from the Asset Depreciation Ranges.

C. First-Year Conventions Under ADR System

20. Q: What first year conventions are available under the ADR System?

A: A half year convention or a new modified first year convention will apply to all item and multiple asset vintage accounts under the ADR System. A

taxpayer who elects to apply the ADR System must elect to apply either the half year convention (treating all assets placed in service during the taxable year as placed in service at the mid-point of the year) or the new modified first year convention (treating all assets placed in service during the first half of the year as placed in service at the beginning of the year and all assets placed in service during the second half of the year as placed in service at the mid-point in the year).

21. Q: Will the first year conventions apply to item accounts under the ADR System?

A: Yes. The first year conventions apply both to item and to multiple asset accounts for which the ADR System is elected.

22. Q: Since there are two first year conventions under the ADR System, may one be used for some asset accounts and the other be used for other asset accounts of the same vintage?

A: No. Under the ADR System, either the half-year or the new modified first year convention must be elected for all multiple asset and item accounts established for the taxable year. However, the taxpayer need not elect the same convention in a subsequent taxable year.

23. Q: May the new modified first year convention be used by a taxpayer who does not elect the ADR System?

A: No. This is a new convention which applies only under the ADR System.

24. Q: How will the new modified first year convention be applied to assets placed in service after December 31, 1970, but during the first half of a fiscal year beginning in 1970 and ending in 1971?

A: Under the new modified first year convention, assets in multiple asset or item accounts which are physically placed in service during the first half of the taxable year are treated as being placed in service at the beginning of the year. However, the new modified first year convention may not be utilized to allow depreciation for any period prior to January 1, 1971, if depreciation

would not otherwise be allowable for such period. Therefore, if the new modified first year convention is elected, assets placed in service after December 31, 1970, but during the first half of a fiscal year beginning in 1970 and ending in 1971, will be treated as placed in service on January 1, 1971. For example, if a taxpayer with a fiscal year ending on September 30, 1971, places an asset in service on March 1, 1971, and elects the ADR System and the new modified first year convention, such asset is treated as placed in service on January 1, 1971.

D. Application of ADR System to Used Assets

25. Q: Will the ADR System apply to used assets placed in service by the taxpayer after December 31, 1970?

A: Yes. In general, the ADR System will apply both to new assets and to used assets placed in service after December 31, 1970. An exception is made when used assets constitute more than 10 percent of the assets placed in service in the taxable year. In that case, the taxpayer is not required to apply the ADR System to the used assets.

26. Q: How does the 10 percent exception for used property apply?

A: If the basis of used assets placed in service during the taxable year exceeds 10 percent of the basis of all assets placed in service during the taxable year, the taxpayer may elect to apply the ADR System only to new assets. The taxpayer has the further option of applying the ADR System to all of the used assets, but is not required to do so. However, he may not elect to apply the ADR System to only a part of the used assets; he must elect to apply the ADR System to all or none of such assets. The basis of both new and used assets is determined on the date placed in service. Only assets in the same trade or business are compared in applying the 10 percent exception.

27: Q: Does the cost of repairs, rebuilding, etc., if otherwise required to be capitalized, affect the application of the 10 percent exception for used assets?

A: Yes. Any capitalized cost of such improvements during the taxable year is treated as a used asset placed in service during the taxable year for purposes of the 10 percent exception.

28. Q: In which vintage account is the capitalized cost of such an improvement included?

A: The capitalized cost of rebuilding or improving an asset is included in an appropriate vintage account for the taxable year in which the rebuilding or improvement is completed, not in a vintage account for the taxable year in which the asset rebuilt or improved was originally placed in service.

29. Q: Does the ADR System determine whether the cost of repairing, rebuilding, improving, etc. is to be capitalized instead of expensed?

A: No. The ADR System does not affect this question.

30: Q: How do these rules apply with respect to used assets transferred to a corporation in a tax-free transaction in which there is a carryover of the basis of the assets?

A: If section 381 applies to the transaction, the transferee corporation is bound by the transferor corporation's election of (or failure to elect) the ADR System in the year or years the assets transferred were placed in service by the transferor, as provided in sections 381(c)(4) and (6). Thus, the transferee's election of the ADR System with respect to other assets placed in service during the taxable year of the transaction does not affect the depreciable period which the transferee may use for the assets acquired in the transaction to which section 381 applies. Where section 381 does not apply to a transfer to a corporation, as in the case of a transaction to which section 351 applies, the acquisition of the assets by the transferee corporation will constitute an acquisition of used assets the treatment of which will be governed by whether the transferee elects the ADR System for the year it places such transferred property in service in its business.

E. Status of Guidelines and Reserve Ratio Test

31. Q: In view of the new ADR System, what is the status of Rev. Proc. 62-21 and the reserve ratio test?

    A: Rev. Proc. 62-21 will remain in effect, but the reserve ratio test will be eliminated with respect to any taxable year ending after December 31, 1970, for which Rev.Proc. 62-21 is elected. The application of Rev. Proc. 62-21 to any taxable year ending before January 1, 1971, is not affected by the ADR System.

32. Q: Now that the reserve ratio test has been eliminated for the future in applying Rev. Proc. 62-21, may taxpayers elect to be tested under Rev. Proc. 62-21 for earlier years for which returns have already been filed?

    A: No. A taxpayer who has not previously elected to be tested under the Guidelines for a taxable year for which a return is required to have been filed may not elect on or after the date of announcement of the ADR System (January 11, 1971) to be so tested for such taxable year. For purposes of determing whether a return is required to have been filed for an earlier year, extensions of time for filing will be taken into account if granted before January 11, 1971 (or if granted after that date pursuant to a request for extension filed before January 11, 1971).

F. Miscellaneous

33. Q: Will the ADR System be available for computation of the earnings and profits of foreign subsidiaries and thereby affect the amount of foreign tax credit applicable to dividends paid by foreign subsidiaries?

    A: The extent to which the new system should be made available for these purposes is being given further study.

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WASHINGTON, D.C. 20220 TELEPHONE WO4-2041

Illustrations of the Effect of the New Modified First-Year Convention under the Asset Depreciation Range (ADR) System

In general, depreciation on an asset is computed from the date the taxpayer acquires it. However, under existing rules a "half-year convention" is applied in many cases whereby all assets acquired during the year are considered as acquired at the mid-point of the year. Under the ADR System, taxpayers will be given the option of selecting a new modified first-year convention under which all assets acquired in the first-half of the year are treated as being acquired on the first day of the year and all assets acquired during the second-half of the year are treated as acquired at the mid-point of the year. The following examples illustrate the impact of this change.

(1) Assume that on May 1, 1971, a calendar year corporation which purchases equipment at various times throughout the year acquires equipment costing $1,000 and having a depreciable life under the existing Guidelines of 5 years:

(a) At present, under the double declining balance method of depreciation, the taxpayer's deduction for a full year would be 40% (2 x 20%) of the cost of the equipment, or $400, but under the existing half-year convention used by the taxpayer its first year deduction would be only $200. The tax saving in the first year would be $96 (48% tax rate x $200).

(b) Under the ADR System the depreciable period would be shortened from five years to four years. Thus, the taxpayer's double declining balance depreciation would increase to 50% (2 x 25%) for a full year, or $500. Under the half-year convention its deduction would be only $250 (1/2 of $500). The tax savings in the first year would be $120 (48% x $250).

(c) In addition to shortening the depreciable period, the ADR System modifies the first year convention. Since the taxpayer in this example bought the equipment before July 1, 1971, it is treated as having acquired the equipment on the first day of the year. Therefore, the first year deduction under the ADR System will be increased to $500. The 1971 tax saving would be $240.

The 1971 tax savings under the ADR System, as illustrated in (c) is approximately 2-1/2 times the saving the taxpayer can obtain

under existing rules and twice the saving it would have obtained if only the depreciable period had been shortened without changing the first-year convention. In terms of net cash flow in the first year, the purchase of the equipment under the ADR System illustrated in (c) requires a net first-year cash expenditure of only $760, while under (b) it requires $800, and under existing rules (illustrated in (a)) it requires $904. The same results follow for any asset purchased between January 1 and June 30.

(2) If the equipment in the above example had a depreciable life of 10 years under the existing Guidelines, the results would be as follows:

(a) Present rules:

- Full year's depreciation 20% (2 x 10%)	$200
- Depreciation under the half-year convention	$100
- Tax savings	$ 48

(b) Shortening depreciable period under ADR from 10 to 8 years:

- Full year's depreciation 25% (2 x 12.5%)	$250
- Depreciation under the half-year convention	$125
- Tax savings	$ 59.60

(c) Shortening depreciable period and using the new first-year modified convention under ADR:

- Full year's depreciation	$250
- Tax savings	$119.20

The 1971 tax savings under the ADR System illustrated in (c) is approximately 2-1/4 times the savings under existing law and twice the savings if only the depreciable period were shortened. From a net cash flow standpoint, the ADR System requires a net first-year cash expenditure of only $880.80, while under the method described in (b) $940.40 would be required, and under existing rules $952 is required.

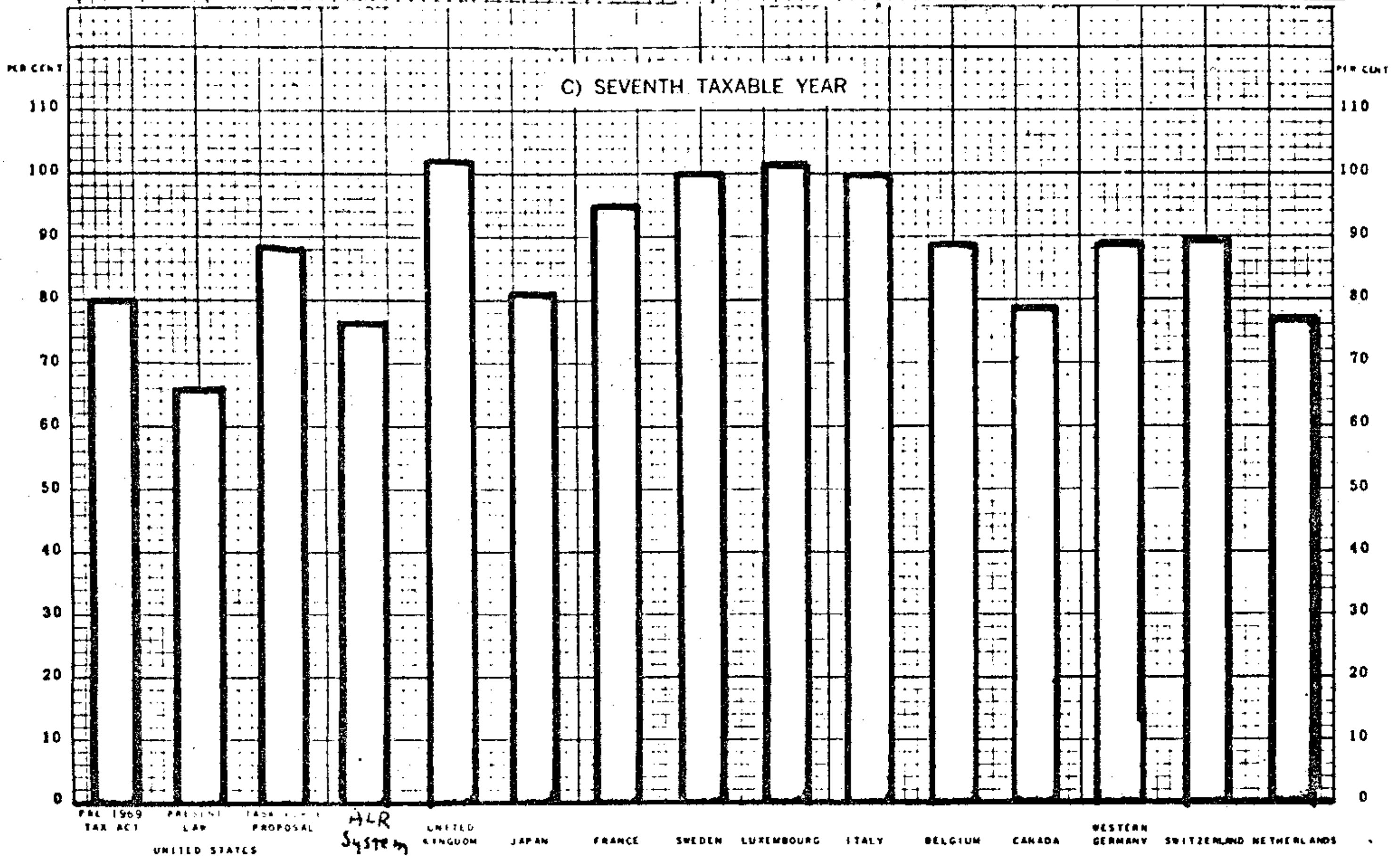
Statement of Paul W. McCracken
on President's Announcment of
Changes in Depreciation Allowances

The modernization and simplification of our system for depreciation, announced today by the President, will make a major contribution to the economy. For one thing they introduce a flexibility, in accounting for the economic cost of capital expiring in the process of production, that is more consistent with fast-moving changes in a dynamic economy.

These basic changes will also have a favorable impact on the market for capital goods in 1971. These outlays have held at a high level during the last year, and there are even encouraging signs pointing toward 1971. New orders of producers capital goods industries showed good strength in November, and the volume of newly approved projects in the third quarter rose. Evenso the combination of reduced earnings, lower operating rates, and higher costs of financing was having an adverse effect on capital outlays prospects, and for some segments of the machinery industry the volume of incoming business has been quite disappointing. These fundamental moves, answered today, can have favorable effects in the 1971 situation.

The most fundamental significance of these moves is that they improve the longer run outlook for the competitiveness and productivity of our economy. Through

enlarging the cash flow and improving the effective rate of return by roughly a percentage point, they will encourage businesses to enlarge their stocks of modernized productive equipment. In this way we can encourage the improvements in productivity essential for a reasonable cost stability and for meeting the new demands on our productive resources. While our depreciation allowances remain somewhat less generous than those of the industrial world generally, these changes will strengthen our competitive position in world markets.


GRAPH D
March, 1970
AGGREGATE COST RECOVERIES ALLOWABLE FOR TAX PURPOSES IN THE UNITED STATES*
AND IN ELEVEN FOREIGN COUNTRIES ON MACHINERY AND EQUIPMENT
C) SEVENTH TAXABLE YEAR
PER CENT
110
100
90
80
70
60
50
40
30
20
10
0
1969
TAX ACT
PRESENT
LAW
PROPOSAL
UNITED STATES
ALR
System
UNITED
KINGDOM
JAPAN
FRANCE
SWEDEN
LUXEMBOURG
ITALY
BELGIUM
CANADA
WESTERN
GERMANY
SWITZERLAND
NETHERLANDS

Capital Cost Recovery

SUMMARY

The way in which United States business is taxed has a significant influence on how the production capability of the economy is used, on how rapidly it grows, on the expansion of employment opportunities, and on the ability of United States producers to compete effectively in the free world economy. It is particularly vital that the expansion and modernization of the production facilities not be discouraged by the tax system. This principle is recognized by the industrial nations of Western Europe and Japan. It was recognized in 1962 by the United States by adoption of the investment credit and some liberalization, through administrative action, of the depreciation rules. The 1969 elimination of the investment credit, unaccompanied by any offsetting encouragement to capital investment, directly conflicts with this principle. Congress' repeal of the investment credit was in large part motivated by the desire to curb inflationary pressures and, although any increase in income tax may have some short-range effect in this direction, we think the long-range result of increasing the tax on business, particularly if the increase results in curbing the growth of the productive capacity, will be to hinder efforts to reduce or stabilize the price level.

Although intended as a permanent addition to the tax law, the investment credit has proven vulnerable to change and suspension. We recommend, instead, the adoption of a simplified and liberal cost recovery allowance structure in place of the useful life depreciation deduction allowed by existing law.

Our recommendations, which are confined to machinery and equipment and structures specially related thereto, may be broadly summarized as follows:

(1) Substitute a capital cost recovery allowance system for the present system of deductions based on the useful life of the property.

(2) Eliminate the reserve ratio test now prescribed by Treasury regulations.

(3) Allow full recovery of cost, unreduced by salvage value, in a period 40 percent shorter than would be allowed under present

Source: <u>The Report of The President's Task Force on Business Taxation</u>, September 1970, pp. 3-33.

Treasury Department guidelines for determining useful lives, provided, however, that no shortening would be effected (a) if the guideline life is five years or less, or (b) to bring the recovery period to less than five years.

(4) Permit the use of a longer recovery period if the taxpayer so elects.

(5) Permit the write-off of the unrecovered cost of an asset retired from a multiple asset account prior to the expiration of the recovery period.

Our proposals contemplate retaining the various cost recovery formulas presently available.

HISTORICAL BACKGROUND

At the beginning of the 1960s, the United States found itself in a mild recession. The balance of payments had been adverse for a considerable period of time and the favorable balance of trade was dwindling. The economies of the industrial nations of Western Europe and Japan had been revitalized and were offering competition to the United States in world markets. Many factors, including the massive aid furnished by the United States, contributed to the improved position of these nations. One factor that had come to be recognized increasingly in the United States was the encouragement given by the tax laws of these countries to investments in plant and equipment. Such encouragement contrasted sharply with the policy of the United States.

It was in this setting that President Kennedy proposed the investment credit in 1961. In his message containing that proposal he observed that ". . . our friends abroad now possess a modern industrial system helping to make them formidable competitors in world markets. If our own goods are to compete with foreign goods in price and quality, both at home and abroad, we shall need the most efficient plant and equipment." Secre-

tary of the Treasury Dillon, in his opening statement to the House Ways and Means Committee in support of President Kennedy's recommendations, noted the rapid build-up of new production facilities abroad and stated that ". . . it was due in good part to the vigorous policies of European governments. Tax incentives for investment played a significant role, including accelerated depreciation, initial allowances, and investment credits."

Extensive hearings were then held by the House Ways and Means and Senate Finance Committees on the Administration's proposal for an investment credit. At those hearings most of the testimony offered by representatives of business urged the simplification and liberalization of the allowance for depreciation in preference to the investment credit. Congress, however, decided in favor of the credit which became part of the law in 1962. As originally adopted, the investment credit reduced the depreciable basis of the asset but this adjustment was eliminated in 1964. Thereafter, in the case of an asset qualifying for the full 7 percent credit, a taxpayer paying tax at a 50 percent rate received the equivalent of 114 percent write-off (assuming no salvage value), and a very substantial part of that amount was allowed in the early years.

The demands of business for depreciation reform were recognized to a certain extent in 1962 when the Treasury Department promulgated Revenue Procedure 62–21 establishing guidelines with shorter service lives for broad classes of depreciable assets.

The investment credit remained in effect until 1966, when it was suspended as part of a comprehensive program to relieve short-term inflationary pressures in the capital goods market. Although originally enacted for a fifteen month period, the suspension was terminated after five months, in 1967, on the ground that such pressures had abated. Now, as a result of the Tax Reform Act of 1969 (the 1969 Tax Act), the investment credit has been terminated.

A review of the growth in our GNP and in the annual investment in new industrial plant and equipment is of interest. The accompanying Table I sets forth these figures for the years 1947 through 1969. Figures are expressed in constant 1958 dollars and as a percentage of GNP. Investment in new plant and equipment is broken down into equipment and industrial buildings. Additionally, gross private fixed investment (other than residential) is shown both in 1958 dollars and as a percentage of GNP.

TABLE I.—*Purchases of New Equipment and New Industrial Buildings and Gross Private Fixed Investment (Nonresidential) in Constant 1958 Dollars, and Relation to GNP: 1947–69*

Year	GNP	New equipment (billions of 1958 dollars)	New industrial buildings (billions of 1958 dollars)	New equipment and industrial buildings (percentage of GNP)	Gross private fixed investment (nonresidential) (billions of 1958 dollars)	Gross private fixed investment (nonresidential) (percentage of GNP)
1947	309.9	23.5	2.6	8.4	36.2	11.7
1948	323.7	25.2	1.9	8.4	38.0	11.7
1949	324.1	22.4	1.3	7.3	34.5	10.6
1950	355.3	24.6	1.4	7.3	37.5	10.6
1951	383.4	25.2	2.5	7.2	39.6	10.3
1952	395.1	24.4	2.7	6.9	38.3	9.7
1953	412.8	25.7	2.6	6.9	40.7	9.9
1954	407.0	24.4	2.4	6.6	39.6	9.7
1955	438.0	27.5	2.7	6.9	43.9	10.0
1956	446.1	28.6	3.4	7.2	47.3	10.6
1957	452.5	28.9	3.5	7.2	47.4	10.5
1958	447.3	24.9	2.4	6.1	41.6	9.3
1959	475.9	27.6	2.1	6.2	44.1	9.3
1960	487.7	29.4	2.8	6.6	47.1	9.7
1961	497.2	27.8	2.7	6.1	45.5	9.2
1962	529.8	31.5	2.8	6.5	49.7	9.4
1963	551.0	33.7	2.7	6.6	51.9	9.4
1964	580.0	38.1	3.3	7.1	57.8	9.9
1965	614.4	43.6	4.5	7.8	66.3	10.7
1966	658.1	49.6	5.7	8.4	74.1	11.3
1967	674.6	50.5	5.1	8.2	73.6	10.9
1968	707.6	52.6	4.4	8.1	75.8	10.7
1969	727.7	58.2	6.3	8.9	81.5	11.2

Source: Department of Commerce, Office of Business Economics, *National Income and Product Accounts of the United States, 1929-65* (Aug. 1966), and *Survey of Current Business* (July 1969), Tables 1.2, line 1; 5.3, line 12; 5.5, line 2. 1969 GNP and GPFI figures are taken from *Survey of Current Business* (Jan. 1970), at page S-1, and are preliminary. Other 1969 figures are also preliminary.

As the table shows, the share of real GNP allocated to real private investment in production facilities has not tended to rise over the postwar years. This fraction did rise, however, in the years 1954–1956, following the adoption of the accelerated depreciation provisions in the Internal Revenue Code of 1954, and again in the years 1964–1966, following the enactment of the investment credit and the depreciation revision in 1962. Of course, this showing does not in itself establish the effectiveness of tax policy to induce investment in production facilities, but on the other hand, it is quite consistent with the results to be expected from tax incentives for investment of this character. Both logic and experience strongly suggest that any substantial cutback of such incentives, such as the recent repeal of the investment credit, will reduce the proportion of the economy's reserves devoted to expansion of production capability.

PRESENT TAX POSITION OF AMERICAN BUSINESS

Comparison with Pre-1969 Tax Act Position

United States business is faced with high income taxes and with the loss of the investment credit. The investment credit was, of course, proposed by the Kennedy administration as a tax incentive for increasing production facilities. The importance of such an incentive was stressed by Secretary of the Treasury Dillon in his statement to the House Ways and Means Committee that "all of our citizens will benefit from modernization of our industry. A basic fact of economic life is that modernization and expansion are essential to higher productivity. Rising productivity will provide us with a rising level of per capita income, with resultant and widely shared benefits in the form of rising real wages and rising investment incomes. Rising productivity will also permit us to hold prices down."

Although these observations were made in a somewhat different economic climate than exists today, they have a continuing relevance. We consider that the emphasis for the future must be even more strongly on increasing the productivity of men and machines if gains in real per capita income are to continue to be realized. Stated in another way, such gains in a period of relatively high employment will have to come largely from providing labor with more and better machines and equipment.

The repeal of the investment credit will reduce the amount of internally generated funds available to business for financing the acquisition of new production facilities. Business relies heavily on this type of financing and its curtailment will, over a period of time, lead to lower capital outlays. It is our view that a lower tax burden on the use of capital facilities would contribute importantly to the growth in total production capability and would be most effectively achieved by revision of the present tax provisions for cost recovery allowances.

Comparison with Other Industrial Nations

Although other industrialized nations have high income tax rates, their provisions relating to cost recovery allowances and capital investment incentives are far more favorable than ours. A comparison of the various systems is instructive. For this purpose we are setting forth, in Table II and Graph A, a comparison of cost recovery allowances for industrial machinery and equipment in the United States and eleven other nations.

TABLE II.*—*Comparison of Cost Recovery Allowances (1) for Industrial Machinery and Equipment in Leading Industrial Countries with Similar Allowances in the United States*

	Representative cost recovery periods (years)		Aggregate cost recovery allowances (percentage of cost of asset)					
			First taxable year		First 3 taxable years		First 7 taxable years	
Belgium	10	(2)	20.0	(3)	48.8		89.0	(4)
Canada	10	(2)	20.0	(3)	48.8		79.0	
France	8	(5)	31.3	(3)	67.5		94.9	(6)
Italy	6	(7)	20.0	(8)	65.0	(9)	100.0	
Japan	11	(10)	34.5	(11)	56.9		31.4	
Luxembourg	10	(2)	28.0	(12)	60.4		101.9	(13)
Netherlands	5	(14)	10.0		42.4		77.1	(15)
Sweden	5	(16)	30.0	(3)	65.7		100.0	
Switzerland	6⅔	(2)	15.0		58.4		90.0	
United Kingdom	12	(2)	57.8	(17)	78.1		102.1	
Western Germany	9	(18)	16.7	(19)	49.6		88.8	(20)
United States:								
With investment credit	13	(2)	21.7	(21)	47.9		80.1	
Without investment credit	13	(2)	7.7		33.9		66.1	

*Capital cost recovery allowances set forth on this Table were gathered by the Task Force and have been reviewed and approved in writing by a leading international firm of public accountants and reviewed and accepted by the U.S. Treasury Department.

NOTES

(1) The capital cost recoveries for each of the foreign countries have been computed on the assumption that the investment qualifies for any special allowances, investment credits, grants or deductions generally permitted. The deductions in the United States have been determined under the double declining balance method without regard to the limited first year allowances for small businesses.
(2) Double declining balance method.
(3) Full year allowance in first taxable year.
(4) Method changed to straight line in fifth taxable year. Straight line rate applied to original cost for fifth, sixth and seventh taxable years.
(5) 250% declining balance method.
(6) Method changed to straight line in sixth taxable year.
(7) Straight li e method.
(8) Includes additional foreshortened allowance of 15%.
(9) Includes additional foreshortened allowance of 15%, 15% and 10% in first, second, and third taxable years, respectively.
(10) Modified double declining balance method; 18.9% per Japanese Government rate table, salvage value built into rate.
(11) Includes special first year allowance of 25%; allowance reduces recoverable base cost in second and succeeding taxable years.
(12) Includes 18% allowance equivalent to 9% investment credit at effective 50% income tax rate; credit does not reduce recoverable base cost.
(13) Method changed to straight line in fifth taxable year. Straight line rate applied to original cost for fifth, sixth and seventh taxable years.
(14) 100% declining balance method.
(15) Method changed to straight line in seventh taxable year.
(16) Modified declining balance method—30% rate; accumulated cost recovery may not be less than total of 20% of cost for each year asset is in service.

(17) Full year allowance in first taxable year; includes 44.4% allowance equivalent to 20% investment grant at effective 45% income tax rate; grant reduces recoverable base cost.

(18) The average cost recovery period for machinery and equipment in Western Germany is 8 to 10 years to which additional allowances are permitted for multiple shift operations: 25% of allowance for two shift operations and 50% of allowance for three shift operations. Allowances may be further increased when plant is located in certain areas such as Berlin, areas bordering on iron curtain countries, and undeveloped areas.

The above Table II sets forth cost recovery allowances based on an average cost recovery period of 9 years. The double declining balance method is used. A 25% additional allowance for two shift operations is taken into account beginning with the fifth year when the method is changed to straight line. The corporate depreciation rate thus computed is slightly over the maximum 20% rate permitted on a declining balance method to reflect that:

(A) The straight line method produces more depreciation than does the double declining balance method for certain short-lived assets; and

(B) Items of machinery and equipment costing under U.S. $200 can be expensed.

No other incentives have been taken into account.

(19) Full year allowance in first taxable year for assets acquired in first half of such year; half year allowance for assets acquired in second half.

(20) Method changed to straight line in fifth taxable year. See (18) above.

(21) Includes 14% allowance equivalent to 7% investment credit at effective 50% income tax rate. Credit does not reduce recoverable base cost.

The contrast between our system of capital cost recovery and those of other countries, shown in Table II, is highlighted by Graph A, a bar chart based on the cost recovery periods shown, and the assumptions made, in Table II.[1]

As appears from Table II and Graph A, even before the 1969 Tax Act, capital cost recoveries for machinery and equipment allowed by the United States in the early years, i.e., first to third years, were substantially less than those allowed by the United Kingdom, Japan, France, Sweden and Luxembourg, approximately the same as those allowed by Italy, Belgium, Canada and Switzerland, somewhat better than those allowed by West Germany, and substantially better than those allowed by the Netherlands. With the 1969 Tax Act in effect and the investment credit repealed, the cost recovery allowance for machinery and equipment under United States rules compares unfavorably through the entire seven year period with the recovery allowed by every other nation shown, and the comparison is extremely unfavorable in all cases through the early years.

[1] In those countries that allow a full year's depreciation on facilities installed in the taxable year irrespective of the time of installation (the "full-year convention"), a full year's write-off is shown on Graph A. In those countries, including the United States, that permit only a portion of a year's write-off, based on the date during the year in which assets are installed, it is assumed that the assets are entitled to one half-year's write-off. The investment credit, however, was not reduced on the basis of date of installation within the year. It is shown on Graph A as the equivalent of a 14 percent depreciation deduction in the year of acquisition.

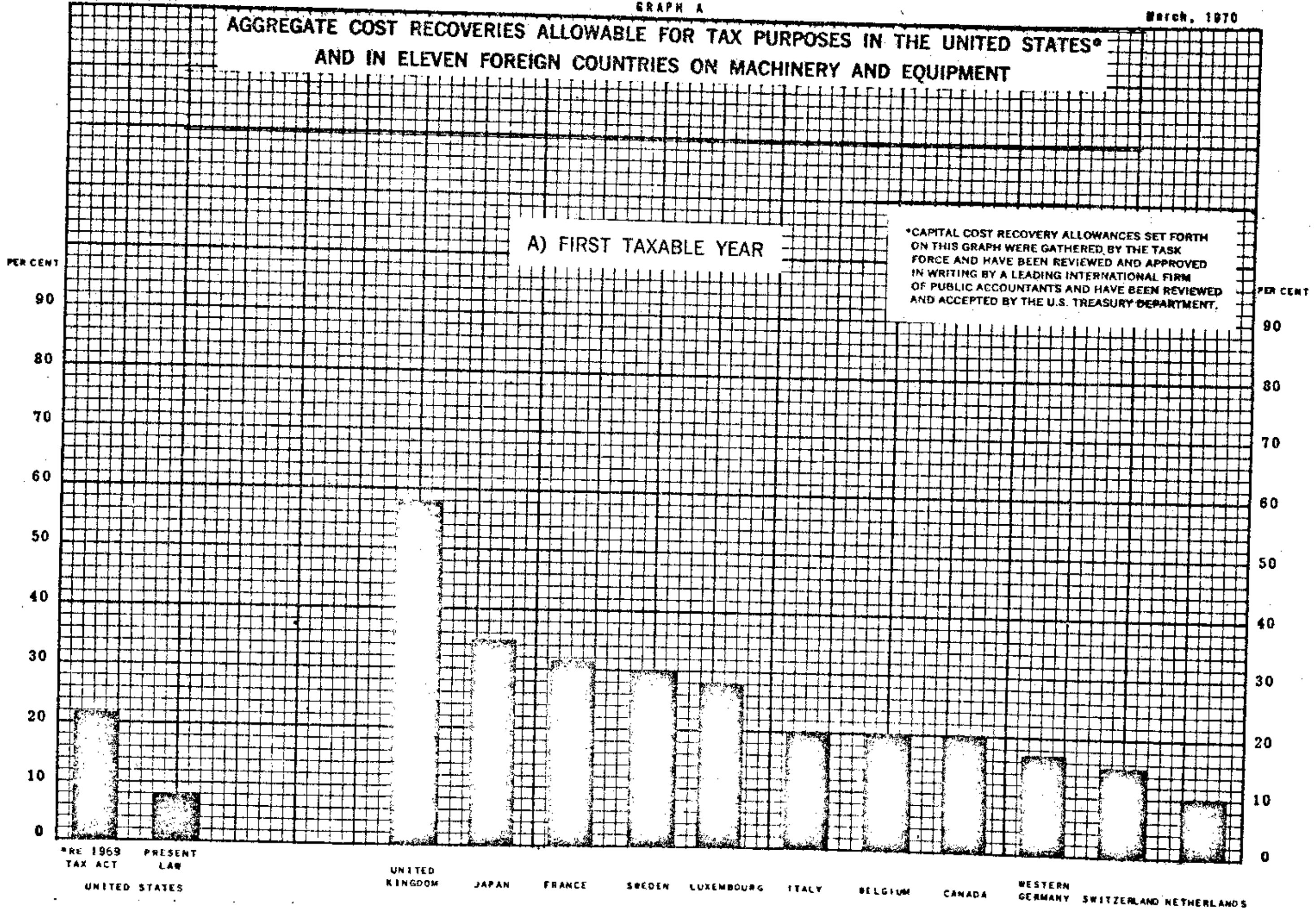
In comparisons between allowances for capital cost recovery, the early years are, of course, very important since the earlier the tax benefit, the sooner cash is freed for the purposes of the business, including further capital investment. As matters now stand, the United States appears to give significantly less emphasis than other countries to weighting capital cost recovery heavily in favor of the early years.

The extent to which the growth of the productive capacity of a nation is generated or accelerated by favorable tax treatment of capital cost recovery is not definitely ascertainable in the highly complex economy prevailing in the free world and in the highly industrialized member nations of that world. By the same token, no precise forecast can be made as to the degree to which unfavorable tax provisions in this area may inhibit growth. However, our own country's experience during the recent past when we did furnish tax incentives to capital investment and the experience of our principal competitors all suggest that such incentives do significantly encourage the development of the productive capacity of a nation.

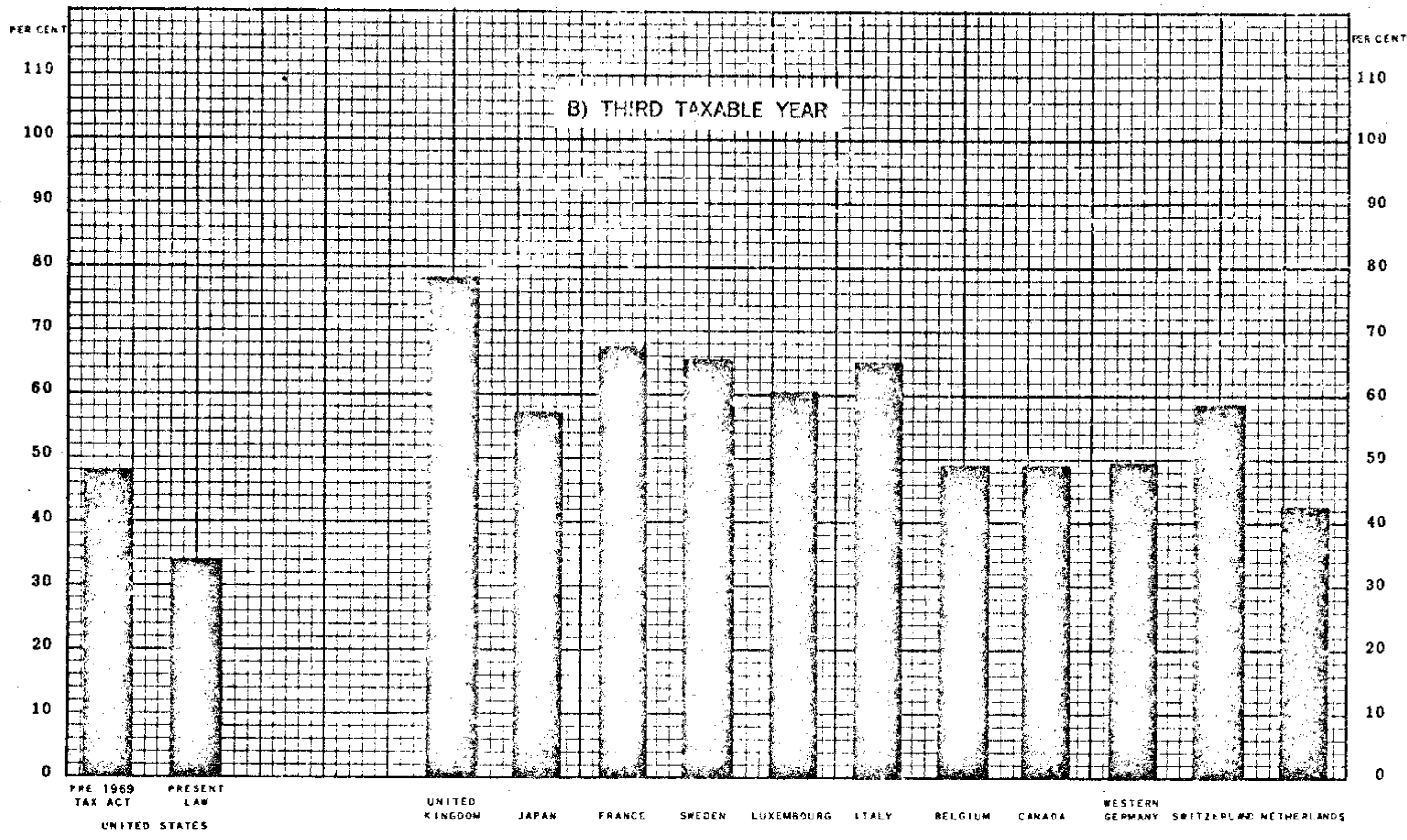
United States industry is now facing intense competition in many areas from modern, well-equipped foreign industrial plants. Japan and its steel industry furnish a dramatic illustration. In 1960, Japanese steel output was slightly in excess of 24 million tons. By 1968 it had more than tripled, to 74 million tons. By 1973 the Japanese plan to have 125 million tons of steel-making capacity. When one considers that the peak output of Japanese steel during World War II was nine million tons compared to 90 million tons for the United States, the growth of this industry in Japan is startling.

By 1973, 80 million tons of Japan's 125 million ton capacity will be less than eight years old and 50 million tons will be less than five years old. At the present time two-thirds of the Japanese steel capacity is less than nine years old. Almost all of the steel plants currently in operation in Japan represent relatively new investments and were designed and constructed on a fully integrated basis. For example, the Japanese have five mills that currently have an annual capacity of five to six million tons each. These are currently under expansion and by 1972–1973 will be 11 to 14 million tons each.[2]

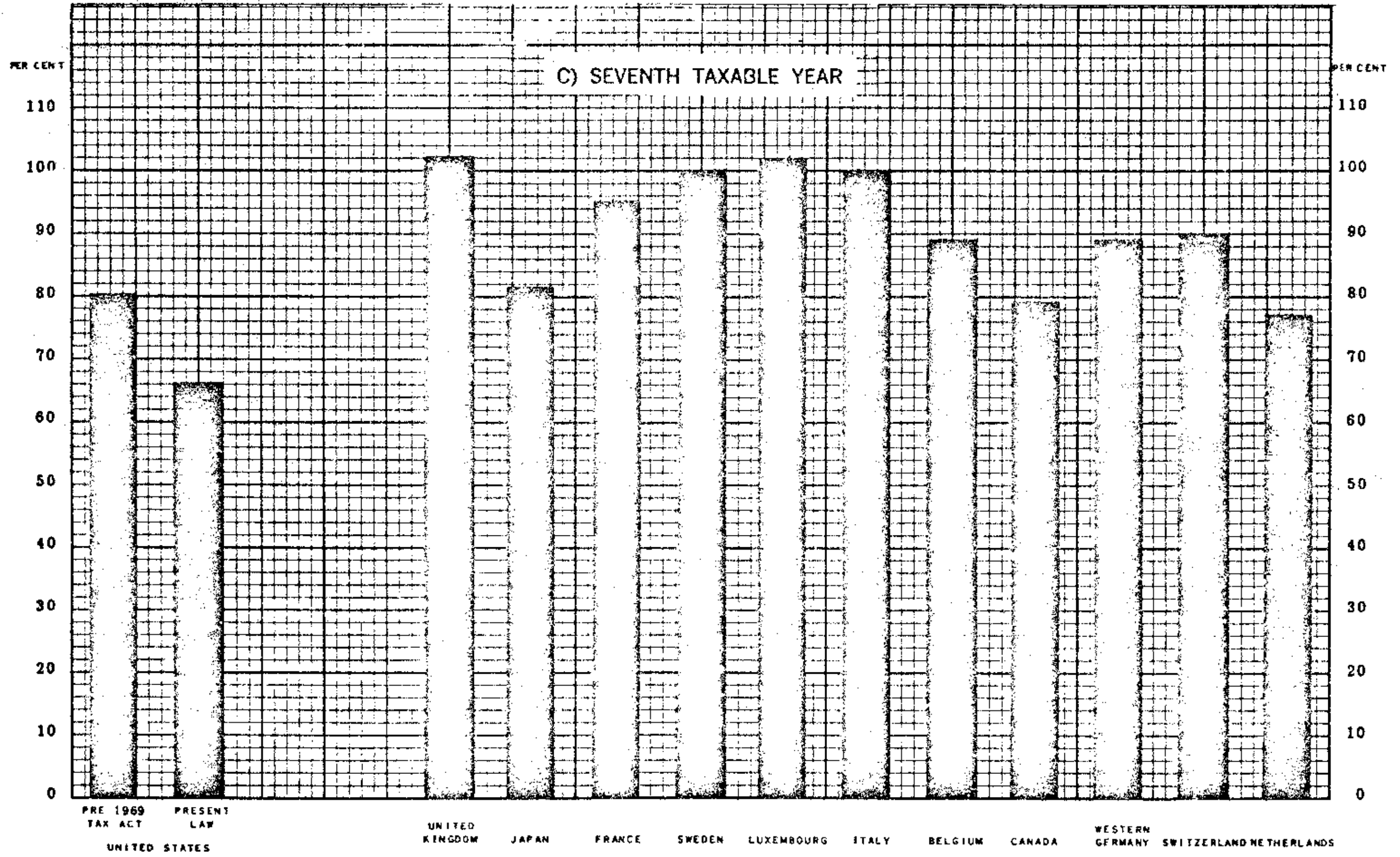
[2] The data concerning the Japanese steel industry were obtained from industry sources by members of the Task Force. An article in the New York Times, December 21, 1969, Section 3, page 12, column 3, uses different estimates that support the same thesis. According to this article, expansion of Japanese capacity in the twelve months ending March 31, 1970 will be 17 million tons, to a capacity of 86 million tons.


GRAPH A
March, 1970
AGGREGATE COST RECOVERIES ALLOWABLE FOR TAX PURPOSES IN THE UNITED STATES*
AND IN ELEVEN FOREIGN COUNTRIES ON MACHINERY AND EQUIPMENT
A) FIRST TAXABLE YEAR
*CAPITAL COST RECOVERY ALLOWANCES SET FORTH ON THIS GRAPH WERE GATHERED BY THE TASK FORCE AND HAVE BEEN REVIEWED AND APPROVED IN WRITING BY A LEADING INTERNATIONAL FIRM OF PUBLIC ACCOUNTANTS AND HAVE BEEN REVIEWED AND ACCEPTED BY THE U.S. TREASURY DEPARTMENT.
PER CENT
90
80
70
60
50
40
30
20
10
0
PRE 1969 TAX ACT
PRESENT LAW
UNITED STATES
UNITED KINGDOM
JAPAN
FRANCE
SWEDEN
LUXEMBOURG
ITALY
BELGIUM
CANADA
WESTERN GERMANY
SWITZERLAND
NETHERLANDS

GRAPH A



GRAPH A



In sharp contrast, much of the steel manufacturing plant of United States industry is obsolete; it is uncertain how much it should be counted as part of total United States steel making capacity. Only about one-third of our physical plant is less than ten years old, although the industry has invested an average of two billion dollars a year in new facilities for the last five years. According to industry sources, capacity rose from 149 million tons in 1960 to between 162 and 165 million tons in 1969, representing gross additions to plant of 48 million tons offset by retirement of approximately 35 million tons of obsolete capacity.[3] A recent survey puts current United States capacity at 195 million tons, apparently including the plant regarded by the industry as obsolete because operation thereof is economically unfeasible except in extraordinary circumstances.[4] Much of the spending by the steel industry in the United States has been for modernization and replacement rather than expansion, and individual items of equipment have been, for the most part, installed on a piecemeal basis. In the last ten years only one sizable new steel plant has been built in the United States on a "greenfield" site.

Other examples of rapid development in foreign productive capacity could readily be cited, such as the tremendous growth of the Japanese automobile industry, or the construction in recent years of large sheet glass factories in Western Europe and Japan, but enough has been said to make the point that the United States must continue the modernization and expansion of its industrial plant or we will not be able to maintain even our present position in world competition.

It is recognized, of course, that many factors other than tax considerations have contributed to the rapid increase in investment, improvements in production technology, and modernization of foreign production facilities discussed above. It is notable, however, that to a greater extent than the United States under pre-1969 Tax Act law and to a much greater degree than under the present law, all the countries referred to have deliberately focused their tax policies on affording, through rapid cost recovery allowances and similar incentives, a tax climate favorable to private investment in plant and equipment. If the United States is to improve, or even maintain, its position in international trade, domestic policy will have to encourage, rather than downgrade, the making of private investment for expanding, modernizing, and increasing the efficiency of our industrial facilities. Constructive revision of the present capital cost recovery system is an important element of any public policy designed to further this objective.

[3] The data concerning the United States steel industry were obtained by members of the Task Force from industry sources.

[4] Article in The Wall Street Journal, January 19, 1970, p. 2, col. 2.

402-574 O—70——3

The Impact of Inflation

The relationship of inflation to capital cost recovery allowances and tax incentives for capital investment must be approached from two aspects: first, the inflationary effect of stimulating capital investment; and, second, the adverse impact of inflation on replacement cost of buildings and equipment.

One of the arguments advanced on behalf of repealing the investment credit was that the boom in business-capital outlays bears considerable responsibility for the current inflation. In our view, however, efforts to slow the growth in private investment in production facilities will prove to be counterproductive and will increase the difficulties in dealing with inflationary strains over the long run. We believe that a rapid rate of expansion of production capability is desirable in the interests of reducing the costs of production and meeting more fully the demands arising in all sectors of the economy. Curbing inflationary pressures is not a one-shot matter; over the coming years, the greater the increase in our ability to produce, the better able will the United States be to cope with these demands.

Too little attention has been paid to the impact of inflation in eroding cost recovery allowances. Since cost recovery allowances are based on the original costs of the plant and equipment, these allowances represent a decreasing proportion of the costs of replacing such facilities as their prices rise. The adequacy of these allowances as a source of funds for financing plant and equipment outlays declines accordingly as plant and equipment prices rise.

The prices of production facilities have been rising sharply, as the following table shows:

TABLE III.—*Price Index—For Gross Private, Fixed Investment (Nonresidential)*

Year	Index	Year	Index
1945	51.0	1958	100.0
1946	56.3	1959	102.2
1947	64.5	1960	102.9
1948	70.7	1961	103.4
1949	72.8	1962	104.1
1950	74.4	1963	104.5
1951	80.4	1964	105.7
1952	82.6	1965	107.5
1953	84.0	1966	110.2
1954	84.8	1967	113.7
1955	86.7	1968	117.1
1956	92.4	1969	121.8
1957	97.9		

Source: Department of Commerce, Office of Business Economics, Survey of Current Business, *National Income and Product Accounts of the United States*, 1929–65 (Aug. 1966); *Survey of Current Business* (July 1969) Table 8.1, line 8. The 1969 figure is preliminary.

The effects of inflation on the real value of cost recovery allowances are portrayed on Graph B.[5] The graph shows the ratio of current-dollar to historical-cost depreciation since 1945 for nonfinancial corporations. This ratio for any year compares (1) the amount of depreciation that would have been allowed if the prices of all the facilities on which depreciation was claimed for that year were the same as the prices for such facilities acquired in that year, with (2) the amount of depreciation actually claimed in that year, based on the prices actually paid for the facilities on hand in that year.

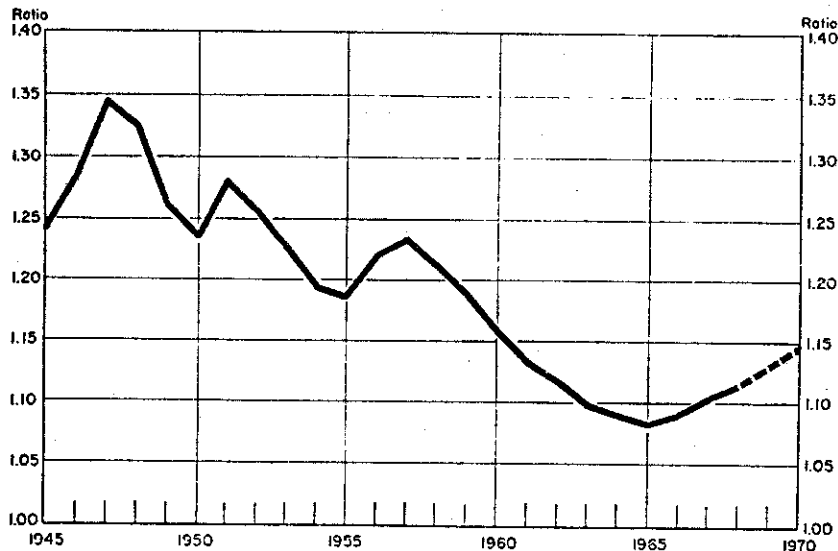
To the extent the ratio shown by the graph exceeds 1, it represents an inequity in the tax treatment of investment in depreciable property. If prices remained constant, or full capital cost recovery allowances were permitted in the year of investment, the ratio would be 1. Factors increasing the ratio are rising prices and the length of time over which an investment may be written off. Further, in a period of changing prices, the ratio is affected by the rate of expansion of the stock of depreciable facilities, i.e., the greater the relative amount of depreciation that relates to recently acquired, higher priced property, the less will be

[5] Source: Terborgh, Underdepreciation from Inflation: A Ghost Returns, p. 6 (Machinery and Allied Products Institute, 1969).

GRAPH B

Ratios of Current-Dollar to Historical-Cost Depreciation, for All Nonfinancial Corporations *

(Double Declining-Balance Method)



the spread between historical-cost and current-dollar depreciation. The important point here is that, given our present system of depreciation on an historical-cost basis, the tax inequity represented by the positive ratio may be reduced by accelerating capital cost recovery, either through shortening of recovery periods or by use of accelerated depreciation formulas.

Prices of production facilities have risen steadily over the past twenty years, and continue to do so. The ratio of current historical-cost depreciation nevertheless began to fall after 1947, reflecting principally the moderating of price increases over much of the period up to 1965. Since 1965, however, the strong increases in prices of production facilities have been pushing the ratio back up and the ratio is expected to be about 1.15 in 1970.

In effect, this ratio of current to historical cost depreciation indicates the underdepreciation of the existing stock of facilities in nonfinancial corporations. The amount of such underdepreciation rose from a little over $1 billion in 1945 to roughly $4.5 billion in 1957, declining thereafter to somewhat less than $3 billion in 1965. Since that time, the amount of underdepreciation has been rising sharply, and it is estimated it will reach $7 billion in 1970 (Graph C).[6] If financial corporations and unincorporated businesses are taken into account, the underdepreciation will be nearly $10 billion in 1970.[7] Continuation of inflationary pressures would, of course, expand this gap significantly.

The problem could be avoided, or at least mitigated, if cost recovery allowances were based on a re-evaluation of the historical costs of production facilities in current prices. We believe that there might be substantial advantages in this approach in terms of reducing an important barrier to the desired growth in production facilities. We are aware, however, of the administrative and compliance difficulties which might arise from such a re-evaluation, and the problems that would arise in other income and deduction areas if such a concept were introduced into the tax law.

Our recommendations, by shortening the time lag between investment and write-off, would accomplish a good deal toward reducing the adverse impact of inflation on the adequacy of cost recovery allowances, without encountering these difficulties.

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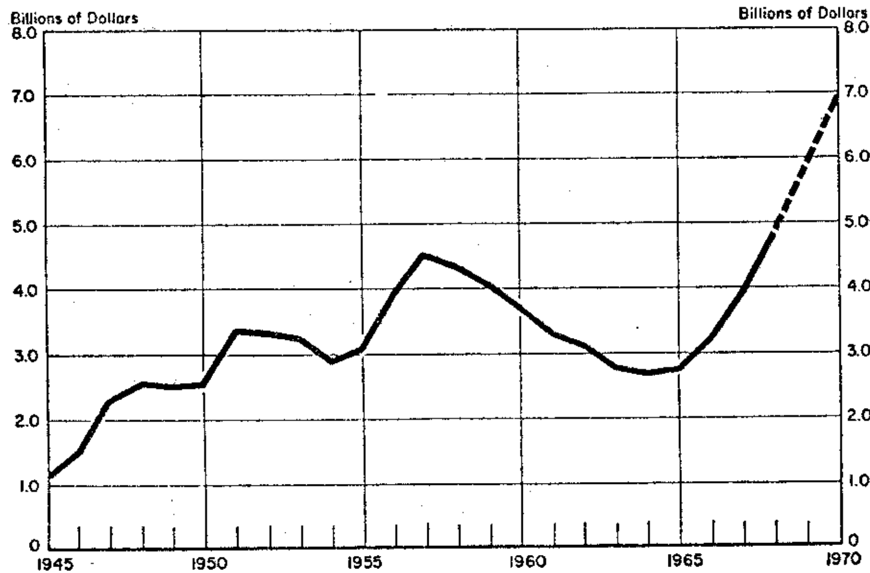
[6] Source: Terborgh, Underdepreciation from Inflation: A Ghost Returns, p. 8 (Machinery and Allied Products Institute, 1969).

[7] Id. at p. 10.

GRAPH C

Amounts by Which Current-Dollar Depreciation Exceeded Historical-Cost Depreciation, for All Nonfinancial Corporations

(Double Declining-Balance Method)



REVENUE CONSIDERATIONS

When we come to setting forth our recommendations in detail, we shall indicate the estimated revenue effects. At this point, however, some general observations are in order.

In view of the repeal of the investment credit allowance, adverse revenue effects of the liberalization of a particular cost recovery allowance must now be considered as a loss rather than as a substitution for an existing allowance. Because of this, the feasibility of the adoption of a particular proposal is doubtless much different today from what it might have been had such proposal been considered as in lieu, in whole or in part, of the investment credit.

Where it has appeared to us that a proposed course might be desirable but the incentive for capital investment furnished by the proposal was not commensurate with the apparent revenue loss resulting, we

have discarded the proposal. This approach may be illustrated by reference to a proposal made to adopt the so-called full-year convention. Under present tax rules if a new piece of machinery is placed in service, say, at the beginning of November by a calendar year taxpayer, the depreciation allowed for that year under item accounting is only two-twelfths of a full year's depreciation. Under the rules of at least three countries, Belgium, Canada and Sweden, a full year's deduction would be allowed in that case and Germany would allow a half year's deduction. Estimates indicated that to adopt the full-year convention for machinery and equipment under our law would cause a revenue loss of approximately $3.5 billion in 1971 if introduced at the beginning of that year. The losses in subsequent years would be less but still substantial. We considered that the price was too high to justify the adoption of the full-year convention.

At least one of our principal proposals, the elimination of the reserve ratio test, appears to involve no present revenue loss and probably only a small revenue loss in the future. Another, the discarding of the salvage value concept, apparently would involve only minor revenue loss. As to such items, therefore, recommendations for their adoption can be considered without concern for the effect on revenue.

In weighing the desirability of adopting our other proposals in the light of the revenue losses indicated, several elements should be borne in mind. The estimated revenue losses take into account an assumed growth factor in the economy and in revenues and in the aggregate dollar amount invested in plant and equipment. On the other hand, they do not reflect any additional revenue from increased business profits attributable to additional investments that may be induced by the liberalization of capital cost recovery allowances. Although all the members of the Task Force believe that increased business profits and hence, increased revenues, will result from adoption of our proposals, no satisfactory method of estimating the increase is available.

RECOMMENDATIONS

The various considerations discussed above lead us to the conclusion that basic changes in the present depreciation system in the Federal income tax law are urgently needed. The changes we recommend are intended

> to encourage the expansion of production facilities in order to sustain and accelerate real economic growth;

to bring the United States tax treatment of investment in production facilities more closely into line with those of the other major industrial nations;

to moderate the adverse effects of inflation on the real value of cost recovery allowances and on the capacity of United States business to finance additions to the stock of production facilities; and

to simplify the provisions of the present law and regulations, thereby reducing the burdens and expense of compliance by taxpayers and the areas of disagreement between them and the Internal Revenue Service.

Our principal proposals are two. First, we recommend that, for machinery and equipment, the present depreciation system be replaced by a simplified system of cost recovery allowances. This proposed change would substitute conventionalized cost recovery for the present particularized depreciation of machinery and equipment and would apply to existing as well as newly acquired facilities. Conventionalized cost recovery would involve classifying all machinery and equipment into broad groups and assigning to each such group a standard recovery period which all taxpayers would be free to use in computing their cost recovery allowances, without reference to their particular experience and pattern of retirement and replacement of facilities. The groupings we propose are those employed in the present depreciation guidelines.[8]

Our second proposal is that the cost recovery periods assigned to machinery and equipment grouped according to the present guidelines be reduced under the proposed capital cost recovery system by 40 percent, subject, however, to two limitations in the case of equipment that has a cost recovery period of eight years or less under the present guidelines. The limitations are that no guideline period of five years or less would be reduced, and no guideline period of more than five years would be reduced to less than five years.

Our proposals are limited to machinery and equipment and structures specially related thereto. We would leave intact the present depreciation system with reference to buildings. At this preliminary point, a word of explanation should be offered as to the Task Force's reasons for excluding buildings from the proposed capital cost recovery system. Data gathered by members of the Task Force indicate that capital cost recovery allowed for industrial buildings in the United States compares unfavorably with

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[8] It is interesting to note that in February, 1970, the American Bar Association, by its House of Delegates, adopted a resolution recommending the amendment of the Internal Revenue Code to provide, among other things, for the allowance of depreciation over prescribed cost recovery periods and for the elimination of the reserve ratio test.

that allowed in other countries. Thus, simplified and accelerated capital cost recovery for investment in new industrial buildings would seem to be in line with our purpose of providing additional incentives to the making of investments in production facilities.

There are, however, other considerations. New industrial buildings, as shown by Table I, account on the average for not more than 10 percent of the total investment in production facilities. Also, it is very difficult to draw a satisfactory line separating buildings that should be included in the favored treatment from those that should not. For example, is there a sound basis for including a factory building but excluding a wholesale, or even a retail, distribution center? Indeed, a number of the members doubted that there was economic justification for distinguishing between industrial buildings and other types of business buildings, such as office buildings or hotels. Yet if no lines were drawn, the Task Force thought that the investment incentives created by including buildings in its proposals would be too widely dispersed, and would not justify the revenue cost that would be incurred.

The Task Force recognizes that there are other problems in the area of cost recovery, in addition to buildings, with which this report does not deal. There is, for example, the question whether there should be special cost recovery provisions for anti-pollution facilities. The President has, however, already indicated the general administration policy on this subject. Another example that might be mentioned is the treatment of purchased goodwill and similar intangible assets. The conventionalized capital cost recovery system could be extended to permit amortization, over a prescribed cost recovery period of, say, 30 to 40 years, of such purchased intangible assets, subject to full recapture upon disposition. Under present law, unless the useful life may be estimated with reasonable accuracy, no cost recovery is permitted until the asset becomes worthless. Such an extension would involve a number of considerations and the conclusion was finally reached that not all capital cost recovery problems could be dealt with by the Task Force and that no recommendation should be made in the area of amortization of intangibles.

Our two major proposals with reference to capital cost recovery for machinery and equipment are set forth in greater detail below.

Simplify Cost Recovery for Machinery and Equipment

Our recommendation would eliminate, to the extent possible, the complications, administrative burdens and controversies associated with deductions for depreciation of machinery and equipment under present law. We would replace the present depreciation system by a new structure of cost recovery allowances, utilizing conventionalized groupings of machinery and equipment and assigning standard cost recovery periods to

such groupings. All taxpayers would be free to use the conventionalized cost recovery groupings and standard recovery periods in computing cost recovery allowances for machinery and equipment.

Present guideline groupings would be utilized. Standard recovery periods would not be measured by the "useful life" concept, and the reserve ratio test would be eliminated. Retirements of machinery and equipment prior to expiration of the standard period would give rise to a deduction for any unrecovered basis, even though the property was carried in a multiple asset account.

For the most part, use of estimated salvage value in determining recoverable basis would be eliminated. Multiple asset accounts would be kept separate by year of acquisition, to prevent allowances exceeding recoverable basis.

Finally, in the case of gain upon disposition of machinery and equipment, the difference between unrecovered basis and original recoverable basis would be included in ordinary income under a full recapture rule.

Adopt present guideline groupings.—We recommend that the groupings of property in the present guidelines under Revenue Procedure 62–21 be retained, and that the Secretary of the Treasury or his delegate continue to have authority to modify such groupings from time to time in the interests of further easing compliance and administration burdens, provided no such regrouping would be authorized that would have the effect of increasing the cost recovery period for machinery or equipment in any of the present groupings.

The property classifications in the present guidelines afford a substantial simplification compared with those prescribed by the Internal Revenue Service at an earlier date in Bulletin "F". Most business taxpayers have had the opportunity, since the present guidelines were introduced by Revenue Procedure 62–21 in 1962, to familiarize themselves with these classifications, and there is, on this account, much to be said for continuing such groupings of machinery and equipment under the proposed new cost recovery system. However, the opportunity for further simplification should not be proscribed, although any such opportunity should not be utilized as a means of lengthening the cost recovery period for any subgroup of facilities.

Assign a standard cost recovery period to each group of facilities.—We recommend that a standard cost recovery period be assigned to each group of facilities, which any taxpayer, as a matter of right, could use in computing his cost recovery allowances. We propose, generally, for machinery and equipment the adoption of shorter cost recovery periods than the present guideline lives. Further, the Secretary or his delegate should, we believe, be given express authority to reduce cost recovery periods for any or all groups of facilities from time to time.

402-574 O—70——4

Cost recovery periods should be prescribed without reference to any estimates of average "useful life" of the property in the group. Estimates of "useful life" are necessarily imprecise. In addition, they are relevant only in a cost recovery system that seeks to particularize cost recovery to the circumstances of each taxpayer. In our view the gains from such particularizing are slight while the administrative and compliance costs involved are relatively heavy.

Facilities in service or contracted for on the effective date of the proposed cost recovery system (which should be no later than the introduction of a bill incorporating the proposal) would not be affected by the proposal but would continue to be governed by existing rules except as indicated below.

Used machinery and equipment acquired after the effective date (regardless of the date of acquisition by the first user) would be assigned the same standard recovery period that would be assigned if the property were new.

Eliminate the reserve ratio test.—We recommend that the reserve ratio test and/or any similar device be eliminated with respect to existing facilities as well as facilities acquired after these recommendations become effective.

A reserve ratio test, or any similar measure for comparing the cost recovery period used for tax purposes with the actual period of retention of assets by the taxpayer, is clearly irrelevant under the conventionalized cost recovery system we have recommended.

Even under the present depreciation system, the reserve ratio test contributes little in determining whether the depreciation allowances claimed by a taxpayer on his return are equal to the true depreciation sustained during the taxable year. If the test results in a taxpayer accelerating retirements of his existing facilities, the effect may be counterproductive, i.e., the consequence may be a smaller amount of production facilities in the private sector. Alternatively, if the taxpayer does not accelerate retirements, his opportunity to assign a shorter "service life" to newly acquired facilities is constrained by the test, i.e., his past retirement pattern limits his freedom to assign a shorter life to new facilities, irrespective of the differences he anticipates in the periods of retention of the new and old facilities.

We are convinced, therefore, that the reserve ratio test serves no useful purpose under the present depreciation system and should be eliminated even if our other recommendations are not adopted. As previously noted, no present and probably very little future revenue loss would be involved in this change.[9]

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[9] Henry H. Fowler does not agree that the reserve ratio test should be eliminated if the present depreciation system is continued.

Permit taxpayers to deduct the unrecovered basis of all machinery and equipment retired prior to the expiration of the cost recovery period.—Retirements of machinery and equipment prior to expiration of their assigned capital cost recovery periods raise two questions that must be dealt with under the proposed system of capital cost recovery allowances. The first is the treatment to be accorded instances of normal early retirement of an asset held in a group or composite account. The second involves the taxpayer who regularly retains assets for a shorter period than their assigned cost recovery periods.

Under present law, although early retirement of an asset depreciated in an item account gives rise to a terminal year deduction of any unrecovered basis, normal early retirements from multiple asset accounts are assumed to be balanced, in accordance with average life dispersions, by retention of other assets in the account beyond the average useful life, and no terminal year deduction is permitted. A taxpayer who regularly retires assets prior to expiration of useful life is permitted to use his average retention period as depreciable life for tax purposes. Estimated salvage value of the asset at the end of such period, to the extent it exceeds ten percent of original basis, is used to reduce original depreciable basis.

Under the proposed capital cost recovery system, the useful life concept would be replaced by standardized recovery periods and average dispersion of retirements of assets held in multiple asset accounts would be centered upon expiration of a conventional recovery period rather than expiration of average useful life. Appropriate treatment of individual early retirements and consistent patterns of short retention of assets under the proposed system is a problem to which the Task Force has devoted substantial time.

A partial solution is to extend to multiple asset accounts the terminal year deduction of unrecovered basis, provided by present law for item accounts, upon early retirement of an asset. This would give the fullest possible relief in instances of early retirement of an asset, and would give partial relief to the taxpayer who regularly retains assets for a period shorter than the standardized recovery period. The terminal year deduction involves no inconsistency with the theory of the capital cost recovery system. It is administratively simple and should give rise to few disputes between taxpayers and the Internal Revenue Service since it does not require estimating of useful lives, one of the principal difficulties with particularization in the depreciation area. The Task Force recommends such extension of the terminal year deduction.

An additional form of relief, that would benefit those taxpayers who regularly retire assets prior to the expiration of the standard cost recovery period, would be to permit a taxpayer who can establish a consistent pat-

tern of early retirements of assets to utilize a cost recovery period shorter than the prescribed standard period that would otherwise apply to such assets. Subject to the comments made below, the Task Force does not recommend that this solution be adopted. Unlike the terminal year deduction, permitting taxpayers to establish shorter-than-standard retention periods would require estimating the period for which an asset would be held by a taxpayer based on that taxpayer's particular experience with similar assets. There would thus be fostered, to some extent at least, the disputes between taxpayers and the Internal Revenue Service that the conventionalized capital cost recovery system is designed to avoid.

The terminal year deduction, which the Task Force recommends for multiple asset accounts, assumes that the taxpayer claiming the deduction can establish the cost of the asset retired and the amount of the cost already recovered. As set forth below,* we propose for other reasons that taxpayers be required to segregate assets in separate accounts by year of acquisition so that this assumption should present no problem except, possibly, in situations where the taxpayer has failed to maintain records identifying costs of particular items in a multiple asset account. In such cases, a deduction for early retirement would not be allowed.

Possibly, however, the terminal year deduction will not provide an adequate solution to the problem raised by regular patterns of early retirements. It may be that too many taxpayers who pursue policies of early replacement of machinery and equipment would be seriously and adversely affected by a system that denied them the present right to establish an individual short replacement cycle and recover capital investment over the actual retention period. To the extent cost recovery periods are not reduced below present guideline lives, the number of such taxpayers will be increased. Even under the Task Force's proposed reductions, the adverse effect may be severe upon taxpayers whose primary investment is in facilities which presently have short guideline lives since our proposed reductions for such facilities are quite limited. Also, taxpayers relying heavily upon used equipment and machinery, which would be assigned the cost recovery periods applicable to the same assets when new, might be seriously affected if the actual retention period for such used property were significantly shorter than for new assets.

If the problem created by patterns of early replacement of facilities is found to be widespread, the Task Force recommends that a taxpayer be allowed to use a shorter cost recovery period than that prescribed for the group in which his facility falls if he can establish that his period of retention for such facilities is shorter than the prescribed period. If this solution were to be adopted, the Task Force believes that estimated

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*See p. 24, section entitled, "Limit cost recovery allowances to recoverable basis."

salvage value should be taken into account in determining recoverable basis for capital cost recovery purposes, although we are recommending below that the use of estimated salvage value be eliminated generally for property subject to the proposed capital cost recovery system.

Allow taxpayers, as a matter of right, to use cost recovery periods longer than the standard cost recovery periods prescribed by the Secretary or his delegate.—We visualize few, if any, circumstances in which this recommendation would involve abuse by the taxpayer and see no disadvantage in allowing the taxpayer this flexibility both as to existing and newly acquired facilities.

Eliminate salvage from the computation of annual cost recovery allowances for newly acquired facilities.—We recommend that recoverable basis of facilities be determined without reference to estimated salvage value, subject to one, or possibly two, exceptions. Under the provisions of present law, salvage value may be disregarded in determining the depreciable basis of personal property with a useful life of 3 years or more, if salvage value is estimated to be 10 percent or less of original basis. Moreover, if estimated salvage value exceeds 10 percent of original basis, the taxpayer may reduce the amount of salvage value by an amount not to exceed 10 percent of original basis.

The effect of these provisions in present law is to reduce significantly the extent to which salvage value is taken into account in determining the amount of basis recoverable. These provisions, however, do not eliminate the requirement for salvage value estimation and accounting, and leave the complexities of doing so substantially unaltered.

Accordingly, in the interest of simplification of accounting for cost recovery, with the consequent reduction in compliance costs and administrative burdens, we urge the elimination of salvage as a factor in cost recovery calculations as to newly acquired assets. Since tax accounting has for many years been based on reflecting salvage value, we believe it would introduce undue complexity to eliminate salvage for existing facilities.

It is considered that the revenue loss from eliminating salvage value as to newly acquired property should not be substantial.

The Task Force is aware of two situations in which elimination of the use of estimated salvage value might open the way for abuse. The first involves the taxpayer who uses a large stock of facilities having a short recovery period and a high resale value relative to original investment. Such a taxpayer might, by use of accelerated cost recovery accounting methods, enjoy in the first year a recovery allowance far in excess of the actual decline in value of the facilities. The excess would, of course, be recaptured and taxed as ordinary income in the year of sale, but in the

interim period between the deduction and the recapture the taxpayer would benefit by interest-free use of the excess, which in some circumstances might be substantial.

On the face of present law, this possibility appears to exist, particularly in the case of the double declining balance method of accounting for depreciation. The possibility was foreclosed, however, by the Supreme Court's decision in *Hertz Corp.* v. *United States,*[10] interpreting and upholding a regulation limiting the amount of deductions for depreciation to the excess of cost over salvage value at the time of disposition of the asset.

The Task Force recognizes that elimination of salvage value from the proposed capital cost recovery system would, in some circumstances, especially where short cost recovery periods are involved, reopen the possibility of substantial tax deferrals by accelerated depreciation combined with early sale of assets having a high resale value. The Task Force recommends a narrowly drawn provision, limiting the amount of accelerated depreciation of machinery and equipment by taxpayers who regularly make early dispositions of such assets at prices substantially in excess of unrecovered basis, to foreclose this possibility.

A second exception to the proposed elimination of estimated salvage will be required if it is found necessary to permit taxpayers to establish shorter-than-standard cost recovery periods upon the basis of individual experience. The principal reason is that to a considerable extent short replacement cycles would represent disposal of machinery and equipment still having substantial value to others.

Limit cost recovery allowances to recoverable basis.—We recommend that taxpayers be required to maintain a separate set of cost recovery accounts for the facilities acquired each year after the effective date of adoption of the new cost recovery allowance system so that all facilities acquired after the effective date would be segregated by year of acquisition. The facilities acquired in each year would, in addition, be grouped according to the standard groups prescribed by the Secretary or his delegate. Total accumulated cost recovery for each such group of facilities acquired in each taxable year might in no event exceed the recoverable basis of the facilities in such group. Similarly, total accumulated cost recovery for facilities on hand as of the effective date of these recommendations (which would be in separate accounts from facilities acquired after the effective date) would be limited to the recoverable basis of such facilities.

Segregating facilities in separate accounts by year of acquisition is essential to preclude cost recovery allowances for any facility or group

[10] 364 U.S. 122 (1960).

of facilities from accumulating to an amount in excess of recoverable basis. Without this requirement, the use of the straightline or sum of the years-digits methods, which involve the application of the cost recovery rate to the original recoverable basis of the facilities, would afford no automatic limitation on the total accumulated allowances with respect to any given facilities, so long as facilities were added to the account.

Apply full recapture of any excess of proceeds realized upon the sale, exchange, or involuntary conversion of facilities over the unrecovered basis, up to the original recoverable basis of the facilities.—An integral part of a conventionalized cost recovery system, such as the one we propose, is provision for the return to taxable income of any excessive cost recovery allowances, as reflected in the excess of proceeds from a sale, exchange, or involuntary conversion of facilities over the recoverable basis of such facilities. A full recapture provision should assure that the conventionalized cost recovery system will not be used by taxpayers as a vehicle for converting ordinary income into capital gains through excessive cost recovery allowances. By the same token, it substantially reduces the occasion for conforming cost recovery periods with the "useful life" of facilities in the case of any particular taxpayer. Similarly, the proposed full recapture would minimize any tax-induced stimulus for disposition of facilities, through sale or exchange, prior to the end of the recovery period.

Accelerate Cost Recovery for Machinery and Equipment

In the earlier pages of this report we have presented the case for accelerating cost recovery allowances. There are fundamentally alternative approaches to this acceleration—reducing cost recovery periods or using a more accelerated cost recovery formula, such as a declining balance method of two and a half or three times straightline.

After consideration of these alternatives, we are inclined towards reduction of cost recovery periods. This approach affords acceleration of cost recovery allowances, irrespective of the cost recovery method (i.e., straightline, declining balance, sum of the years-digits, etc.) used by the taxpayer. Of course, the amount of such acceleration also depends on the method employed, and we emphasize that the differences between the approaches are secondary to the central objective of affording a less restrictive cost recovery system—one that will reduce the tax barriers against investment in production facilities and that will therefore afford a tax environment more conducive to economic growth, modernization of production capacity, and effective competition by United States business in world markets.

General.—As one guide for providing acceleration of cost recovery allowances, we have examined the changes that would be required to bring the allowances afforded United States business more closely into alignment with those afforded businesses in the nations which are our principal competitors in international trade. To overcome the adverse effects of the repeal of the investment credits, and to provide such acceleration of cost recovery allowances as would make United States allowances roughly comparable with the average provisions in these other nations, we estimate that the cost recovery periods for most of the personal property grouped according to the present guidelines would have to be reduced on the average by somewhat more than 40 percent, retaining the present cost recovery formulas.

Our recommendation is that the cost recovery periods for machinery and equipment grouped according to the present guidelines be reduced by 40 percent, except that no guideline period of five years or less would be reduced, and no guideline period of more than five years would be reduced to less than five years. It is our view that the availability of the double declining balance method of cost recovery furnishes adequate inducement for the purchase of machinery and equipment having a relatively short cost recovery period. The provisions governing the investment credit, in reducing the amount of credit for property having a life of less than eight years, reflected a similar view.

Under the recommendation, the cost recovery period classifications assigned to used property acquired after the effective date would be the same as those assigned to new facilities. For example, if equipment assigned a ten year cost recovery period classification were sold after four years, the purchaser would have a cost recovery period of ten years. The argument against this method is that it may result in excessive cost recovery periods for used machinery and equipment. The Task Force, however, considers that this method is consistent with the concept of the capital cost recovery system and is simple, and that the allowance of full deduction upon an early retirement should adequately protect taxpayers in the normal situation. Our recommendation as to used property is, however, subject to the comments we made in section 4 above with respect to the possible modification of the proposal than shorter-than-standard cost recovery periods may not be established by taxpayers.

For purposes of illustrating the application of our recommendation we are setting forth in the following table the present guideline lives and the proposed cost recovery periods for the first two categories of Group One and all categories of Group Three of the present guidelines.

TABLE IV.—*Proposed Cost Recovery Periods Compared with Present Guideline Lives*

	Present guideline lives (years)	Proposed cost recovery periods (years)
GROUP 1		
DEPRECIABLE ASSETS USED BY BUSINESS IN GENERAL		
1. Office furniture, fixtures, machines and equipment	10	6.0
2. Transportation equipment:		
(*a*) Aircraft (air frames and engines, except aircraft of air transport companies)	6	5.0
(*b*) Automobiles, including taxis	3	3.0
(*c*) Buses	9	5.5
(*d*) General-purpose trucks:		
Light (actual unloaded weight less than 13,000 lbs.)	4	4.0
Heavy (actual unloaded weight 13,000 lbs. or more)	6	5.0
(*e*) Railroad cars (except cars of railroad companies)	15	9.0
(*f*) Tractor units (over-the-road)	4	4.0
(*g*) Trailers and trailer-mounted containers	6	5.0
(*h*) Vessels, barges, tugs and similar water transportation equipment	18	11.0
* * *		
GROUP 3		
MANUFACTURING		
1. Aerospace Industry	8	5.0
2. Apparel and Fabricated Textile Products	9	5.5
3. Cement Manufacture	20	12.0
4. Chemicals and Allied Products	11	6.5
5. Electrical Equipment:		
(*a*) Electrical equipment	12	7.0
(*b*) El ctronic equipment	8	5.0
6. Fabricated Metal Products	12	7.0
7. Food and Kindred Products, Except Grain and Grain Mill Products, Sugar and Sugar Products, and Vegetable Oil Products	12	7.0
8. Glass and Glass Products	14	8.5
9. Grain and Grain Mill Products	17	10.0
10. Knitwear and Knit Products	9	5.5
11. Leather and Leather Products	11	6.5
12. Lumber, Wood Products and Furniture	10	6.0
13. Machinery, Except Electrical Machinery, Metalworking Machinery, and Transportation Equipment	12	7.0
14. Metalworking Machinery	12	7.0
15. Motor vehicles and Parts	12	7.0
16. Paper and Allied Products:		
(*a*) Pulp and Paper	16	9.5
(*b*) Paper Finishing and Converting	12	7.0

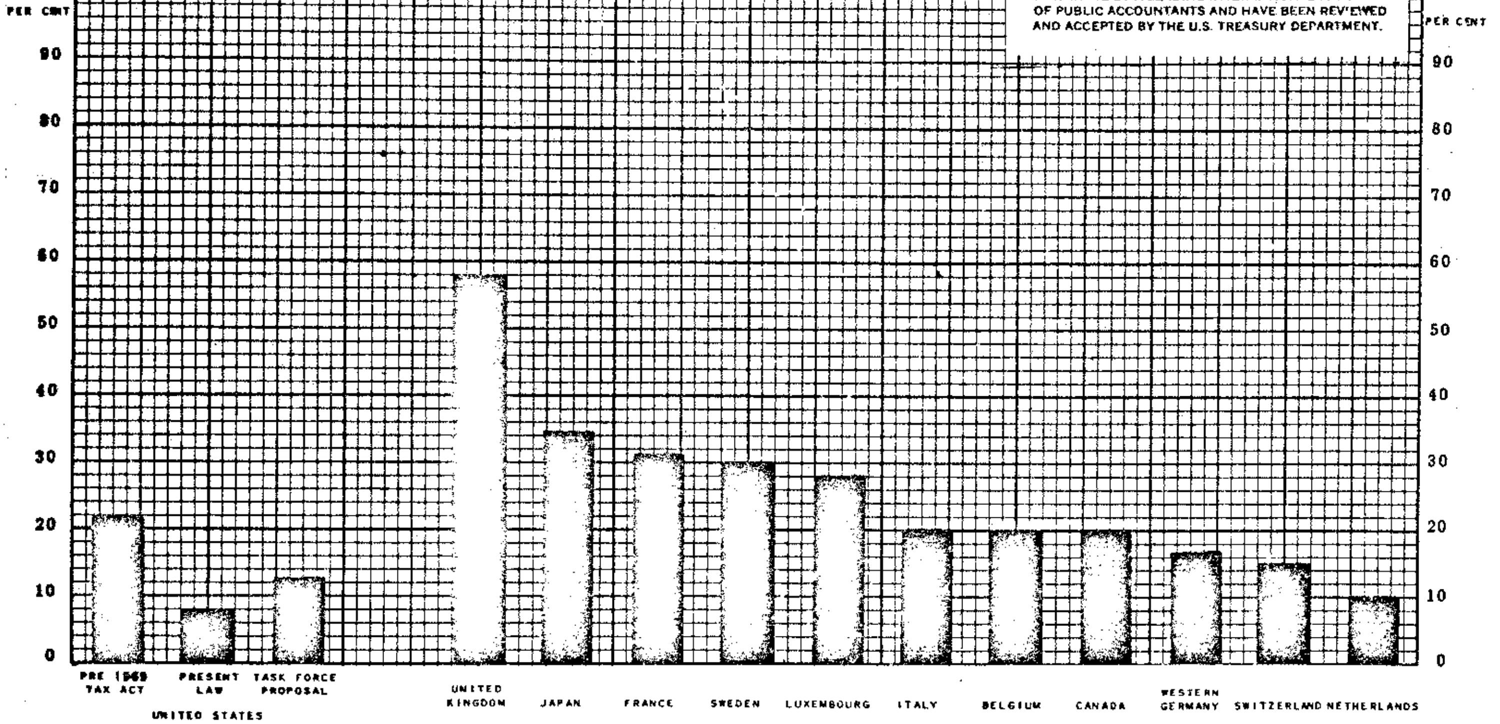
402-574 O—76——5

TABLE IV.—*Proposed Cost Recovery Periods Compared with Present Guideline Lives*—Continued

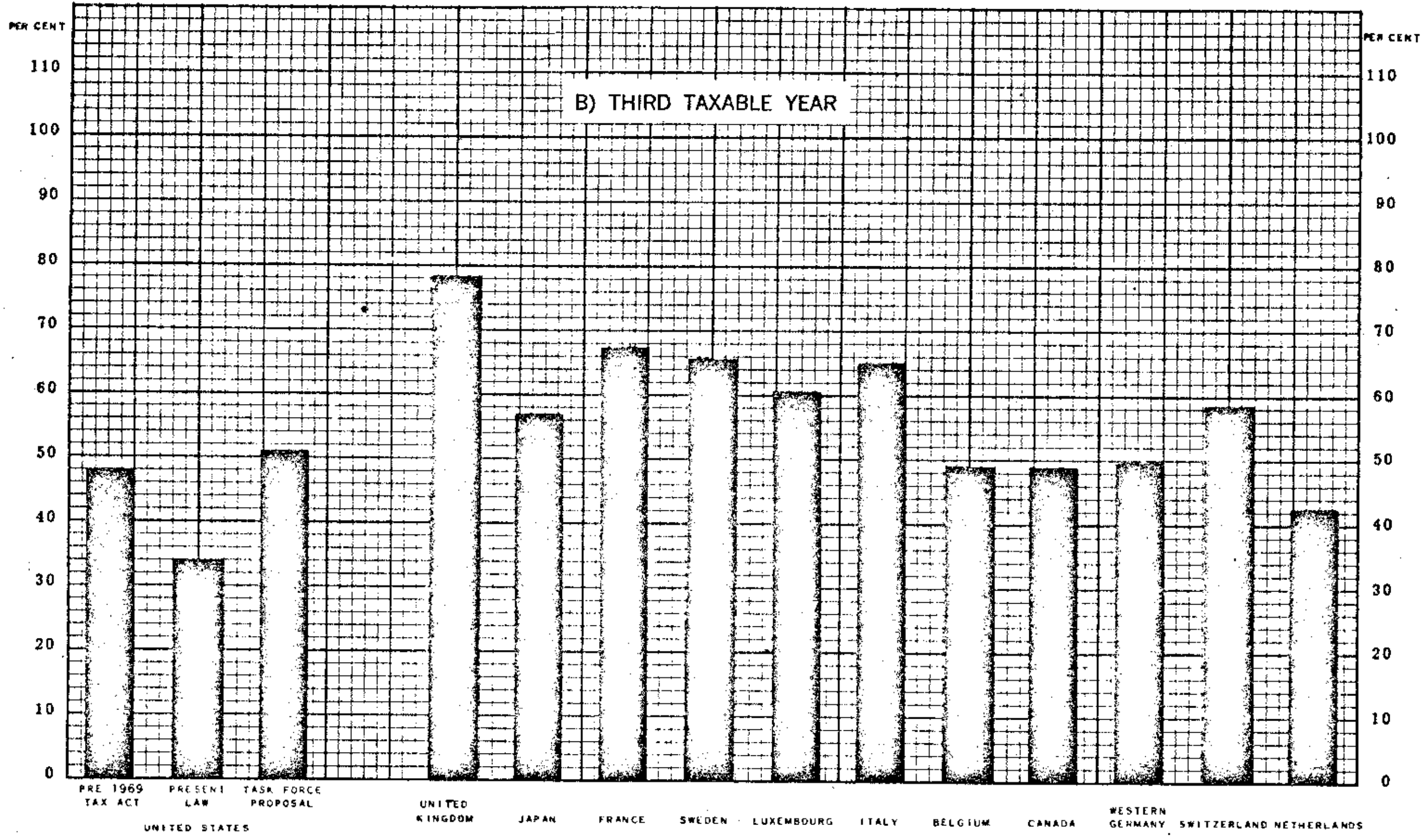
	Present guideline lives (years)	Proposed cost recovery periods (years)
MANUFACTURING—Continued		
17. Petroleum and Natural Gas:		
(*a*) Drilling, Geophysical and field services	6	5.0
(*b*) Exploration, drilling and production	14	8.5
(*c*) Petroleum refining	16	9.5
(*d*) Marketing (petroleum and natural gas)	16	9.5
18. Plastics Products	11	6.5
19. Primary Metals:		
(*a*) Ferrous metals	18	11.0
(*b*) Non-ferrous metals	14	8.5
20. Printing and Publishing	11	6.5
21. Professional, Scientific, and Controlling Instruments; Photographic and Optical Equipment; Watches and Clocks	12	7.0
22. Railroad Transportation Equipment	12	7.0
23. Rubber Products	14	8.5
24. Ship and Boat Building	12	7.0
25. Stone and Clay Products, Except Cement	15	9.0
26. Sugar and Sugar Products	18	11.0
27. Textile Mill Products, Except Knitwear		
(*a*) Textile mill products, excluding finishing and dyeing	14	8.5
(*b*) Finishing and dyeing	12	7.0
28. Tobacco and Tobacco Products	15	9.0
29. Vegetable Oil Products	18	11.0
30. Other Manufacturing	12	7.0

Graph D is a bar chart showing a comparison of the capital cost recovery that would be permitted under our proposal for a 40 percent reduction in recovery periods with capital cost recovery currently permitted under the laws of Japan, Canada and the industrial nations of Western Europe. Comparisons are made at the end of one, three and seven years, and capital cost recovery permitted under United States law is also shown both prior to repeal of the investment credit and under present law with no such credit.

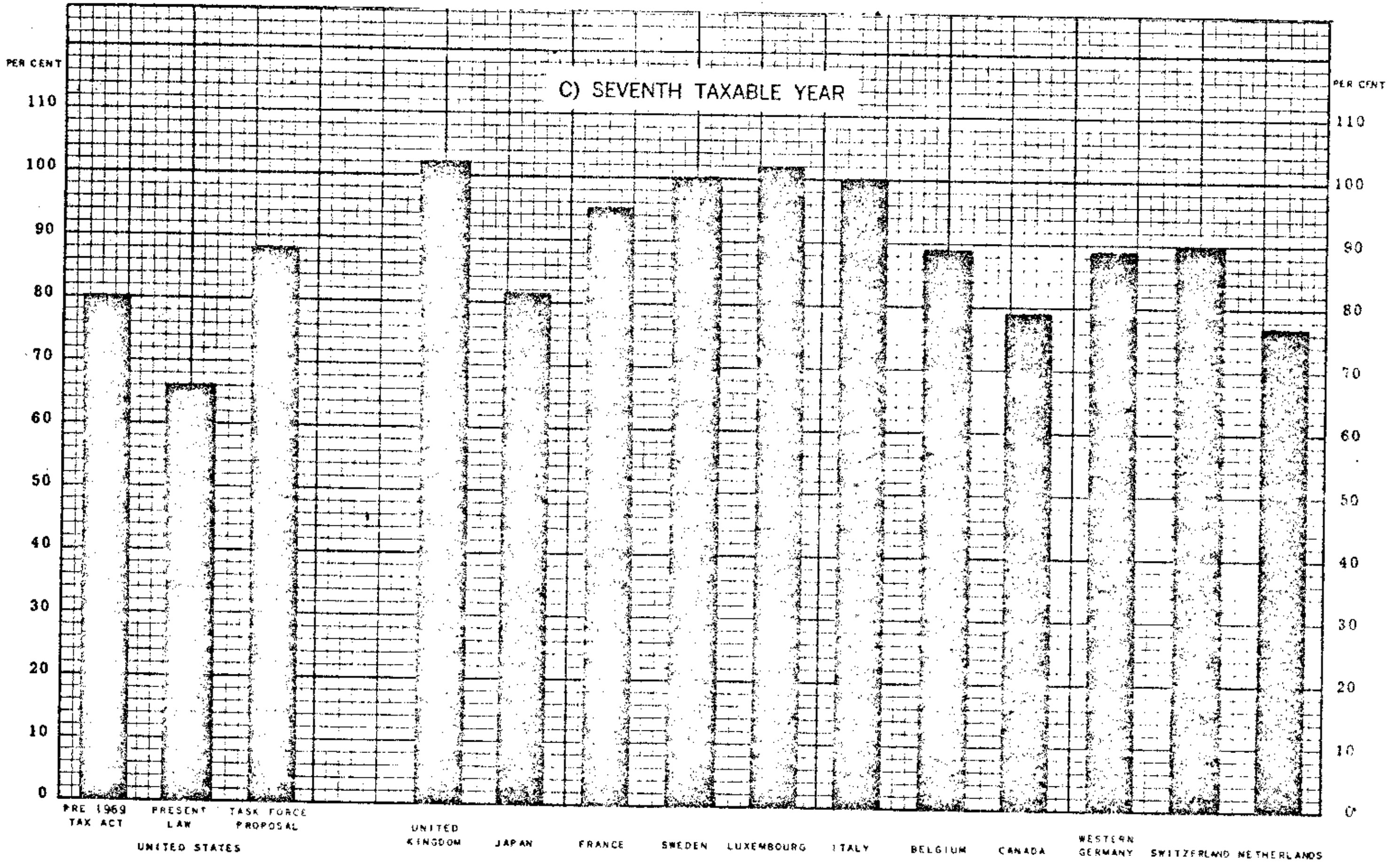
Under our recommendation, the United States cost recovery allowance in the first year would be substantially less than allowances permitted in all the countries shown with the exception of the Netherlands, which has an allowance substantially the same as that permitted under our proposal. By the end of the third year, capital cost recovery for invest-


GRAPH 6
March, 1970
AGGREGATE COST RECOVERIES ALLOWABLE FOR TAX PURPOSES IN THE UNITED STATES*
AND IN ELEVEN FOREIGN COUNTRIES ON MACHINERY AND EQUIPMENT
A) FIRST TAXABLE YEAR
*CAPITAL COST RECOVERY ALLOWANCES SET FORTH ON THIS GRAPH WERE GATHERED BY THE TASK FORCE AND HAVE BEEN REVIEWED AND APPROVED IN WRITING BY A LEADING INTERNATIONAL FIRM OF PUBLIC ACCOUNTANTS AND HAVE BEEN REVIEWED AND ACCEPTED BY THE U.S. TREASURY DEPARTMENT.
PER CENT
90
80
70
60
50
40
30
20
10
0
PRE 1969 TAX ACT
PRESENT LAW
TASK FORCE PROPOSAL
UNITED STATES
UNITED KINGDOM
JAPAN
FRANCE
SWEDEN
LUXEMBOURG
ITALY
BELGIUM
CANADA
WESTERN GERMANY
SWITZERLAND
NETHERLANDS

GRAPH D



GRAPH D



ment in the United States would still be less than in the United Kingdom, Japan, France, Luxembourg, Sweden, Italy and Switzerland, and the same or only slightly greater than in the case of the other countries. By the end of the seventh year (and, of course, by that time only one year would remain under our proposal for a 40 percent reduction of an assumed thirteen-year recovery period) United States cost recovery allowances still would not be equivalent to those of the United Kingdom, France, Luxembourg, Sweden and Italy.

"Special purpose" structures.—We recommend that "special purpose" structures be treated on the same basis as the machinery and equipment to which they relate rather than as real property. The problem is to define a "special purpose" structure in a way that is equitable to both the taxpayer and the revenue. Such a definition would be designed to afford favorable treatment, at the very least, to any structure of such a character that it would have to be substantially rebuilt upon removal or replacement of the equipment it was constructed to support, house or otherwise serve.

Implementation of Recommendations

We recommend that the proposals discussed above be implemented by appropriate amendments of the Internal Revenue Code. The proposals in section A for substituting in the case of machinery and equipment a system of cost recovery allowances for the present depreciation system involve some matters that have been dealt with under the present system by administrative procedures and regulations rather than by changes in the statute. For example, the reserve ratio test was formally introduced in Revenue Procedure 62–21, and, although our proposal for elimination of the test could be effectuated by administrative action, we strongly urge amendment of the statute to this end. Moreover, since the shift from depreciation to cost recovery unrelated to the useful life concept does require amendment of the present law, we urge that all the matters covered in the recommendations which are related to such a shift be incorporated in the statute.

For example, one of our proposals is that the statute would designate groups of property in accordance with existing guideline groupings and would assign standard cost recovery periods thereto. We believe that this proposal should be incorporated into the statute together with authority for the Secretary or his delegate to modify such groupings from time to time, subject to the proviso that regroupings not involve an increased cost recovery period for facilities in any group.

Revenue Implications

In estimating the effects of our recommendations upon tax liabilities of business income taxpayers, we have relied on a consistent set of assumptions. Since different assumptions could have a major impact on the revenue estimates, these estimates are useful only in so far as the assumptions are accepted. A significant difference in the assumed rate of growth of investment in production facilities, for example, will substantially alter the revenue consequences. A major change in the composition of investment would also change the estimated revenue effects. All estimates were made by the Treasury Department, whose representatives, in this as in all matters with which we have dealt, gave complete and untiring cooperation.

Crucial Assumptions Underlying Estimates

The projected revenue losses are based on an estimated $76 billion of investment in equipment in 1971. This investment base is assumed to grow at the rate of five percent per year. Any effect that the proposed tax changes might have on the rate of growth of investment is ignored.

The estimate of total investment is based upon separate ones as to various classes of property such as farm equipment, fabricated metal products, etc. The initial estimate was for 1971, and it was assumed that no change in the proportional composition of this investment would occur. Commerce Department estimates of the depreciable lives used for tax purposes and the proportion of investment depreciated at straightline and accelerated methods under present law were employed.[11] A 45 percent marginal tax rate was assumed.

Using the above assumptions concerning 1971 investment, growth rate, depreciation method, and marginal tax rate, the Treasury, at our request, has projected future depreciation deductions under the present law and cost recovery allowances under the proposed changes, and also the future revenue loss from the acceleration of cost recovery allowances under the various proposed changes.

Using the same assumptions, Table V shows the amount of the annual reduction in business income tax liabilities that would result if the investment tax credit were retained in the law. This table affords the basis for comparison of the revenue effects of our proposals for acceleration of cost recovery allowances with the revenue effects that would have accompanied continuation of the investment tax credit.

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[11] See Allan H. Young, "Alternative Estimates of Corporate Depreciation," Department of Commerce, Office of Business Economics, *Survey of Current Business* 17–28 (April 1968).

TABLE V.*—*Tax Revenue Cost of Investment Credit***

Year:	Billions of dollars	Year:	Billions of dollars
1971	$3.6	1984	$6.9
1972	3.8	1985	7.2
1973	4.0	1986	7.6
1974	4.2	1987	7.9
1975	4.4	1988	8.3
1976	4.6	1989	8.8
1977	4.9	1990	9.2
1978	5.1	1991	9.7
1979	5.4	1992	10.1
1980	5.6	1993	10.6
1981	5.9	1994	11.2
1982	6.2	1995	11.7
1983	6.5		

*Source: United States Treasury, Office of Tax Analysis.
**Assumes 5 percent per annum growth in investment.

If our recommendation—that recovery periods for machinery and equipment be reduced 40 percent from the present guideline lives, subject to the proposed five-year limitations—is adopted, the estimated revenue losses are as shown in Table VI.

TABLE VI.*—*Tax Revenue Cost of 40 Percent Reduction in Cost Recovery Periods for Machinery and Equipment***

Year:	Billions of dollars	Year:	Billions of dollars
1971	$1.4	1984	$3.6
1972	3.7	1985	3.7
1973	5.1	1986	3.8
1974	6.1	1987	4.0
1975	7.3	1988	4.1
1976	7.6	1989	4.3
1977	6.9	1990	4.5
1978	6.4	1991	4.7
1979	5.6	1992	5.0
1980	4.9	1993	5.2
1981	4.3	1994	5.5
1982	3.8	1995	5.8
1983	3.6		

*Source: United States Treasury, Office of Tax Analysis.
**No recovery period reduced to less than 5 years. Assumes half-year convention and 5 percent per annum growth in investment.

For purposes of comparison we are setting forth in Graphs E and F bar charts comparing the revenue costs of our proposal with the costs of continuing the investment credit. Graph E assumes a five percent annual growth. It will be noted that, on this basis, the Federal Government would be approximately $52 billion better off in 1995 than if the investment credit had been retained.

Graph F is based upon an assumption of no growth. On this basis, by 1995 the Federal Government would be $42.5 billion better off than if the investment credit had been retained.

In order that the revenue losses may be considered in proper perspective, table VII has been prepared showing the following:

1. The estimated annual revenue cost that would result if the investment tax credit were retained in the law—from Table V.

2. The estimated revenue cost that would result from adoption of our recommendation that cost recovery periods for machinery and equipment be reduced 40 percent from present guideline lives, subject to the proposed five-year limitations—from Table VI.

3. The estimated revenue from the Federal income tax on corporations and unincorporated businesses, giving effect to the changes made by the 1969 Tax Act but not to our recommendations.

4. The estimated total revenue from the Federal income tax, giving effect to the changes made by the 1969 Tax Act but not to our recommendations.

In evaluating the estimated revenue costs of adoption of our recommendations, a number of considerations should be kept in mind. As will be seen from Table VII, these estimates are based upon the estimated growth of the GNP and the consequent growth of the revenue from the existing Federal income tax structure. In making the estimates, the Treasury Department has assumed a GNP growth rate of five percent per annum and a five percent per annum growth in purchase of production facilities. It should be emphasized, therefore, that the estimated revenue costs from the adoption of our recommendations are very much larger than those that would be involved if the estimates were based upon the present GNP, investment in production facilities and revenue collections. This point is well illustrated by a comparison of Graph E with Graph F.

Furthermore, as noted above, the estimates of revenue costs resulting from the adoption of our proposals take no account of the expected favorable effects on the rate of expansion of productive capacity throughout the economy with resulting additional increases in productivity, hence of personal income and business profits. In other words, these estimates should not be read as *net* revenue losses. Indeed, these apparent losses might well prove to be the keys to greater revenue gains than would otherwise be possible.

Finally, these apparent revenue losses should be assessed in the context of the objectives sought by the changes we have proposed. The Task Force is unanimous in the view that the proposed changes would contribute significantly to the attainment of these objectives, and that the long-term benefits would be well worth the costs involved.

MARCH, 1970

GRAPH E

IMPACT ON TAX REVENUE OF TASK FORCE PROPOSAL

COMPARED WITH ELIMINATED INVESTMENT CREDIT

On
75.7 Billion
1971 INVESTMENT

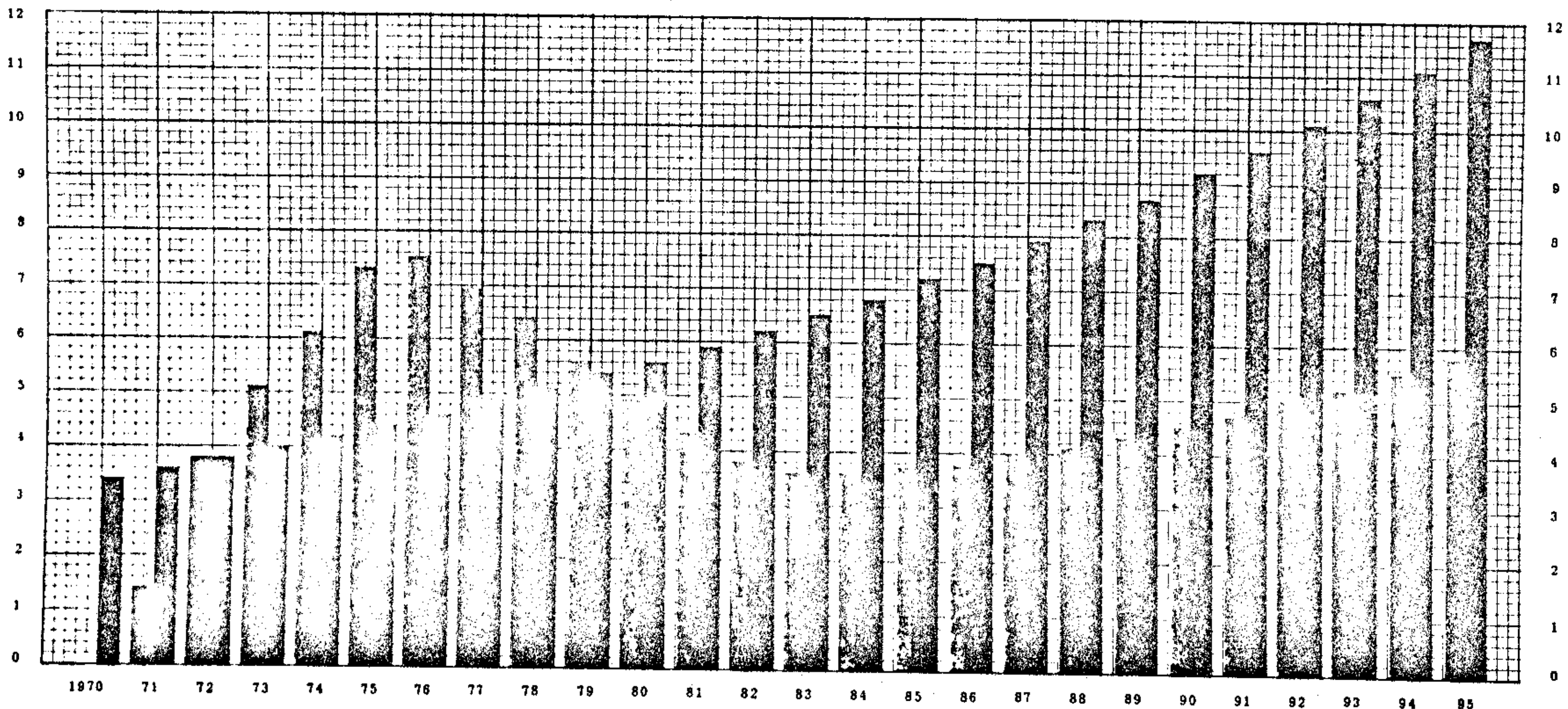
assuming 5% annual growth

To
244.0 Billion
IN 1995

CUMULATIVE REVENUE GAIN TO TREASURY - THROUGH 1995

3.4	5.6	5.7	4.6	2.7	(0.2)	(3.1)	(5.1)	(6.4)	(6.6)	(5.9)	(4.3)	(1.9)	1.0	4.2	7.7	11.4	15.3	19.5	23.9	28.6	33.5	38.6	44.0	49.6	55.5

ANNUAL $ IN BILLIONS



40% REDUCTION IN GUIDELINE LIVES WITH NO LIFE REDUCED TO LESS THAN 5 YEARS

INVESTMENT CREDIT

DATA SOURCE
U.S. TREASURY

402-574 O - 70 (Face p. 3?) No. 1

TABLE VII*

[In billions of dollars]

Calendar Years	Investment tax credit revenue cost	40 percent reduction depreciable lives revenue cost**	Revenue from income tax on corporations and unincorporated businesses	Total revenue from income taxes
1971	3.6	1.4	47.9	129.6
1972	3.8	3.7	53.4	139.4
1973	4.0	5.1	60.4	151.6
1974	4.2	6.1	66.2	163.4
1975	4.4	7.3	70.7	174.0
1976	4.6	7.5	74.4	183.9
1977	4.9	6.9	78.2	194.4
1978	5.1	6.4	82.3	205.4
1979	5.4	5.6	86.6	217.1
1980	5.6	4.9	91.2	229.4
1981	5.9	4.3	95.9	242.4
1982	6.2	3.8	100.8	256.2
1983	6.5	3.6	106.1	270.8
1984	6.9	3.6	111.6	286.2
1985	7.2	3.7	117.5	302.6
1986	7.6	3.8	123.6	319.8
1987	7.9	4.0	130.1	338.0
1988	8.3	4.1	136.9	357.3
1989	8.8	4.3	144.0	377.7
1990	9.2	4.5	151.6	399.2
1991	9.7	4.7	159.5	422.0
1992	10.1	5.0	167.8	446.1
1993	10.6	5.2	176.6	471.6
1994	11.2	5.5	185.9	498.6
1995	11.7	5.8	195.6	527.0

*Source: United States Treasury, Office of Tax Analysis Assumes half-year convention and 5 percent per annum growth in investment.

**No recovery period reduced to less than 5 years.

Source: Wall Street Journal, January 12, 1971, p.2. Reproduced with permission.

Treasury Issues Liberalized Rules On Depreciation

Purchase of More Efficient Machinery Is to Be Aided By a 'Simplified' System

Jobs, Inflation Are Targets

By RICHARD F. JANSSEN and ALBERT R. HUNT
Staff Reporters of THE WALL STREET JOURNAL

WASHINGTON — The Treasury issued optional new depreciation rules that give businesses much more leeway in the speed with which they write off equipment for tax purposes.

What the Treasury described as a "simplified and modernized" system is designed to stimulate purchase of more efficient machinery, the department said, in order to hold down inflation while spurring employment.

The direct revenue loss through allowing businesses to bunch their depreciation deductions more tightly, the Treasury said, will be $800 million in the current fiscal year, ending June 30, and $2.7 billion in the next one; the revenue losses will climb to $4.1 billion by fiscal 1976, it said, and then decline to $2.8 billion by fiscal 1980.

The key features of the new approach are:

—An optional "asset depreciation range" system, under which each business can chose to take its depreciation deductions in a period up to 20% shorter—or up to 20% longer—than specified in the continuing standard "guideline lives" for various items.

—A choice of "first year conventions," which let those using the asset depreciation range take more generous deductions soon after new equipment is installed.

—And abolition of the "reserve ratio test" so that those choosing to stick with the old guideline lives needn't prove that they're actually replacing equipment that rapidly.

Paul W. McCracken, chairman of the President's Council of Economic Advisers, conceded that the initial impact on capital spending will be minimal. By the end of 1971, he told a news conference here, it "might make a difference" of around $1 billion. The Government's latest survey projects that capital spending will rise only 1.4% to $81.67 billion this year.

Mr. McCracken observed that in 1962, the last time depreciation rules were liberalized, it took about "a year or so" to make a significant impact, and he said he expects a similar lag this time.

Administration officials also insisted this action was different from a corporate tax cut. In a prepared statement, President Nixon said that a liberalized depreciation allowance "is essentially a change in the timing of a tax liability. The policy permits business firms to reduce tax payments now, when additional purchasing power is needed, and to make up these payments in later years."

At the Western White House in San Clemente, Calif., Treasury Under Secretary Charls E. Walker stressed the same point, observing that the depreciation changes aren't "the same as an investment tax credit or a corporate tax reduction."

But the Treasury, in a fact sheet on the changes, said that a business's taxes won't be increased in future years if it replaces its "facilities consistent with the new periods" or enlarges its productive capacity. And Mr. Walker conceded that under the new plan businesses essentially receive "an interest-free loan."

Treasury Secretary Kennedy, at a Washington, D.C., news conference, conceded that the changes are "one method" of providing a better balance between consumption and investment. In September 1969, the Treasury Secretary cited the need for this "better balance" in calling for a reduction in the corporate tax rate to 46% from 48%. Congress, however, never acted on this proposal.

Another argument cited by Administration officials for the changes was the competitive position of U.S. industry with other nations. Even after the changes, Mr. Walker said, depreciation allowances for U.S. industries would lag well behind that of most other major industrialized nations. But he added this wasn't to imply that any further changes were planned.

Mr. Kennedy insisted that the "power and authority" existed to make these changes administratively, rather than seeking Congressional approval, and noted the "uncertainties" of going the legislative route.

The Treasury Secretary said certain Congressmen, including Chairman Mills (D., Ark.) of the House Ways and Means Committee, were consulted and that Rep. Mills agreed that legislation wasn't required. United Press International quoted Mr. Mills as saying that while he had no objection to the depreciation moves, he did question whether this alone would accomplish the stated objective of helping the economy.

But Rep. Reuss (D., Wis.) a member of the Congressional Joint Economic Committee, was sharply critical of the move, which he said "amounts to a $2 billion bonanza for business, rewarding businessmen with tax deductions for capital spending they would undertake in any case."

He added that the Administration "cannot restore consumer confidence until it shifts its efforts from concocting bonanzas for business to taking meaningful steps to halt inflation. It ought to be plugging existing tax loopholes not making new ones."

The move also was blasted by Lane Kirkland, secretary-treasurer of the AFL-CIO. "The President is helping those who need it least at the expense of those who need it the most," Mr. Kirkland said. He further charged that "President Nixon's bonanza to business undoes much of the progress toward tax justice made by Congress in the Tax Reform Act of 1969."

For an individual company, the Treasury said, the immediate impact could be to more than double its 1971 depreciation deductions. A manufacturer that purchased $15,000 of lathes in 1970, for instance, could deduct only $3,000

(Treasury Issues cont.)

under the five-year depreciation period specified then. But the identical purchase in 1971 could bring it a $6,250 deduction, the department said, assuming that it took advantage both of the 20% shorter life option for a four-year write-off period and the revamped first year deduction choice.

Although most companies clearly would want to use the shorter write-off periods, officials suggested that small, new companies and those currently running at a loss might wish to adopt longer depreciation periods so that they'd save some of the tax benefit of equipment purchases for a time when their earnings might be higher.

The liberalized rules generally apply to assets physically placed in service after Dec. 31, 1970, the Treasury said, but don't apply to buildings and real estate improvements; pending further study, it said, the asset depreciation range choice won't be open to telephone, electric, gas or water utilities, although it will apply to property of railroads, airlines and trucking companies.

Further study is being given, the Treasury added, to the extent to which the depreciation-range option should apply to "special purpose structures or enclosures" that are closely related to the machinery they house. As to items for which guideline life standards don't exist, the Treasury said it will try to work out ranges with the industries involved.

With the 1962 guideline life as the base for each class of capital goods, the Treasury said, the Internal Revenue Service will publish tables showing the outer limits of 20% either way in terms of years, rounded to the nearest half year. Taxpayers operating within those ranges won't be challenged, the Treasury said, eliminating the administrative burden on both business and the IRS of arguing about individual items.

Businesses will be able to decide each year when they submit their income tax return whether they wish to apply the wider ranges, the Treasury said. They can vary their practices from one year to another, it noted, with each year's "election" applying only to assets put in service during that year.

Different periods within the range may be selected for different years, it said, and a taxpayer with more than one business needn't apply it to all of them. Accelerated depreciation methods can't be used, however, on an asset for which the range permits a write-off period shorter than three years.

Those using the asset depreciation range will be permitted to continue treating all assets acquired in a taxable year as dating from mid-year, the Treasury said, but may also choose the "new modified first year convention." This feature will let a company treat all assets acquired in the first half of a year as dating from the start of the year, and assets acquired in the second half as put in service at mid-year, providing 75% of a full year's deduction if equal amounts are acquired in the two halves.

The new "convention" will apply only to users of the asset depreciation range, the Treasury stressed, and if chosen must apply to all multiple asset or individual item accounts for that year; different methods may be used in subsequent years, however.

Taxpayers shunning the depreciation range and sticking with the basic guideline lives, the Treasury advised, won't be subject to the "reserve ratio test" for taxable years ending after Dec. 31, 1970. This complex formula had been vigorously defended by Democratic administration officials as needed to guard against excessive deductions. If a company deciding to stick with the old guideline lives hasn't met the test for all prior years, however, the Treasury said it may still adjust its asset lives accordingly.

The adjusted version for the last taxable year ending before Jan. 1 will be used for subsequent years, it said, but no further adjustments may be made by the test for any subsequent year.

Among other points, the Treasury said a taxpayer may apply the depreciation-range method to used assets put in service after 1970. But a taxpayer needn't do so even if he is applying it to new assets in a year when used assets account for more than 10% of total assets put in service, with the capitalized cost of repairs counting as a used asset for this purpose. Also, the Treasury said it's still studying the extent to which the method should apply, for purposes of computing foreign tax credits, to foreign subsidiaries of U.S. companies.

Easing of Depreciation Rules Won't Spur Capital-Spending Flood, Survey Indicates

A WALL STREET JOURNAL *News Roundup*

President Nixon's new liberalized-depreciation rules aren't likely to unleash a flood of corporate capital spending in the immediate future.

"If something marginal comes along, this might swing it," said William Agee, vice president, finance, of Boise Cascade Corp., Boise, Idaho. "But it won't drastically change our plans. Only better business will do that," he declared.

Such is the lethargic reaction of a score of businessmen across the country to the new depreciation rules unveiled by the Treasury yesterday afternoon in Washington.

In response to questions by The Wall Street Journal, corporate executives and economists overwhelmingly agreed that only an improved business outlook will spur company spending in the months ahead for new plant and equipment.

"A depreciation plan like this isn't a very effective initiating factor," explained James J. O'Leary, vice chairman and chief economist for U.S. Trust Co., New York. In his view, capital spending won't climb until there has been a "healthy rise" in corporate profits and consumer spending. "Without this, no amount of special incentives will have the desired impact," he asserted.

Companies will want to use up their idle plant capacity before spending for any new facilities, predicted James Cooper, a vice president and director of research at Irving Trust Co., New York.

"You don't change your existing plans for this kind of thing," concurred William Perks, financial vice president and treasurer of Norton Co., an abrasives manufacturer headquartered in Worcester, Mass. "Its impact on Norton in 1971 is highly questionable," he said.

One producer of automation and measurement equipment, Esterline Corp., looked for gains as a result of the liberalization. "This move will stimulate the release of many orders that have been quoted on but held in abeyance for the last six to eight months," said Raymond S. Fries, senior vice president in New York.

Some others look for gains in the years ahead. Among them is Albert H. Cox Jr., chief economist of Lionel D. Edie & Co. and senior economic adviser to its parent, Merrill Lynch, Pierce, Fenner & Smith Inc. He suggested in New York that while the depreciation move "will have a marginal impact in the second half of this year," it could have a "more significant" effect in 1972 and 1973.

Mr. Cox insisted, however, that depreciation guidelines aren't "the key to reviving the economy." He said the principal ingredient is the monetary policy that the Government has been following for the past year. The economist predicted consumer buying will climb 7% this year because of the monetary policies. "Without this, the liberalized write-offs wouldn't mean very much," he stated.

Milton Friedman, the influential economist at the University of Chicago, asserted: "On the whole I am dubious that the change will have much short-term effect." The move, he said, "won't be effective" in stimulating the economy. But he suggested that any increased demand for loans to finance capital improvements could put a floor under interest rates.

Even if they don't spur capital spending in the immediate future, the new depreciation rules could mean handsome tax savings and additional cash for companies. Generally, the amount deducted for depreciation, lumped together with after-tax earnings, make up a company's cash flow.

Charles R. Allen, vice president and chief financial officer of TRW Inc., estimates a 20% reduction in depreciation lives will boost the cash flow of the Cleveland-based aerospace company $400,000 to $500,000 in the first year. For the second year, the gain could jump to "a little over $1 million," he said.

Not that TRW plans to increase its spending because of the windfall. "I doubt seriously that a change in depreciation guidelines would affect our spending rate," he said.

Source: Wall Street Journal, January 12, 1971, p.2. Reproduced with permission.

Business Gets U.S. Tax Help

Nixon Eases Deductions to Aid Investment

By Robert J. Samuelson
Washington Post Staff Writer

The Nixon administration yesterday announced a major overhaul of tax depreciation regulations, allowing businessmen more generous tax deductions for investment in new equipment. The changes, which will cost the Treasury $2.6 billion in corporate taxes this year, are designed to stimulate lagging investment.

The announcement came four days after the Labor Department reported that unemployment had reached a nine-year high of 6 per cent in December.

At a press briefing at the Western White House in San Clemente, Charls Walker, Under Secretary of the Treasury, said the changes had been under intensive consideration since December, but added:

"This is good stuff for the economy . . . It will put people to work."

According to economists in Washington, however, it may be a year before the tax changes have any significant influence on the job market.

"The impact will build fairly slowly," said Paul McCracken, chairman of the President's Council of Economic Advisers, at a Washington press briefing. "It takes some time for these decisions (about future investment) to be changed."

McCracken ventured that the depreciation liberalization might encourage $1 billion in additional investment by the fourth quarter of 1971. Both he and Walker studiously avoided estimating any net increase in jobs.

The significance of the changes, McCracken emphasized, lies in the long-range stimulus to investment in more efficient plant equipment, which should help businesses offset wage increases and remain competitive in international markets.

Affected by the downturn in the economy and the poor performance of corporate profits, new business investment in 1971 was expected to remain nearly stagnant, rising only 1.8 per cent to $81.7 billion, according to the latest government surveys. In 1970, the increase was an estimated 6.6 per cent.

Nevertheless, the new tax plan was strongly criticized yesterday by the AFL-CIO, which condemned the Nixon administration's "further commitment to the 'trickle-down' theory of economics."

"In this time of recession, inflation, and 6 per cent unemployment, it is incredible that the President can find no better action than to extend a tax windfall of several billion dollars to the nation's corporations," the AFL-CIO said.

In another statement, Sen. George McGovern (D-S.D.) said that the depreciation changes are "among the least effective ways of stimulating the economy."

Another Democrat — who asked to remain anonymous— said that the depreciation liberalization, by offering relief for business, would create a bad political climate for President Nixon's "bipartisan" approach to economic recovery.

The administration first raised the possibility of a major revision of the depreciation regulations in 1969 as a partial offset to the repeal of the 7 per cent investment tax credit. That credit — sponsored by President Kennedy and enacted in 1962—resulted in a multi-billion-dollar tax savings for firms with large investments.

Under the depreciation provisions of the tax law, businesses are allowed to recover the cost of their plant investments by annual tax deductions over the expected "life" of the piece of machinery.

Normally, most businesses utilize "accelerated" depreciation techniques, allowing them to deduct a high percentage of equipment's cost in the early years of use and smaller percentage in its later years.

Accelerated depreciation only works as a permanent tax savings—and a lasting incentive to new investment— if the business reinvests its savings in new equipment.

If it doesn't the tax savings of the early years will be offset by tax increases in the later years of a piece of equipment's life. But if the firm does reinvest at an increasingly high volume—which most firms do—it will generate new deductions and new tax savings.

Source: Washington Post, January 12, 1971, p. A1, A4. Reproduced with permission.

(Business Gets U.S. Tax Help cont.)

Tax Depreciation Allowance Overhauled to Aid Business

Machinery Life Shorter

What the Treasury did yesterday was allow industries to shorten the average "life" of a piece of machinery. The Treasury said that businesses could shorten the depreciation period by 20 per cent; thus, if the depreciation "life" for a piece of machinery was 10 years, it could now be reduced to 8 years, meaning that the full cost could be recovered in eight years instead of 10.

In addition, the Treasury:

• Liberalized the regulations that allowed a firm to take a half year of depreciation for a piece of equipment placed in service any time during a year. Under the new regulations, firms will be able to take a full year's depreciation on anything purchased in the first half year, and a half year on anything purchased in the final six months.

• Eliminated the so-called "reserve-ratio" test. (Under that test, businesses had to make a rough justification of the actual amount of time they used a piece of equipment and the "life" they claimed for depreciation purposes.

Treasury Department officials said yesterday that the "reserve-ratio" test — if rigorously applied—threatened to create a multitude of administrative problems, and disputes between government attorneys and businesses.)

The new regulations become effective for all equipment placed in service after Dec. 31, 1970. Electric, gas and telephone utilities were excluded, however.

According to the Treasury Department's estimates, the tax losses will be $0.8 billion for Fiscal 1971 (ending June 30, 1971) and $2.7 billion for Fiscal 1972, rising to a peak of $4.1 billion in Fiscal 1976 and declining to $2.8 billion in Fiscal 1980.

The depreciation changes face a legal challenge. Lawyers from Ralph Nader's Public Interest Research Center filed suit in federal district court, claiming that the Treasury did not adhere to the Administrative Procedures Act, which requires prior notice and public comment before the issuance of certain public regulations.

Although a petition for a temporary restraining order was denied, further hearing on the issue has been scheduled before Judge John Pratt.

Depreciation Easing Was Only a Proposal, Administration Says; Effect of Suit Denied

By RICHARD F. JANSSEN
Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON — The major depreciation easing that President Nixon "approved" Monday will be subject to change after regulations are proposed and public hearings held, Treasury officials said.

This was the intention from the start, they said, denying any connection with a lawsuit filed Monday by associates of consumer advocate Ralph Nader. The suit complains that the Treasury didn't give the public legally required advance notice of the multibillion-dollar tax benefit for business and asks that it be blocked.

Basically, the Treasury action allows businesses to write off equipment for tax purposes in periods as much as 20% shorter than before and to recoup more of the cost of such investment in the first year. The larger depreciation deductions, announced as retroactive to Jan. 1, are estimated by officials as costing the Treasury $2.7 billion in revenue in the fiscal year starting next July 1 and about $4 billion four years hence.

The White House and Treasury announcements Monday were widely interpreted as representing final decisions. There wasn't any specific mention of their being merely proposals. The Treasury statement did include a sentence saying that "the income tax regulations will be amended to provide for this system," however, and Treasury men last night said this language implies that the regulations will be issued in proposed form subject to change after public hearings.

This is so because the Administrative Procedure Act requires such steps before any tax regulation is implemented unless the change is "favorable to all taxpayers," Edwin S. Cohen, Assistant Treasury Secretary for Tax Policy, explained. "This could not be in that category," he said, because the new system "may be favorable to some taxpayers but draws a line that would be unfair to others."

Thus, Mr. Cohen said, "the only fair way to proceed" is with proposals and hearings. "I will swear to you," he said, that the draft versions of the statements as of last Saturday and even "earlier in the week" contained the language that he described as conveying this intent.

The injunction request, however, will be pressed even though "the Treasury has decided now" to publish proposals, said Samuel A. Simon, a lawyer with Mr. Nader's Public Interest Research Group. The proposals would be a "sham," he contended, because the President has already made his "announcement of fact" of the policy changes.

It may ta..e a month or so before details of the plan can be put into proposed-regulation form and published in the Federal Register, an official said, but after they are, "we'll be happy to hear everyone" at open hearings.

After opinions are heard, Mr. Cohen said, the Treasury doubtless will still want to adopt the basic system of "ranges," announced as allowing businesses to shorten or lengthen write-off periods for various items as much as 20% from the standard "guideline lives" prescribed by the Treasury back in 1962. It is only "very hypothetically" possible, another official added, that the whole system would be withdrawn.

"But specific rules," Mr. Cohen said, "may be changed" as a result of hearings. The 20% range is "fixed in general," he said, but "the precise terms of how it is to be applied aren't fixed." For instance, he said, the Treasury's plan to express outer limits of the range by rounding to the nearest half year "isn't cut in stone."

Similarly, he said, some business representatives at a Treasury briefing following Monday's press conference raised questions about the provision that a taxpayer using the ranges needn't apply them to newly purchased used equipment if it accounts for more than 10% of total assets put in service in a given year. That cutoff "seemed fair," Mr. Cohen said, but added that "we would be glad to consider if it should be 5% or 10% or 15%."

In their suit, the Nader associates complained that as professional tax-reform advocates they will "suffer professionally because of the deprivation of their opportunity to participate in the making of the rule," that as taxpayers they will suffer because the revenue loss is being incurred "without the procedural safeguards" of the Administrative Procedure Act, and that "businesses will suffer because they will begin immediately to rely on a rule which shall be challenged in the courts as unlawful for failure to comply with" that act.

U.S. District Judge Aubrey E. Robinson, who had denied the temporary restraining order they had sought on the basis of newspaper reports prior to the Treasury action, scheduled a hearing on their request for a preliminary injunction on Jan. 21. Mr. Simon and Thomas H. Stanton, co-plaintiff in the action, said the greatest difficulty they expect is establishing that they have legal "standing" in the depreciation matter, but expressed confidence of prevailing.

In a separate development, the easing of depreciation rules was criticized by former Democratic Administration economist Walter W. Heller as "the wrong thing" to do to stimulate the economy.

The Nixon Administration could have got "far more bang for each buck" by restoring the 7% tax credit for investment in business equipment that lapsed in 1969, Mr. Heller said. He said that easing the depreciation rules was a "passing strange" action following President Nixon's veto of a manpower bill aimed at directly creating public-sector jobs.

Mr. Heller's comments were telephoned to a National Bank of Washington luncheon here from a hospital bed where the University of Minnesota professor is being treated for a back problem. Participating in the same luncheon panel, Paul A. Volcker, Treasury Under Secretary for Monetary Affairs, declined to say which alternative would have been better, remarking that he also was in the Treasury when the 7% credit was enacted in 1962.

Source: Wall Street Journal, January 13, 1971, p. 4.
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Depreciation Move Gets Proxmire, Chamber Nod

Two frequent opponents on matters of economic policy — the U.S. Chamber of Commerce and Wisconsin Democratic Sen. William Proxmire, chairman of the Joint Economic Committee — yesterday endorsed the Nixon administration's depreciation liberalization.

Chamber executive vice president Arch N. Booth said the new rules will "greatly expand employment opportunities and ... give American industry greater opportunities to compete in world markets," by allowing modernization and expansion of industrial facilities.

Proxmire hailed President Nixon's action as a "major step in the right direction to get the economy off dead center." In the long-run, he said, the faster tax write-offs will result in higher productivity and lower business costs. In the short-run it could avoid a "significant downturn" in plant and equipment spending, he said.

U.S. District Court Judge Aubrey E. Robinson set Jan. 21 for hearings on a request for an injunction that would bar the new tax break. Two lawyers associated with Ralph Nader went to court Monday, seeking a restraining order that was denied. The two, Thomas H. Stanton and Sam A. Simon, yesterday predicted eventual victory in their battle to stop what they charged was "illegal" Treasury action to change rules without public hearings.

In Searcy, Ark., yesterday, House Ways and Means Committee chairman Wilbur Mills (D-Ark.), told an Associated Press reporter that the administration's depreciation action makes it harder than ever to accept the administration's revenue-sharing proposals.

Source: Washington Post, January 13, 1971, p. D7.
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Volcker Sees No Extremes

By William H. Jones
Washington Post Staff Writer

A top Treasury Department official declared yesterday that the Nixon administration did not intend to "buy our way out of the unemployment probelm" by returning to previous "extremes" to revive the economy.

At the same time, the government reported slightly higher wholesale prices in December and an 8 per cent retail sales gain during the Christmas shopping season.

Addressing an economic forum of the National Bank of Washington, under secretary for monetary affairs Paul A. Volcker said the administration seeks a "balanced" growth. "If we do it in a careful way," Volcker said, "I don't think we have to fear that inflation will burst upon us with full force . . . it won't disappear, but we will make progress."

Speaking to the same forum by telephone from the University of Minnesota hospital, former Council of Economic Advisers chairman Walter W. Heller stated flatly there was no way the administration could meet the President's announced goal of full employment by the end of 1972.

Heller, now an economics professor at Minnesota, also criticized the administration's liberalized depreciation schedules, announced Monday, as a $2.5 billion tax "bonanza" to big business. "This is not a temporary loss of revenues," he continued, but a "long term, permanent tax loss" that could total $4 billion by 1976. Heller, who was scheduled to speak here, is under treatment for what he described as a "slipping disk."

Another NBW panelist, Commercial Credit Co. senior vice president Daniel H. Brill, expressed doubt that the nation's financial system was getting braced for "the next bout of tight money"—with higher interest rates possible by year's end.

Meanwhile, the Labor Department reported that wholesale prices advanced 0.1 per cent in December, after a decline of the same level in November. The closely-watched industrial commodities wholesale index rose 0.3 per cent last month, after holding steady in November, and were 3.6 per cent higher than December, 1969. The Bureau of Labor Statistics said that after seasonal adjustment, there was basically no change from November in the December index.

For all of 1970, the BLS reported, wholesale prices gained 2.3 per cent—smallest increase in 2½ years. At year-end, the wholesale price index stood at 117.8, meaning wholesalers paid on the average $117.80 in 1970 for every $100 of goods purchased in the 1957-59 base period.

At another meeting here, Assistant Secretary of Commerce for economic affairs Harold C. Passer, revealed that nationwide retail sales in the four-week period ending with the Christmas week rose 8 per cent over 1969 (excluding auto sales). With a price inflation of about 4 per cent, the real sales growth was 4 per cent, "a marked improvement," Passer commented.

"It is also significant that, because retailers in general were cautious in their buying for the Christmas season," Passer said, "their post-Christmas inventories are on the low side. This suggests that they will be re-ordering in good volume in the months ahead, thus giving support to the currently rising trend of business activity." Passer addressed the American Mining Congress.

On other points, Passer rejected an "incomes" policy of wage-price guidelines, because "it doesn't work," and defended as an "educational device" the much-maligned "GNP Clock" of the Commerce Department, which was unveiled Dec. 15, pinpointing that day as the time when the U.S. economy reached $1 trillion in terms of output.

Referring to questions about the amount of inflation in the GNP figures, Passer said the occasion marked a "long-term accomplishment," and that comparisons should not be made with the previous month, quarter or year, but "with decades or centuries ago."

Volcker pointed to two administration programs as keys to long-term, "balanced" recovery: the new depreciation guidelines and revenue-sharing to channel funds to state and local governments.

Heller said he was distressed by President Nixon's recent television interview, because Mr. Nixon displayed "no evidence" of plans for "insurance to keep the inflation vultures from coming home to roost in 1972."

A wage-price policy of some sort, Heller argued, would help in at least a "marginal" way now to control increases and would "pay off in the future" as insurance that the inflationary spiral of the late 1960's wouldn't be repeated.

Source: Washington Post, January 13, 1971, p. D7.
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