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Taxation - Income Tax -Whether the Phrase Useful Life Refers to Actual Useful Life or the Period of Usefulness to a Particular Taxpayer and Whether There Is an Amount Other Than the Build-in Salvage Value Below Which a Taxpayer Using the Declining Balance Method May Not Depreciate the Asset

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of a citizen's rights under the Federal Constitution.[15] It would appear that the Congressmen not only wished to grant redress for the ordinary torts of the day committed by state officials, but also from the unrefuted statements of antagonists to the bill, one would be led to believe it was their intent to sanction such actions as libel, defamation, and invasion of privacy.

R. E. BECKER

TAXATION—INCOME TAX—WHETHER THE PHRASE "USEFUL LIFE" REFERS TO ACTUAL USEFUL LIFE OR THE PERIOD OF USEFULNESS TO A PARTICULAR TAXPAYER AND WHETHER THERE IS AN AMOUNT OTHER THAN THE BUILT-IN SALVAGE VALUE BELOW WHICH A TAXPAYER USING THE DECLINING BALANCE METHOD MAY NOT DEPRECIATE THE ASSET—In *Hertz Corporation* v. *United States*,[1] the genius of the Commissioner of Internal Revenue has once again run the gamut of Appellate and Supreme Court review in attempting to prevent the drawing of a credit claimed against the United States Treasury. The Hertz Corporation, engaged in leasing and renting trucks and automobiles on both a long and short term basis, was merged into by the J. Frank Connor, Inc., through a statutory merger in 1956, thereby becoming entitled to file claims for refund of Federal Income Tax to which Connor Inc. might have been entitled. The merged corporation had used the straight line method of depreciation;[2] however, the 1954 revision to the Internal Revenue Code provided the

15 "Suits may be instituted without regard to amount or character of claim by any person within the limits of the United States who conceives that he has been deprived of any right, privilege, or immunity secured him by the Constitution of the United States, under color of any law, statute, ordinance, regulation, custom, or usage of any state. That is to say, that if a police officer of the city of Richmond or New York should find a drunken negro or white man upon the streets with loaded pistol flourishing it, and by virtue of any ordinance, law, or usage, either of city or state, he takes it away, the officer may be sued, because the right to bear arms is secured by the Constitution." Whitthorne of Tennessee, Cong. Globe, 42d Cong., 1st Sess., 337 (1871).

"It authorizes any person who is deprived of any right, privilege or immunity secured to him by the Constitution of the United States, to bring an action against the wrongdoer in the Federal Courts, and that without any limit whatsoever as to the amount in controversy. The deprivation may be of the slightest conceivable character, the damages in the estimation of any sensible man may not be five dollars or even five cents, they may be what lawyers call merely nominal damages." Thurman of Ohio, Id. at 216.

1 364 U. S. 122, 80 S. Ct. 1420, 4 L. Ed. 2d 1569 (1960).

2 26 U. S. C. § 167 (1958); Int. Rev. Code of 1954, § 167; as well as Int. Rev. Code of 1939, § 23, provide the authority for the use of the straight line method of depreciation of property used in the trade or business, or of property held for the production of income. Under this method the taxpayer deducts the cost of the property in equal annual installments during the life of the property. The amount deducted each year is the result of multiplying the reciprocal of the remaining useful life by the depreciated basis (in the first year, the purchase price less salvage value).

authority for the use of an accelerated, declining balance method of depreciation[3] on depreciable property meeting certain requirements. Due to its volume of business, the Company was able to purchase its automobiles and trucks at a volume discount and by depreciating them, using a useful life basis of four years for automobiles and five years for trucks, with the declining balance method, a tax refund was computed[4] and applied for. The Commissioner, with a tight grip on his purse, failed to recognize the claim and prepared for the siege by Massey, Evans, and Hertz.[5] Hertz chalked up a quick first round victory in the District Court;[6] but, to the astonishment of most, but not all[7] observers, the Court of Appeals reversed.[8] Certiorari was granted and the Supreme Court of the United States dealt a staggering dollar and cents blow to the business world, which stunned the accounting world, by affirming the holding of the Appellate Court that the phrase "useful life" of an asset has reference to the useful life to the particular taxpayer and that under the declining balance method the asset cannot be depreciated below its resale value.

3 26 U. S. C. § 167(b) (2) (1958), Int. Rev. Code of 1954, § 167(b) (2), provides two methods of depreciation foreign to the 1939 Code. Under one of these, the declining balance method, a fixed percentage (not more than twice the straight line depreciation rate) of the unrecovered cost of an asset is deducted each year as depreciation.

4 Hertz actually computed a three year refund totaling $14,561.12. For the purposes of illustration, however, a simplified example of how this resulted will better serve the purpose. Assume that a corporation is in a position to purchase automobiles for $2,000. The automobile is depreciated under the straight line method, using a basis of four years useful life, at a rate of $500 per year. Assume further, that due to certain variable factors, which will be discussed below, the corporation decides to sell the automobile twelve months after purchase for $1,500. The amount of depreciation taken during the twelve month period amounts to $500. On the other hand, if the declining balance method is applied, using the same useful life basis, a different result is reached. The total depreciation over the twelve month period will amount to $1,000. A sale for $1,500 thus results in a long term capital gain, under Sec. 1231 of the 1954 Code, of $500. Now, by applying these two examples to a hypothetical taxable income before depreciation of $10,000, the basis for the refund is seen. In the first instance a deduction of $500 was taken against an income of $10,000 leaving a balance of $9,500 taxable as ordinary income for that twelve month period. In the second instance, a deduction of $1,000 was made from the same figure leaving only $9,000 taxable as ordinary income and $500 taxable as a long term capital gain.

5 Massey Motors, Inc. v. United States, 364 U. S. 92 (1960), and Commissioner of Internal Revenue v. Robley H. Evans and Julia M. Evans, 364 U. S. 92 (1960), were companion cases to the Hertz case. The Evans case involved much the same facts as Hertz but Massey dealt with the depreciation, by an automobile retailer, of executive cars as well as automobiles which Massey rented to an unaffiliated finance company. Although the issues are related, the Evans and Massey cases were decided under the 1939 Code while the 1954 Code applies to the Hertz case. The great significance of the holdings in this case will be seen more clearly in the discussion of the second phase of the Hertz case. Those holdings were that salvage value for the purposes of depreciation, is not junk value but resale value.

6 165 F. Supp. 261 (D. Del., 1958).

7 Kirby, 54 Nw. U. L. Rev. 434, argues that the opinion of the Court of Appeals is supported by both law and reason and he concludes that affirmance by the Supreme Court will probably follow.

8 268 F. 2d 604 (3rd Cir., 1959).

Section 167 of the 1954 Code restricts the use of the declining balance method of depreciation to those instances where the asset has a "useful life" of three years or more.[9] The Commissioner realized that if he could successfully show that the automobiles which Hertz (the Connor Company) had held for an average of 26.17 months each,[10] during the years in question, would not qualify for accelerated depreciation because they did not meet the "useful life" requirement, Hertz would be unsuccessful in its claim. Unquestionably, the automobiles had an economic useful life of four years; but, argued the Commissioner, "useful life" always has meant the useful life to the particular taxpayer, i.e., the taxpayer's holding period.[11]

A depreciation deduction is defined as a reasonable allowance for exhaustion, wear, and tear.[12] By way of a hypothetical,[13] the taxpayer points out that under the government's treatment of "useful life" the definition of depreciation is changed to something indeterminate— "(S)ome combination of exhaustion, wear and tear and other considerations foreign to and unconnected with the wearing out of the assets and the direction of the statute."[14] Although its exactness depends upon the outcome of the second phase of the case,[15] the Commissioner has an answer—"It is not wear and tear in the abstract which is to be recovered through depreciation deductions; it is the wear and tear measured by the difference between the cost of the asset and its estimated salvage value when it is resold."[16]

9 26 U. S. C. § 167(c) (1958); Int. Rev. Code of 1954, § 167(c).

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Year ended		Holding Period in Months		
March 31	No. of Vehicles	Average	Longest	Shortest
1954	28	32	67	21
1955	12	30	39	23
1956	66	23	51	16

11 Both the Commissioner and Hertz agreed that the 1954 Internal Revenue Code did not change, and was not an attempt to change the prior law as to what the useful life of an asset is. However, the Commissioner contended that pre 1954 Income Tax Law was that "useful life" meant useful life to the taxpayer while Hertz contended the same was the economic usefulness of the asset.

12 26 U. S. C. § 167(a) (1958); Int. Rev. Code of 1954, § 167(a).

13 Brief for the Petitioner, p. 20, Note 1, Ante. "For example, let us consider the case of two taxpayers who are in the same type of business and who buy—at the same time and at the same price—an identical asset. (Let us assume also the same degree of physical usage and wear and tear, and the same inspection and repair procedures.) Similarly, suppose that the two taxpayers accurately estimate their holding periods differently—all else being the same.

"Under the Government's definition of useful life, depreciation will be computed differently for the two taxpayers in the above example, despite the fact that the assets involved will be undergoing exactly the same rate of exhaustion, wear and tear contemplated by the statute."

14 Ibid.

15 Treasury Regulations, Note 45, Infra.

16 Brief for Respondent, p. 24, Note 1, Ante.

The case for Hertz advances on the proposition that a host of earlier decisions[17] (pre 1954) support its position. The Commissioner, while playing with words and ideas in order to convince the Court that these cases had no application here, overlooked the fact that Petitioner was more concerned with showing that the Commissioner himself was inconsistent in his arguments[18] than in citing the cases as authority for his position. To further substantiate this proposition, Petitioner requested consideration of several, more recent cases,[19] including the words of the Court[20] and the argument of the Commissioner[21] in the *Philber* case and the argument of the Commissioner in the *Penn* case[22] as well as others in

17 See Sanford Cotton Mills, 14 B. T. A. 1210 (1929), where the Commissioner reduced the rate of depreciation of taxpayer's trucks to 20% (five-year life) from 33⅓% (three-year life). The evidence showed that the taxpayer actually kept and used the trucks for approximately 2½ years. Inconsistent with the Commissioner's position in the Hertz case, the Board of Tax Appeals found favor with the Commissioner by holding that a 25% rate (four-year life) was reasonable. In Appeal of Merkle Broom Co., 3 B. T. A. 1084 (1926), where, although the evidence showed that taxpayer purchased a new fleet of "Salesmen's cars" every two years, the Commissioner again argued that the rate should be decreased from 33⅓% (three-year life) to 20% (five-year life). Again the Board of Tax Appeals announced that a 25% rate (four-year life) was reasonable. See also, Appeal of West Virginia & Pennsylvania Coal & Coke Co., 1 B. T. A. 790 (1925); Appeal of J. R. James, 2 B. T. A. 1071 (1925); Max Kurtz v. Commissioner of Internal Revenue, 8 B.T.A. 679 (1927); Whitman-Douglas Co. v. Commissioner of Internal Revenue, 8 B. T. A. 694 (1927); Wallace G. Kay v. Commissioner of Internal Revenue, 10 B. T. A. 534 (1928); John A. Maguire Estate Ltd. v. Commissioner of Internal Revenue, 17 B. T. A. 394 (1929); Cohen v. Lowe, 234 F. 474 (1916).

18 The problem presented by this case is quite unique. Heretofore, the Commissioner, in order to faithfully perform his duties, has endeavored to force the longest possible "useful life" period upon the taxpayer inasmuch as this would result in a lesser deduction for depreciation each year and therefore result in the greatest tax advantage for the government. Here, on the other hand, the Commissioner has found it necessary to plead for a shorter "useful life" period to be enforced in order to place the government in the best position, taxwise.

19 Pilot Freight Carriers, Inc., 15 TCM 1027 (1956); Charlie Hillard, 31 T. C. 961 (1959); Davidson v. Tomlinson, 165 F. Supp. 455 (1958); Lynch-Davidson Motors, Inc. v. Tomlinson, 172 F. Supp. 101 (1958).

20 Philber Equipment Corporation v. Commissioner, 237 F. 2d 129 at 130 (1956). "Taxpayer knew that when equipment was purchased, it would probably be able to rent the equipment for a period substantially less than its useful life, and sale of the equipment would follow expiration of the lease."

21 Brief for Respondent, p. 5, Philber Equipment Corporation v. Commissioner, 237 F. 2d 129 (1956). "Because of existing conditions taxpayer knew when it purchased equipment that it would be likely be able to rent such equipment only for a period that was substantially less than its useful life."

22 Brief for Respondent, p. 10, Penn v. Commissioner of Internal Revenue, 199 F. 2d 210 (1952). "The basic fallacy in taxpayer's argument lies in her assumption that 'depreciation' has reference to the life of the owner of property, rather than to the life of the property itself. . . . Taxpayer's argument disregards not only the portion of Section 23(1) which deals specifically with property held by a life tenant, but the general provision that depreciation deductions are allowable 'for the exhaustion, wear and tear . . . of property'. The 'wear and tear of property' has no relation to the life expectancy of its owner. On taxpayer's theory, every owner of a depreciable interest in property would be entitled to

the same vein,[23] and concluded, "Just as the wear and tear of property has no relation to the life expectancy of its owner, the wear and tear of property has no relation to the holding period of its owner."[24]

Petitioner also relies on Bulletin "F"[25] in support of his contention. Perhaps the Petitioner should have been more cautious in his discussion of the Bulletin but this does not change the fact that it is a starting point from which correct rates may be determined. He was deft, but not convincing, in arguing that if the Commissioner's definition of useful life was adopted there would be no need for the Bulletin.[26] The Court appropriately points out the distinguishing feature that one asset may be acquired with an intention of utilizing it for its full economic life (here the Bulletin would provide a starting point) while the same asset may be purchased by another to be used for a much shorter period.[27]

Some of the most convincing evidence in taxpayer's behalf was the introduction of expert testimony[28] to the effect that "useful life" meant the business life of the asset regardless of whether or not it changed hands[29] and further that it has been the practice to use a four year useful life in the case of automobiles.[30] What is more, the witness from the Arthur Andersen firm, in answer to a hypothetical based on the facts of this case, testified that he would advise a client to depreciate by using a useful life of four years even though it would be sold prior to the

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deduct annual depreciation at a rate based on the number of years he expects to live and enjoy the income from the property, instead of the number of years the property may be expected to produce income, a result repugnant to the fundamental concepts of depreciation."

23 Herbert Shainberg, et al., 33 T. C. 241 (1959); Terminal Realty Corporation, 32 B. T. A. 623 (1935).

24 Reply Brief for Petitioner, p. 12, Note 1, Ante.

25 A guide to taxpayers issued by the Internal Revenue Service, dealing with depreciation and setting out average rates by which to measure the useful life of various types of property. Revised in January 1942 and again in 1955 (I. R. S. Publication Number 173).

26 Brief for Petitioner, p. 34, Note 1, Ante. "We do not believe it plausible that when the Commissioner listed in Bulletin 'F' (page 52): 'Trucks: . . . medium—6 years; Heavy—8 years', he meant that a medium truck would be kept and used by a given taxpayer for six years, but a heavy truck would be used by that taxpayer for eight years. Did he not unquestionably mean that though it would be almost impossible to foretell when a taxpayer might decide perhaps for reasons wholly unconnected with the condition of the truck, to sell it to a neighbor or trade it in on a new one, it was feasible to say that a medium truck, whether in one taxpayer's or a half dozen taxpayers' hands, has a life of approximately six years, whereas a heavy truck has a life of approximately eight years."

27 Note 1, Ante.

28 Partners in the leading accounting firms of Ernst & Ernst, Price Waterhouse & Co., and Arthur Andersen & Co.

29 Record, pp. 29, 33, Note 1, Ante.

30 Ibid.

expiration of that period.[31] On this basis the District Court found, "Over the years, 'useful life' has come to be regarded in the field of business and accounting to mean the business life of an asset regardless of whether it passed from one owner to another."[32] The Commissioner follows the lead of Kirby[33] and retorts with a text book definition of useful life[34] which favors his contention. The Court of Appeals in passing[35] follows the text book and fails to attach any significance to the fact that the book was published after the fact of the depreciated assets here in issue.

The Court of Appeals apparently based its decision[36] on a statement made by Mr. Justice Brandeis in the *Ludey* case,[37] which appears to be dictum to the extent relied upon here. The crucial words, "useful life of the plant in the business," said the Commissioner, refer to the taxpayer's business and this ". . . view has consistently been taken by other courts and by the Commissioner . . ."[38] but, save for a few insignificant pronouncements by the Commissioner and the very Treasury Regulations[39] taxpayer is challenging in this case, he conveniently forgets to tell us by which courts his ". . . view has consistently been taken. . . ." The Court of Appeals attached the significance asked for by the government to this phrase but denied consideration of the fact that substantially the same phrase[40] used in the Treasury Regulations from 1918 until 1942 was substituted with "useful life of the depreciable property"[41] in the 1942 and subsequent Regulations. The taxpayer's reasoning leads to the conclusion that the phrase "property in the business" merely establishes a qualification on the kind of property that may be depreciated. The Supreme Court, however, considered this to be a "strained meaning"[42] and upheld the lower court.

31 Record, pp. 60, 64, Note 1, Ante.

32 165 F. Supp. 261 at 265 (1958).

33 Note 7, Ante.

34 Finney & Miller, "Principles of Accounting," 5th ed., 1958, pp. 352-396.

35 268 F. 2d 604 (1959).

36 Record, p. 138, Note 1, Ante.

37 United States v. Ludey, 274 U. S. 295 at 300, 47 S. Ct. 608, 71 L. Ed. 1054 (1927). "The amount of the allowance for depreciation is the sum which should be set aside for the taxable year, in order that, at the end of the useful life of the plant in the business, the aggregate of the sums set aside will (with the salvage value) suffice to provide an amount equal to the original cost."

38 Brief for Respondent, p. 20, Note 1, Ante.

39 Treas. Reg. § 1.167(a)-1(b) (1959). "Useful life.—For the purpose of Section 167 the estimated useful life of an asset is not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of his income. . . ."

40 "useful life of property in the business."

41 Treas. Reg. § 29.23(1)-1 (1942).

42 Massey Motors, Inc. v. United States, 364 U. S. 92 (1960). The Court in the Hertz decision dismissed the issue of useful life with a few words and a

The fact that the Treasury Department itself refuses to take a definite stand in Bulletin "F" would seem to reflect that the subjective intent of the taxpayer is nebulous at the outset and to point out that economic usefulness is a much more practical and sensible test. The decision of the Court favoring the conception of useful life called for by the Commissioner leaves the already murky area of depreciation with an even greater headache for the taxpayer by placing the additional variable element of subjective intent on the all too long list of variable factors[43] which determine the period for which a taxpayer will be allowed to depreciate a depreciable asset.

The second phase of the *Hertz* case involved a refund claim resulting from a recomputation of the depreciation on *rental trucks* which the company had sold in the years in question.[44] The trucks, unlike the automobiles involved in the first part of the case, had been held by the company, on the average, for more than three years.[45] This qualified them for the declining balance method of depreciation under any definition of useful life. The Commissioner is backed up by the Treasury Regulations[46] in his claim that even under the declining balance method, an asset cannot be depreciated below a reasonable salvage value; he then justifiably relies

referral to the decision in the Massey case (a companion case involving substantially the same issue, decided however, under the 1939 code rather than the 1954 code). Since both parties and the Court agreed that the meaning of useful life did not change with the adoption of the 1954 Code, it was unnecessary to reconsider the issue in the light of the 1954 Code.

43 Treas. Reg. § 1.167(a)-1(b) (1959). "This period," useful life, "shall be determined by reference to his experience with similar property taking into account present conditions and probable future developments. Some of the factors to be considered in determining this period are (1) wear and tear and decay or decline from natural causes, (2) the normal progress of the art, economic changes, inventions, and current developments within the industry and the taxpayer's trade or business, (3) the climatic and other local conditions peculiar to the taxpayer's trade or business, and (4) the taxpayer's policy as to repairs, renewals, and replacements."

44 As in the case of the automobiles, the Connor corporation had filed their return for the years of 1954, 1955, and 1956, computing depreciation on their trucks under the straight line method. A recomputation under the declining balance method combined with the application of Sec. 1231, Internal Revenue Code, 1954, provided the basis for the refund claim.

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Year ended March 31	No. of Vehicles	Holding Period in Months Average	Longest	Shortest
1954	5	23	24	21
1955	4	45	51	32
1956	9	45	85	10

46 Treas. Reg. § 1.167(b)-1(a) (1959). "Application of Method—Under the straight line method the cost or other basis of the property less its estimated salvage value is deductible in equal annual amounts over the period of the estimated useful life of the property." Treas. Reg. § 1.167(b)-2(a) (1959). "While salvage is not taken into account in determining the annual allowances under this method, in no event shall an asset (or an account) be depreciated below a reasonable salvage value."

upon the *Evans* and *Massey* cases[47] for the proposition that salvage value is not junk value but resale value. The claim of the Petitioner is dependent upon the theory that there is no authority for these regulations pertaining to the declining balance method; but, because of the high regard given to *Treasury Regulations,*[48] he has two strikes against him at the outset.

The Commissioner claims the authority exists in the language of Section 167(a) of the 1954 Internal Revenue Code allowing a "reasonable allowance" for depreciation supported by Section 167(b) which provides that this "reasonable allowance" shall be "computed in accordance with regulations prescribed by the Secretary or his delegate." That the regulation is not only unauthorized but appears to be specifically prohibited, strongly supports the Hertz position. The Committee Report clearly expressed a Congressional intent to recognize that the declining balance method of depreciation has an inherent salvage value.[49] The Commissioner however, was convinced that there was no inconsistency here inasmuch as the regulation does not provide for a deduction but only a cut off point, measured by salvage value, beyond which no further depreciation may be taken. Under the straight line depreciation, continued the Commissioner, a taxpayer will recover a lesser amount because salvage value may exceed the unrecovered cost under the declining balance method and such a result would be in conflict with the intent expressed by the Congress.[50] However, there is another argument designed to cast doubt upon the validity of the Regulation. The Senate recognized that fast total write-offs would occur in the case of short lived assets and stated this as the reason for the three year useful life requirement.[51] In no event

[47] Note 5, Ante.

[48] Commissioner of Internal Revenue v. South Texas Lumber Co., 333 U. S. 496 at 501 (1948). "This Court has many times declared that Treasury Regulations must be sustained unless unreasonable and plainly inconsistent with the revenue statutes and that they constitute contemporaneous constructions by those charged with administration of these statutes which should not be overruled except for weighty reasons."

[49] S. Rep. No. 1622, 83d Cong., 2d Sess. at p. 201 (1954). "The salvage value is not deducted from the basis prior to applying the rate, since under this method (the declining balance method) at the expiration of useful life there remains an undepreciated balance which represents salvage value."

[50] H. R. Rep. No. 1337, 83d Cong., 2d Sess. at p. 25 (1954). "The changes made by your committee's bill merely affect the timing and not the ultimate amount of depreciation deductions with respect to a property."

[51] Ibid at p. 29. "Restriction of declining-balance rate on short lived assets.—The use of the 200 percent declining balance rate in the case of short lived properties would result in extremely fast write-offs. For example, in the case of an asset with a 2-year service life, the doubling of the 50-percent straight-line rate would be equivalent to expensing the cost in the year of acquisition. These properties would retain substantial value and could be resold subject to capital gain rates.

"To prevent unrealistic deductions and resulting tax avoidance, your committee has provided that the liberalized methods be made available only with respect to assets with useful lives of 3 or more years."

could a total write-off occur if the Committee had intended a limit below which depreciation could not be taken. What is more, in recognizing the problem, Congress provided a remedy; had they intended to remedy the situation in the manner called for by the Commissioner and the Treasury, they would have *so done.*

This contention in behalf of the taxpayer appears to be sound and it is not without outside support.[52] The Court however, sided with the government and agreed that Sections 167(a) and 167(b) of the 1954 Internal Revenue Code provided the authority for the Regulations in question.[53] The Court distinguished between residue salvage or that which "represents salvage value" and "true salvage value" and states ". . . when true salvage value exceeds this amount, the latter (true salvage value) controls."[54] Greater reliance was placed on the Commissioner's argument that it was the intent of Congress to affect only the timing and "not ultimate amount of depreciation deductions with respect to a property."[55]

Throughout the taxpayer's argument, the idea is advanced that this case is an attempt by the Commissioner to maximize revenue by dealing a death blow to capital gains treatment of depreciable property.[56] As the Commissioner's position was upheld, the taxpayer will never realize capital gain on the sale of depreciable property unless he mistakenly estimates the resale price (salvage value according to the Commissioner

52 Graves, "Depreciation Problems," the Journal of Accountancy 43, 46 (Oct. 1956). "One of the features of the declining-balance method is that salvage does not enter into the computation of depreciation allowances when that method is used. Since the Code states specifically that depreciation allowances computed under that method are to be treated as reasonable allowances, it would appear that an asset could be depreciated below salvage value. That this may have been the intent of Congress is indicated by the recognition of the Congressional committees that the mechanics of the method result in an ultimate salvage value because the depreciation allowances are not sufficient to provide for complete recovery of basis at the end of the estimated life of an asset. However, the regulations provide that an asset cannot be depreciated below salvage value under any method. This provision is not unreasonable in itself but there seems to be no authority for it in the Code."

53 Note 1, ante. "There is nothing inherent in the declining balance system which requires us to assume that depreciation should be allowed beyond what reasonably appears to be the price that will be received when the asset is retired."

54 Note 1, ante.

55 Note 50, ante.

56 26 U. S. C. § 1231 (1958); Int. Rev. Code of 1954, § 1231. Under this section property used in the trade or business is first defined as including depreciable property used in the trade or business and held for more than six months. The section goes on to state that all recognized gains and losses during the taxable year from sales or exchanges of property which is used in the trade or business, are totaled. If the gains are in excess of the losses, they are treated as long term capital gains. If the losses are in excess of the gains, they are treated as ordinary gains and losses.

and the Courts). But the *Cohn* case[57] holds that depreciation deductions should be disallowed to the extent that the taxpayer underestimates the proceeds to be realized upon resale. In the application, therefore, capital gains on depreciable property[58] are totally eliminated, a result that is impossible to reconcile with the adoption of Section 1231. What is more, this same result is quite repugnant to the purpose behind the liberalized depreciation method[59] for it tends to block the incentive for a rapid turnover of depreciable property. So, it would appear that at long last, the Treasury Department has achieved through the courts the curtailment of capital gains treatment which it has been attempting to attain since 1947 through legislation.[60]

"Many inequities are inherent in the income tax. We multiply them needlessly by nice distinctions which have no place in the practical administration of the tax law."[61]

J. P. GRAVES

WILLS—RIGHTS OF DEVISEES AND LEGATEES—WHETHER INCOME ARISING UNDER A TESTAMENTARY TRUST RELEASED FROM UNLAWFUL ACCUMULATION PASSES BY INTESTATE SUCCESSION—An interesting question concerning the disposition to be made of income which had accumulated in a testamentary trust for a longer period than permitted by law, was recently presented to the Supreme Court of Illinois in the case of *Murphy* v. *Northern Trust Company*.[1] In that case, the testator had left his residuary estate in trust under a will dated in 1932 which directed the trustee to pay his widow a specified sum monthly from the net income thereof and to accumulate any sums in excess and to add them to the

57 Cohn v. United States, 259 F. 2d 371 (6th Cir., 1958).

58 Note 56, ante.

59 Note 49, ante. "The stimulus to investment through liberalized depreciation is most important with respect to the creation of new assets."

60 In 1947 and 1948 Congress held extensive Revenue Revision Hearings. The Treasury Department submitted an accelerated depreciation report in an attempt to reduce the effect of Section 117(j) of the 1939 Internal Revenue Code. Congress, in adhering to a policy of encouraging the sale and purchase of capital equipment failed to take any action on this attempt. Again in 1950 the Secretary of the Treasury attempted to persuade Congress to treat losses on depreciable property as capital rather than ordinary losses. Congress rejected this recommendation as it did a similar one drafted by the Committee on Federal Taxation of the American Institute of Accountants and submitted to Congress during the hearings on the 1954 Code. Finally, on January 18, 1960, during the course of this litigation, the President in his budget message to Congress, recommended that gain on the sale of depreciable property be treated as ordinary income.

61 United States v. Lewis, 340 U. S. 590, 71 S. Ct. 522, 95 L. Ed. 560 (1951) (Douglas, Dissenting).

1 17 Ill. (2d) 518, 162 N. E. (2d) 428 (1959), affirming 20 Ill. App. (2d) 244, 155 N. E. (2d) 821 (1959).