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## Correspondence: Percentage Depletion; A Familiar Controversy

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## Correspondence

### "PERCENTAGE DEPLETION"

*Editor, THE JOURNAL OF ACCOUNTANCY:*

DEAR SIR: I have read with some surprise the editorial in the October issue of *THE JOURNAL OF ACCOUNTANCY*, pages 246 to 247, entitled "Percentage Depletion," which seems to indicate approval of the allowances in the present tax law. No mention is made of the very valid arguments against discrimination in favor of mining interests which such a provision makes. The obvious effect of discovery depletion has been to allow to the mines a deduction from gross income in determining net income which does not represent any cost or capital outlay, a privilege granted to no other class.

If today depletion were computed strictly on a percentage basis, the system would have the advantage of simplicity, directness, economy and ease of administration claimed in the editorial, even if it lacked the supreme virtue of equal justice. The law contains a provision under which the taxpayer may claim depletion based on cost if that would give a result more favorable to him than the percentage plan. Obviously, this provision detracts greatly from the simplicity, directness, economy and ease of administration of the law and, at the same time, adds to the injustice.

It is strange to find the organ of a profession arguing in favor of a special privilege granted to those who are exploiting and gradually exhausting the natural resources of the country for private gain, when no similar relief is given to those whose income is derived from the exploitation and gradual exhaustion of their own natural abilities and life.

It is clear to any one who has studied the question that percentage depletion allowances are merely a form of subsidy to mining interests. Whether such subsidies are warranted or not is another question, but if they are to be given at all, it seems to me that they should be given openly and not in the form of tax discrimination.

Yours truly,

GEORGE J. STRONG

New York, N. Y.

### "A FAMILIAR CONTROVERSY"

*Editor, THE JOURNAL OF ACCOUNTANCY:*

DEAR SIR: The editorial, "A familiar controversy," in your December number prompts the writer to throw into the controversial caldron an appraiser's viewpoint.

The valuation of railroad and public-utility property as a basis of service rates, as your editorial states, has never worked satisfactorily, and it never will work satisfactorily as long as emphasis is placed upon legalistic theory in valuation, with less importance given to value-facts. We need a new and effective value-concept by way of supplement to the present idealistic mottoes of "fair" value, "true" value and "prudent" value, and the money concepts of "market" and "cash" value—none of which concepts are in fact workable rules of appraisal.

"Value for use" comes as nearly as possible to being a workable concept, which would take into consideration all of the facts relating to value and valuation. It would consider original costs, when ascertainable and when applicable, but would emphasize the making up of inventories from the property items, rather than from books of account, thus obviating the difficulty of allocating costs to existing operative useful plants, which is an impossible task in the case of plants 10 years old or older, and where the total costs are as great as \$500,000. Of course, a dated cost of reproduction is necessary in any appraisal of reproducible property, because it sets up a definite, uniform standard and because cost of reproduction is verifiable for any date and can be closely estimated for past or future dates. But the fact that reproduction cost is an essential factor in property appraisal does not, in the judgment of the practical appraiser, justify the division of thought under which controversy continues over the desirability or non-desirability of considering reproduction cost as a basis of valuation.

Value, in its very nature, can never be absolute—it is merely relative, and when reproduction cost as of a certain date is determined, that is the first step in the systematic valuation of property. The appraiser thinks of reproduction cost as of a given date as the maximum possible valuation at that date, and uses reproduction cost as the basic valuation from which deduction should be made for losses of usefulness which may be considered under the various headings of depreciation. If a property is new, if it is without mechanical deterioration and without obsolescence, and if it has full utility for the uses of the owner, then the "fair," "true," "prudent," "market" and "cash" values are all to be considered in a detailed report of reproduction cost less specific depreciation based on inspection and observation. If wear and tear, exposure or misuse have operated to reduce the useful values, then the appraiser judges the percentage or amount of that accrued loss under the headings of mechanical or physical deterioration. If a property item has lost usefulness in whole or in part because of inventive improvements, if the original uses have been unfavorably affected by loss of demand for the things produced, or if there is a special cost for repairs or replacement because an item is no longer in the market, then the appraiser will judge the accrued loss of usefulness due to these conditions under the

title of obsolescence. It may be found at this stage of the process of appraisal that the property, appraised with "value for use" as the goal, cannot be profitably used by its owner, and the loss of useful value to the owner due to lack of utility must be separately judged. The remainder, after deductions for mechanical deterioration, obsolescence and lack of utility, is the present useful value. This is a fact, ascertained by systematic processes of valuation, and should have greater weight in the minds of courts and commissions than legalistic interpretations of value-concepts which cannot be matched with the facts; provided, of course, that the facts are based on accurate inventories, pricing at current market costs, and that depreciation judgment has been based upon expert interpretation and observation.

The process here described, and the resulting conclusions, are exemplified continually in the valuation of property for insurance, financing, accounting and many other purposes, where book values do not show useful values, due to changes in market costs and the use of annual depreciation rates, instead of specific judgment of losses in useful values.

Reproduction-cost appraisals made by factual processes as of one date can be adjusted to future dates by repricing at current reproduction costs, and useful values can be adjusted to later dates by revision of specific depreciation judgment. Changes in cost prices attributable to changes in the purchasing power of money should be considered in periodical reappraisals. When reproduction cost prices are high, wages, supplies and other operating costs are also high; and service rates may be properly increased to correspond to changes in the price level. When reproduction cost prices recede, operating costs come down and the utility corporation should reduce its rates. This is the orderly way in which utility rates may be equitably based upon valuation; and the cost of systematic appraisal by this plan would be a mere bagatelle compared to the cumbrous legal methods which have been unsuccessfully followed in public-utility appraisals in the past.

The present economic system would be workable if the powers that be would undertake to operate it with a larger view of the advantages of systematic, factual appraisal. Ever since the Federal rate-valuation law was adopted in 1912 we have been trying to make it work as a legal question, without success. The economists, the lawyers and the courts have failed in their efforts to establish equitable utility values for rate-making purposes; why not call in independent, disinterested appraisers in place of partisan lawyer-engineers to assist in the settlement of utility valuation problems on a factual, workable basis? There would be no violation of the "due-process" inhibition in appraising with reasonable definiteness the facts concerning useful value, for such appraisals would be "fair" and "true" and "prudent," and would conform to the best interpretation of money concepts of value, and

would also conform to the concept of useful value. The valuation law calls for appraisal of property used and useful, and it should be appraised at its value for use, by processes which will take into consideration all relative facts.

Yours truly,

WALTER W. POLLOCK

Philadelphia, Pa.