

Clearly, none of these elements of economic substance are to be found in the principal case.

The alarm of the minority, generated by the majority's designation of the "sham test" was unnecessary, for it is doubtful that a new "guidepost" was actually being created. Before the court can characterize any transaction as a sham, the individual components of the arrangement must be separately examined. They must be measured against the already existing guideposts of personal liability, definitions of maturity, and substantial economic substance. It is only when the separate parts fail to meet the mark that the whole is designated a "sham" and interest incident to the transaction is disallowed as a deduction from gross income.

ANDREW C. SCHULTZ

Taxation—Depreciation Deduction—Useful Life—Salvage Value.—

*Massey Motors, Inc. v. United States; Commissioner of Internal Revenue v. Evans.*¹—In each of these companion cases the Court applied Section 23(1) of the Internal Revenue Code of 1939 to establish the correct depreciation equation² for computing the depreciation allowance in given tax years in respect to automobiles employed in rental and complementary uses. In the *Massey* case taxpayer owned an automobile agency which leased out new model cars and employed current models for company use. Using the straight-line method in computing his yearly depreciation allowance for the cars, taxpayer claimed a useful life of 4 years and a salvage value of zero. These cars would be resold within 15 months and if the resale price was greater than the remaining undepreciated cost, taxpayer would claim a capital gain. In the *Evans* case, taxpayer computed depreciation with respect to the automobiles rented to a U-Drive agency on the same basis as did taxpayer Massey. In both cases the Commissioner of Internal Revenue took issue with the depreciation allowances on the theory that the useful life of the automobiles should equal their useful life in the taxpayer's business rather than their physical life, and that upon disposition the salvage value should equal their resale value rather than their junk value. Taxpayer Massey succeeded in his claim for a tax refund in the United States District Court,³ but the decision was reversed by the Court of Appeals for the Fifth Circuit.⁴ The Commissioner's ruling that taxpayer Evans had a tax deficiency was supported by the Tax Court,⁵ but the decision was reversed by the Court of Appeals for the Ninth Circuit.⁶

The Supreme Court in a 5-4 decision HELD: The business taxpayer

¹ 364 U.S. 92 (1960).

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$$\frac{(\text{Total cost}) - (\text{Salvage value})}{(\text{Years of estimated life})} = \text{Yearly depreciation allowance.}$$

³ 156 F. Supp. 516 (S.D. Fla. 1959).

⁴ 264 F.2d 552 (5th Cir. 1959).

⁵ 16 C.C.H. Tax Ct. Mem. 639 (1957).

⁶ 264 F.2d 502 (9th Cir. 1959).

must compute his yearly depreciation allowance for rented automobiles over a period of time equal to the estimated useful life of the assets in his business, and, in so computing, the salvage value must equal the reasonable resale value of said assets on disposition.

As a result of this decision, the business taxpayer who employs an asset in his business for a period of time less than the physical life must, in computing the total cost to be allocated for depreciation purposes, using the straight-line mode,⁷ subtract the resale value from the original cost, then divide the remainder by the number of years of use in the business; the quotient is then deducted from his yearly gross income. For the straight-line taxpayer, the unhappy effect will be increased yearly income taxes and reduced capital gains taxes in the years he disposes of these assets. The effect on the Government will be substantially increased revenues from such taxpayers—a very satisfactory effect.

The administrative and judicial development of "useful life" and "salvage value", as terms in the business taxpayers' depreciation formula, is mirrored by the Supreme Court split in the *Massey* and *Evans* decisions. These terms were explicitly defined in a Treasury Regulation released in 1956,⁸ which climaxed a series of regulations and bulletins that had wavered between support of the Commissioner's theory⁹ and that of the taxpayers.¹⁰ The courts also vacillated in their positions as to the correct application of the terms. However, it should be noted that the definition of the terms was never the legal issue in these cases. In several cases the Commissioner of Internal Revenue succeeded in convincing the court to require a number of taxpayers to depreciate business vehicles over the entire physical life of the vehicles rather than to depreciate them over the shorter period of time in which the vehicles were actually used in the business.¹¹ In so doing, the Commissioner was able to lengthen the depreciation period, which reduced the annual depreciation allowances, and increased the taxpayer's taxable income. In other cases, the court swung almost 180 degrees and ruled that depreciation must be computed not on a physical life-junk value basis, but rather on a shorter, useful life-resale value basis. In these cases the Commissioner also desired to increase the taxable income, but here he accom-

⁷ The case of *Hertz Corp. v. United States*, 364 U.S. 122 (1960), was decided at the same time as the principal case and extended Treas. Reg. § 1.167(b)(2) (1956) to the declining balance and other accelerated depreciation methods allowed under the Internal Revenue Code of 1954. The IRC of 1954 further provides that these methods may only be employed if the depreciable asset has a useful life of at least 3 years. Thus, in holding that the term "useful life" means the useful life in the taxpayer's business, the Court put these accelerated depreciation methods out of the reach of taxpayers such as *Hertz*, *Massey*, and *Evans*.

⁸ Treas. Reg. § 1.167(a)(b)(c) (1956).

⁹ Treas. Reg. 33, art. 130 (1914); Treas. Reg. 103, § 19-23(1)-1, 19-23(1)-2 (1940); Int. Rev. Bull. F. Pt. 1 (1942).

¹⁰ Treas. Reg. 111, § 29-23(1) (1942); Rev. Rul. 108, 1953-1 Cum. Bull. 185; Rev. Rul. 54-229, 1954-1 Cum. Bull. 124.

¹¹ *Sanford Cotton Mills*, 14 B.T.A. 1210 (1929); *Max Kurtz*, 8 B.T.A. 679 (1927); *Merkle Broom Co.*, 3 B.T.A. 1084 (1925).

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plished this by increasing the salvage value of the asset, which in turn reduced the depreciation base. These cases found the Commissioner on both the successful and unsuccessful sides.¹²

In the light of the inconsistent positions taken by the courts and the Commissioner, if the Court had reached a contrary decision it would not have been surprising. The majority rested its decision on its view of the basic purpose of depreciation and depreciation accounting. In *Detroit Edison Co. v. Commissioner*¹³ the Court said: "The end and purpose of it all [depreciation accounting] is to approximate and reflect the financial consequences to the taxpayer of the subtle effects of time and use on the value of his capital assets." To illustrate: Taxpayer purchases for a market value of \$2000 a depreciable business asset with an economic life of 4 years, which he sells for the market value of \$1500 2 years later. The actual devaluation of this asset during these two years, and the only amount which logically represents the cost of the taxpayer's using depreciable assets in his business, would be \$500. To allow the taxpayer to deduct as *his* expense the devaluation of the asset after he resells it, as in essence taxpayers Massey and Evans advocated, would be to alter this accepted purpose of depreciation. In treating this purpose as the crucial factor in its holding, the Court was able to demonstrate that the Commissioner's contention of "useful life" and "salvage value" was not first established in 1956, but were merely undefined in the tax years in dispute.¹⁴

Although the majority holding in the *Massey* and *Evans* cases may be justified, this is not to conclude that it is practical. The possible effect of these cases will be to involve both the Treasury and the taxpayers in long and costly litigation on such questions as: 1) Was the useful life employed by the taxpayer reasonable in the light of past business experience? 2) Could the taxpayer reasonably have foreseen forthcoming economic pressures which forced early resale of his asset? And 3) Was the forecasted salvage value reasonable? The Internal Revenue Code of 1954 does provide for some alteration of the depreciation allowances during the life of the asset,¹⁵ but there still remain too many unchecked variables to avoid extensive litigation. The solution might be found in the repeal of Section 1231 of the Internal Revenue Code of 1954,¹⁶ which should eliminate the basic bone of contention—capital gains or ordinary income upon the resale of the asset. With this section

¹² W.H. Norris Lumber Co., 7 C.C.H. Tax Ct. Mem. 728 (1948); L.A. Davidson, 12 C.C.H. Tax Ct. Mem. 1080 (1953); Bolta Co., 4 C.C.H. Tax Ct. Mem. 1067 (1945); First Nat'l Bank, 30 B.T.A. 632 (1934); Suncrest Lumber Co., 25 B.T.A. 375 (1932).

¹³ 319 U.S. 98, 101 (1943).

¹⁴ The dissenting Justices in the *Massey* and *Evans* cases did not disagree with the majority as to the proper definition of the terms "useful life" and "salvage value," but rather as to the retrospective application of the 1956 Treasury Regulation to pre-1954 tax years.

¹⁵ Treas. Reg. § 1.167(b)-2(c) (1956). This section allows for alteration of the useful life of an asset during the depreciation period.

¹⁶ In essence, this section allows the taxpayer to compute a capital gain on the resale of his depreciated asset.

omitted, the taxpayer will strive for accuracy in depreciation and the Government will theoretically be in the same position regardless of whether the asset was correctly depreciated.¹⁷

EDWARD A. SCHWARTZ

Trade Regulation—Clayton Act Section 3—Requirement Contracts—Substantial Share of Relevant Market.—*Tampa Elec. Co. v. Nashville Coal Co.*¹—Tampa Electric, a public utility situated in peninsular Florida, supplies electric energy to some eleven percent of Florida's population. Having started the construction of a new generating plant, Tampa entered into a contract by which it was obligated to buy the total coal requirements of two of the plant's contemplated six units from Nashville Coal Co. for a twenty year period. Nashville Coal was only one of 700 coal producers in the Appalachian coal area who could serve Tampa. Previous to this contract, every electrical generating plant in peninsular Florida burned oil as burner fuel. Tampa's coal requirements were expected to vary between one and two million tons per year, at a minimum cost of \$128,000,000 over the twenty year contract term. Thus, within a few years of the contract starting date, the utility's coal consumption would surpass that of the remainder of the state. Just prior to the contract starting date, Nashville notified Tampa that it would not perform because the contract was in violation of the federal antitrust laws.² Tampa Electric brought declaratory judgment proceedings against Nashville to have the contract declared valid and enforceable. The District Court granted respondent's motion for summary judgment³ and the Court of Appeals affirmed.⁴ On writ of certiorari the Supreme Court reversed. HELD: the contract does not violate Section 3 of the Clayton Act as the competition foreclosed by the contract does not constitute a substantial share of the relevant market.

The "rule of reason" test developed in interpreting the Sherman Act.⁵ It necessitated, in each case, an analysis of the case in the light of a broad public policy, hospitable to competition and cold to monopoly, to see

¹⁷ "Theoretically" is used because the taxpayer could have changed tax brackets since deducting the depreciation allowances.

¹ 81 Sup. Ct. 623 (1961).

² "It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods . . . for use, consumption, or resale within the United States . . . on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods . . . of a competitor or competitors of the . . . seller where the effect of such lease, sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce." 38 Stat. 731 (1914), 15 U.S.C. § 14 (1958). Respondents also argued that the contract violated the Sherman Act, 26 Stat. 209 (1890), as amended, 15 U.S.C. §§ 1-2 (1958).

³ 168 F. Supp. 456 (M.D. Tenn. 1958).

⁴ 276 F.2d 766 (6th Cir. 1960).

⁵ *Standard Oil Co. v. United States*, 221 U.S. 1 (1911).