ADJUSTMENT OF THE BASIS OF PROPERTY FOR DEPRECIATION, OBSOLESCENCE, AMORTIZATION, AND DEPLETION

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

EIGHTY-SECOND CONGRESS

SECOND SESSION

ON

H. R. 3168

AN ACT TO AMEND SECTION 113 (b) (1) (B) OF THE INTERNAL REVENUE CODE WITH RESPECT TO THE ADJUSTMENT OF THE BASIS OF PROPERTY FOR DEPRECIATION, OBSOLESCENCE, AMORTIZATION, AND DEPLETION

JANUARY 22, 1952

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ADJUSTMENT OF THE BASIS OF PROPERTY FOR DEPRECIATION, OBSOLESCENCE, AMORTIZATION, AND DEPLETION

TUESDAY, JANUARY 22, 1952

COMMITTEE ON FINANCE,
UNITED STATES SENATE,
Washington, D. C.

The committee met, pursuant to call, at 10 a. m., in room 312, Senate Office Building, Senator Walter F. George (chairman) presiding.

Present: Senators George, Hoey, Kerr, Frear, Millikin, Butler, Martin, and Williams.

Also present: Elizabeth B. Springer, chief clerk, Senate Committee on Finance; Colin F. Stam, chief of staff of the Joint Committee on Internal Revenue.

The CHAIRMAN. The committee will come to order.

The hearing this morning on H. R. 3168, a House bill which was before this committee before we adjourned in October, but we did not have the opportunity to take it up fully for consideration. Some hearings were indicated.

Senator Gillette, for himself, and Senator Hickenlooper have offered an amendment to H. R. 3168. The amendment seems to be designed to make the bill retroactive. I think that is the whole effect of it. The bill and the amendment will be incorporated in the record.

(H. R. 3168 and the amendment are as follows:)

AN ACT To amend section 113 (b) (1) (B) of the Internal Revenue Code with respect to the adjustment of the basis of property for depreciation, obsolescence, amortization, and depletion

[H. R. 3168, 82d Cong., 1st sess.]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) subparagraph (1) (B) of section 113 (b) of the Internal Revenue Code, entitled "Adjusted basis," is amended by inserting after the word "allowed" the words "as deductions in computing net income and resulting in a reduction of the taxpayer's taxes" to cause the first sentence thereof to read as follows:

"(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed as deductions in computing net income and resulting in a reduction of the taxpayer's taxes (but not less than the amount allowable) under this chapter or prior income tax laws."

(b) The amendment made by this Act shall be applicable with respect to taxable years beginning after December 31, 1947.

Passed the House of Representatives April 12, 1951.

Attest:

RALPH R. ROBERTS,
Clerk.

[H. R. 3168, 82d Cong., 1st sess.]

AMENDMENTS intended to be proposed by Mr. GILLETTE (for himself and Mr. HICKENLOOPER) to the bill (H. R. 3168) to amend section 113 (b) (1) (B) of the Internal Revenue Code with respect to the adjustment of the basis of property for depreciation, obsolescence, amortization, and depletion, viz:

On page 2, line 6, after the word "by" insert the following: "section (a) of".
On page 2, line 8, strike the figure "1947" and insert the following: "1938".
On page 2, following line 8, insert the following:
"(c) For the purposes of the Revenue Act of 1932 and all subsequent revenue Acts, the amendments made to the Internal Revenue Code by section (a) of this Act shall be effective as if they were a part of each such revenue Act on the date of its enactment."

The CHAIRMAN. Mr. Camp, the author of the bill in the House, is not present at the moment. I thought if he were here we would hear from him first.

I will submit for the record a statement by Mr. W. N. Haddad, of Bell, Boyd, Marshall & Lloyd, Chicago, in favor of the bill and in favor of the Gillette-Hickenlooper amendment.

Also for the record, two letters incorporating a statement by Mr. John E. McClure, of McClure & Updike, Washington, D. C., who can't be present today, also favorable to the bill and to the Gillette-Hickenlooper amendment.

(The documents referred to are as follows:)

BELL, BOYD, MARSHALL & LLOYD,
Chicago, January 16, 1952.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance, United States Senate,
Washington 25, D. C.

DEAR SENATOR GEORGE: Having written you sometime ago about my interest in H. R. 3168, I was notified last week by the clerk of your committee of a hearing which you propose to hold on that bill on January 22. Unfortunately, other commitments will prevent my acceptance of your invitation to appear before the committee on the 22d. However, I should like to express briefly my views on the bill and should appreciate the insertion of this letter in the record of the hearing.

H. R. 3168 is designed to correct the rule laid down by the Supreme Court in the Virginian Hotel case to the effect that a taxpayer who erroneously takes an excessive depreciation deduction is bound by his error in later years although the error had no effect on taxes. The Court based its decision on a construction of the word "allowed" in the statute—a construction completely at odds with the legislative history of the section involved. It is clear beyond doubt that Congress never intended the result which the Court reached.

Although this decision has not affected a great many taxpayers, it has worked an unconscionable injustice on those to whom it has been applied. The bill now pending before your committee will correct that injustice for all open years if the committee reports the bill with the Gillette-Hickenlooper amendment which restores the bill to the form in which it was originally introduced by Congressman Camp. I recommend most strongly that this be done.

There seldom arises in the tax field a situation calling for legislative action where all the law and all the equities are on the side of the taxpayer. This, however, is just such a situation. No one, to my knowledge, has ever supported the Virginian Hotel rule as a just one and no one has denied that it is a clear misinterpretation of congressional intent. I am certain you are aware that H. R. 3168 as originally introduced had been recommended again and again by the American Bar Association and the American Institute of Accountants. The American Bar Association recommendation was made first in 1943 when a petition for rehearing in the Virginian Hotel case was pending in the Supreme Court.

I think this bill presents an excellent opportunity for the Congress to demonstrate that fairness to taxpayers will be preserved even at the cost of some revenue.

I respectfully urge that the committee report favorably on H. R. 3168 with the Gillette-Hickenlooper amendment.

Sincerely yours,

W. N. HADDAD.

McCLURE & UPDIKE,
Washington, D. C., January 14, 1952.

In re H. R. 3168.

Senator WALTER F. GEORGE,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: I understand that public hearings will be held on this bill on Tuesday, January 22, 1952. I would appreciate your personal consideration of the following:

1. The bill should be amended so as to apply as far back as 1932, for the purpose of recomputing depreciation for prior years, but not so as to reopen tax years in which the determination became final prior to the date of its enactment into law.

2. That is to say, the act should not open up tax years already barred by the statute of limitation, but where the year is open and not barred by the statute of limitation, then for the purpose of determining the correct tax liability for such open year, the proper amount for exhaustion, wear and tear, obsolescence, amortization, and depletion, for years as far back as 1932, should be determined.

Respectfully submitted.

JOHN E. McCLURE.

McCLURE & UPDIKE,
Washington, D. C., January 18, 1952.

In re H. R. 3168.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance, United States Senate,
Washington 25, D. C.

SIR: I have been informed that the Treasury Department opposes the retroactivity of this bill primarily on the ground that it would cause an undue hardship on the Bureau of Internal Revenue in auditing returns for prior years. To this I have two views:

In the first place, if the decision of the Supreme Court in the Virginian Hotel Corporation case (318 U. S. 523) was erroneous, and I submit that it was, then the Treasury should be the one to correct it, because it was the Treasury who brought about the wrong decision.

In the second place, let me respectfully say that the Treasury Department is in error in stating that an undue burden would be cast upon the Bureau of Internal Revenue. I say this because the Bureau is constantly examining the books of corporations from the very time the corporation was formed, and also examining the books of taxpayers from the very time property was acquired where there is a retirement thereof. Let me give you some actual illustrations:

(1) In the recent case of *Boston and Maine Railroad* v. *Commissioner* (16 T. C. No. 180) the facts show that the Commissioner went as far back as 1913 for the purpose of ascertaining the historical data on certain properties retired in 1937 to 1943, inclusive.

(2) Just recently, in the settlement of Reading Co. for the years 1940, 1941, and 1942, the Commissioner went back to 1896 for the purpose of ascertaining the then value of property paid in at the inception of the corporation. This for the purpose of determining the invested capital credit.

(3) In every case in which the taxpayer has depreciable or depletable properties, the Commissioner's office, once in about 5 years, examines the taxpayer's books and records for the purpose of ascertaining whether or not the deductions for prior years were sufficient. If the Commissioner finds that the taxpayer took an insufficient amount for depreciation or depletion for prior years, the Commissioner sets up what he determines to be the correct amount for such prior years, making such computation apply back to the acquisition of the properties, which in some cases is even prior to 1913. Any experienced revenue agent will bear out this statement.

(4) Let me take a most likely situation. In 1951 a taxpayer retired a piece of property which it acquired in 1910, claiming a large loss, or reporting a profit in the event of a sale or exchange. What happens? The revenue agent goes back to 1910 to ascertain whether or not the taxpayer had deducted the proper amount for depreciation, and if for any year or years the taxpayer failed to take any deduction, or a deduction for an insufficient amount, the revenue agent recomputes the loss or gain on the disposition of the property in 1951 by charging that taxpayer with the insufficient amount taken in prior years. This is an everyday occurrence to the Bureau of Internal Revenue.

(5) Now let me give you one of the best illustrations of all. All taxpayers, literally thousands of them, who claim an excess profits credit based upon invested capital under the current Excess Profits Tax Act of 1950, must go back to the very time the corporation was formed and build up the historical data of each item of property which was turned in to the corporation for stock or as paid surplus. The same thing is true of property otherwise acquired for the purpose of ascertaining the accumulated earnings. See section 437 (c) of the code.

(6) Moreover the burden is on the taxpayer to prove its own case. Doubtless if the bill is made retroactive, as it should, taxpayers will be required to submit detailed data in support of any corrections which are sought to be made. The Commissioner will require this to be done in such a way that it will be a very easy matter for the Bureau to check the details thereof. Thus, there will be very little work on the part of the Bureau.

So, when the Treasury Department says that the retroactivity of H. R. 3168 would cast an undue burden upon the Bureau it is saying something that cannot be sustained on the analysis of actual experience of what goes on within the Bureau of Internal Revenue in the audit of tax returns.

True, there are literally millions of tax returns, but very few, very few indeed—only 15 or 20 taxpayers to the best of my belief—who were adversely affected by the Virginian Hotel Corp. decision. Even as to these few returns, they are among the old taxpayers whose books are constantly audited and reaudited for the purposes which I have just set forth.

Respectfully submitted.

John E. McClure.

The Chairman. Mr. Kirby, are you the first witness on this bill?

Mr. Kirby. I think so, Senator.

The Chairman. I thought we would hear Mr. Camp if he were here, but he is not here right now.

Mr. Kirby. I would like to have Assistant Commissioner Martin come up with me on this.

The Chairman. Mr. Martin, come right around, sir.

Mr. Kirby. There may be some questions that you would like to go into in connection with the administration and the revenue effects of the bill and Mr. Martin is thoroughly familiar with those aspects of the bill.

STATEMENT OF VANCE N. KIRBY, TAX LEGISLATIVE COUNSEL, DEPARTMENT OF THE TREASURY; ACCOMPANIED BY FRED S. MARTIN, ASSISTANT COMMISSIONER, BUREAU OF INTERNAL REVENUE, DEPARTMENT OF THE TREASURY

Mr. Kirby. The Department is very glad to appear before this committee and discuss the aspects of H. R. 3168, a bill which would reverse the Supreme Court's decision in the Virginian Hotel case.

In brief, the bill would extend the tax benefit rule to such depreciation as has been claimed and allowed in prior years, but which is in excess of the amount allowable as depreciation. Let me illustrate. Assume that the allowable yearly amount of depreciation with respect to certain property is $1,000 a year. The taxpayer claims, and the

Bureau does not disallow, a $2,000 depreciation deduction for that year. In other words, he is taking a deduction in excess of the properly allowable depreciation. He continues this practice through five loss years, and several years thereafter sells the property.

Under the present law, as laid down in the Virginian Hotel case, the basis of the property for determining whether gain arose on the sale will be reduced not only by the $1,000 yearly allowable depreciation, but as well by the $1,000 excessive depreciation which he has claimed on his return, even though in the five loss years the taxpayer received no tax benefit from the excessive deduction.

The Supreme Court indicated that this result followed since:

> Congress has provided for deductions of annual amounts of depreciation which, along with salvage value, will replace the original investment of the property at the time of its retirement. The rule which has been fashioned by the court below deprives the taxpayer of no portion of that deduction. Under that rule, taxpayers often will not recover their investment tax-free. But Congress has made no such guaranty—

that you will recover your depreciation tax-free.

> Nor has Congress indicated that a taxpayer who has obtained no tax advantage from a depreciation deduction should be allowed to take it a second time. The policy which does not permit the second deduction in case of "allowable" depreciation is equally cogent as respects depreciation which is "allowed."

It should be noted that the Commissioner of Internal Revenue in IT 2944, which was issued in 1935, took the position ultimately confirmed by the Supreme Court in the Virginian Hotel case. The Virginian Hotel case came down in 1943. In 1935 the Commissioner of Internal Revenue took the same position which was ultimately confirmed by the Supreme Court in the latter case.

Senator KERR. I wonder if you could stop right here and just briefly state the position of the Department and the conflict which exists which the Gillette-Hickenlooper amendment seeks to resolve.

Mr. KIRBY. I think it really would be a little clearer if I followed this statement, which is a fairly short statement, Senator. I would be glad to go over any part of it later.

Senator KERR. I must say I can follow a fellow a lot better if I can clear up any doubts and do not remain in such a condition of uncertainty until some opening in the cloud might make me see the light which I otherwise would not perceive.

Mr. KIRBY. Let me say that the Gillettee-Hickenlooper amendments only affect the effective date.

Senator KERR. That is all the marriage license does with reference to children born thereafter, you know. It is a matter of timing, I know that.

Mr. KIRBY. Under the bill no reduction in basis will be made in the above illustration for the excessive portion of the depreciation claimed, that is, where a person took $2,000 of depreciation during five loss years instead of $1,000 which was properly allowable under the law. Under that illustration the bill would restore the excessive depreciation to basis and would allow you to carry it forward into the later years.

Senator KERR. Let me ask you a question. I want to get a picture of the problem, if I can. Does it have to do with a situation where a taxpayer took more than the normal rate of depreciation in a year in which there was no taxable gain and, therefore, no profit against

which to charge that excess depreciation, and now, or at some time prior to this and subsequent to the decision, sought to get the credit for that excess depreciation in the same year in which he did have a profit or a taxable income?

Mr. KIRBY. That is correct. That is the situation.

Senator KERR. Is that the problem or the proposition we are considering?

Mr. KIRBY. That is exactly the situation.

Senator KERR. And does the Treasury oppose that?

Mr. KIRBY. The Department is quite concerned about that.

Senator KERR. Well, I understand that. I am kind of concerned about it, too.

Mr. KIRBY. For three considerations, the first of which——

Senator KERR. Just answer my question. Do you oppose that?

Mr. KIRBY. We really do not favor this bill even in its reduced form. The Department, on the House side, opposed the bill as originally introduced by Representative Camp because it went back to years as early as 1932 and would have resulted in tax refunds even for open years under the World War II excess-profits tax. Now, the House modified the effective date so that it would permit only refunds with respect to years after 1947. Now, that modification much improved the bill but, in our view, the bill is not desirable. First, it is not necessary prospectively, because of the carry-over provisions of the present law.

We have a 7-year carry-over of any losses, so that it will be unusual for a taxpayer not to receive tax benefit from excessive depreciation. It there had been a comparable carry-over of losses back during the depression years so that the excessive deductions were not completely lost insofar as tax benefit were concerned, then this problem really would not have arisen.

Senator KERR. Now, in the light of that, does the Treasury oppose the bill or the amendment?

Mr. KIRBY. Yes.

Senator KERR. It does?

Mr. KIRBY. Yes.

Senator KERR. Do you oppose it on the ground of being against the principle or on account of what the cost of the bill would be?

Mr. KIRBY. The cost is not as much as we believed at one time.

Senator KERR. Regardless of that, do you oppose the bill because of the principle or because of how much you think it would cost in revenue?

Mr. KIRBY. Well, we oppose it, first, as I said, for the reason that it is not necessary for the future, due to the long carry-over period, and second, because the benefit that would be given under this bill would be very unevenly distributed. In other words, the only real relief that would be forthcoming is to persons who, after 1947, still retain property which they held in those earlier loss years, generally in the 1930–35 depression period. It is only those taxpayers holding, say, factories or hotel property during the depression years and still retain that property after 1947 who would obtain any benefit under the bill.

Now those taxpayers who were in exactly the same situation in 1930–35, that is, who had claimed excessive depreciation in loss years, but who had sold or otherwise disposed of the property prior to 1948, will obtain no benefit whatsoever under the bill. The bill thus would

discriminate against them, as well as against those who did receive a tax benefit in the depression years from excessive depreciation. This latter group received a tax benefit of only 15 percent approximately whereas the bill would return benefits to a chosen few under a 50 percent rate.

Senator KERR. That is a marvelous speech, but I would appreciate it if you answered my question.

Mr. KIRBY. I am giving you the main reasons why the Department does not really favor this amendment, Senator.

Senator KERR. Is your opposition based on the fact that you oppose the principle of the bill or is it on account of the losses in revenue, or both? Will you answer that question for me?

Mr. KIRBY. It is both, Senator.

Senator KERR. It is both?

Mr. KIRBY. Yes.

Senator KERR. I understand that, but I am afraid you lost me in your long dissertation, and as I looked at you I was afraid you were getting a little confused yourself. You oppose it both on the question of principle and loss of revenue?

Mr. KIRBY. On revenue.

Senator KERR. Now, that is what you just said.

Mr. KIRBY. On revenue and the equity provisions, uneven distribution.

Senator KERR. That is part of the principle; isn't it?

Mr. KIRBY. Yes; I would say so.

Senator KERR. You oppose it both on the principle and loss of revenue?

Mr. KIRBY. Yes.

Senator KERR. Yet, as I understand it, you say that it is not of any necessity because the same benefit is available since 1947, or 1948, through the carry-over provision of the law applicable since that time.

Mr. KIRBY. Yes.

Senator KERR. Is that correct?

Mr. KIRBY. That is right.

Senator KERR. Well, then, that would be a recognition of the principle involved in this bill insofar as the present law is concerned; would it not?

Mr. KIRBY. That is right, insofar as the present law is concerned.

Senator KERR. Did you oppose that provision in the present law?

Mr. KIRBY. No, indeed; we recommended that.

Senator KERR. Then, if I get it right, you are in the position of opposing this bill on principle and having recommended another bill which put into effect either a similar principle or a principle which would produce similar results.

Mr. KIRBY. I will put it this way, if I may, Senator——

Senator KERR. Just answer my question the way I put it.

Mr. KIRBY. I would say that the enactment of this bill is not necessary, in view——

Senator KERR. I understand that. You covered that.

Mr. KIRBY. What the bill does is hand out relief in certain cases attributable to actions in the past whereas in other similarly situated cases they do not obtain that relief. Under present law all taxpayers are treated equally on current actions. That is the point.

Senator KERR. If they sold the property, they are not in the same position as the ones who haven't sold; are they?

Mr. KIRBY. They are different to that extent.

Senator KERR. Well, that is the difference; isn't it?

Mr. KIRBY. That is the difference; yes, indeed.

Senator KERR. Then, don't you find yourself in the position of opposing the application of this principle prior to a certain period and favoring it subsequent to a certain period? Isn't that one result?

Mr. KIRBY. I think that is exactly it, Senator.

Senator KERR. All right. That is what I want to get.

Mr. KIRBY. May I say this——

Senator KERR. You can say anything you want to after you answer the question. I am simply waiting for you to answer the question. I get lost when you make a speech before you answer the question. Now go ahead. What did you want to say?

Mr. KIRBY. I want to say this: that if we were to start completely afresh and we did not have the retroactive effects of this amendment, which would operate unevenly in its application, I think we would all agree that the bill is entirely proper.

Senator KERR. You think it is a sound principle. You think it should not be made retroactive because in doing so its benefit would not accrue to everybody; it would not accrue to those who, had they not sold, might have been benefited.

Mr. KIRBY. That is right.

Senator KERR. All right.

Mr. KIRBY. And there are other bars to getting the relief.

Senator WILLIAMS. Mr. Kirby, do I understand correctly——

Mr. KIRBY. Senator, could I just continue?

Senator WILLIAMS. Yes.

Mr. KIRBY. It is not merely the fact that they may have sold the property prior to the effective date of the bill; there are other reasons that would deprive them of the benefit of this bill, if it were broadened as is proposed by the Gillette-Hickenlooper amendment, to give relief in all prior open years. In other words, such broadening would also discriminate against people that have allowed their tax years to close.

Senator KERR. Would you favor the broadening of the bill to make it applicable to those?

Mr. KIRBY. If all people would be treated the same——

Senator KERR. Don't make a speech on general equity now; just answer the question. Would you favor broadening it to include those who are not in the position to get the benefits of it but who had similar losses?

Mr. KIRBY. Senator, the cost would be enormous.

Senator KERR. Will you answer the question? If you can't answer the question, just say so; but, if you can answer it, answer it. Do you favor that?

Mr. KIRBY. I cannot favor it when the cost would be so enormous, Senator.

Senator KERR. Just say "No"; just tell me you don't favor it if you don't favor it. That is a simple question. Do you or do you not favor broadening to where it would cover those?

Mr. KIRBY. I would not favor it, in view of the enormous cost.

Senator KERR. All right.

Mr. KIRBY. I would like to give the reasons for the answers that I give you; that is all, Senator.

Senator KERR. As I said, I don't mind how many reasons you give for an answer, but I sure would appreciate getting the answer and then the reasons.

Mr. KIRBY. Let us look at the three important aspects that I think the committee should consider in taking up this bill.

Senator WILLIAMS. Mr. Kirby, before you start making that point, may I ask you a question?

Mr. KIRBY. Yes.

Senator WILLIAMS. Do I understand you correctly to say that it is the Treasury's position that, if a firm claims a $2,000-a-year depreciation and under the law they would probably only be eligible for $1,000, they should still keep the $2,000 computation?

Mr. KIRBY. Yes, and that is exactly what the Supreme Court held.

Senator WILLIAMS. The question is this: Just suppose you have a firm that has held this same property for 15 or 20 years and did not claim any depreciation at all and they sell it, do you allow them to carry, under the present-day law, the full $100,000 which they paid for it, or do you make them go back mathematically and compute an imaginable depreciation?

Mr. KIRBY. We make them go back.

Senator WILLIAMS. Notwithstanding the fact they had never claimed it, you make them go back and compute it?

Mr. KIRBY. Yes; make them go back, under the statute, and make them deduct their allowable depreciation. It is not an imaginable figure, but depreciation actually sustained and under two Supreme Court decisions, of long standing, *U. S.* v. *Ludley* and *Fidelity-Philadelphia Trust Co.*, it must be taken into account.

Senator WILLIAMS. It is allowable?

Mr. KIRBY. Yes.

Senator WILLIAMS. You make them do it even though they never claimed that in their computation for income-tax purposes?

Mr. KIRBY. Yes, under the above two cases.

Senator WILLIAMS. When you make them claim it, do you make them go back to the income taxes in years when they did not claim it?

Mr. KIRBY. If the years are open, they would be entitled to recompute their taxes.

Senator WILLIAMS. And if they are not open you do not?

Mr. KIRBY. There would be no tax recomputation if the statute of limitations has run, but adjustment of basis for allowable depreciation would still be required.

Senator WILLIAMS. What is the statute of limitations?

Mr. KIRBY. Three years after the filing of the return, generally.

Senator WILLIAMS. It is the Treasury's position that if a corporation claims in excess of what you recognize you make them go back and correct it because that is in favor of the Treasury Department, but if they fail to claim any at all you still go back and penalize them?

Mr. MARTIN. It is required by law.

Mr. KIRBY. The statute says you have got to take into account the allowable depreciation.

Senator WILLIAMS. Do you think that statute is right?

Mr. KIRBY. I think it is.

Senator WILLIAMS. Do you think you have a right to make them carry back even though they haven't taken credit for it? Do you think you have a right to take it away from them if you don't give it to them both ways?

Mr. KIRBY. Yes. I would say the income-tax law intends that you compute your tax on an annual basis, and it tries to give you depreciation for each particular year involved in order to determine the taxable income for that particular year. Now, with respect to a failure to comply with the statute and with the statute of limitations running on that failure, you just cannot go back under the law and readjust the taxable income for that year. Depreciation must be recognized when it occurs and cannot be postponed to suit the convenience of the taxpayer.

Senator KERR. I believe we had a little discussion here the other day in which you said you would favor a law which permitted that.

Mr. KIRBY. Maybe so, Senator.

Senator KERR. Where the situation existed, that you would compel them, at a certain date, to readjust previous returns to reflect depreciated amounts so that the price, if sold today, would be correspondingly reduced. I believe you said in a situation similar to that, where, by your action, or by the workings of the law, they had to take a charge-off in the year in which their tax return was closed, that you would permit the opening of it to where they would get the benefit of the loss which the Treasury under the law compelled them to take.

Mr. KIRBY. I think you may be referring to that section 3801 which does try to wash out some possible inconsistent positions by the taxpayer or the Government.

Senator WILLIAMS. I think I can see where you can support one position of the Treasury, but I can't see how you can support both these positions at the same time.

Mr. KIRBY. You see, Senator, if a taxpayer fails to take the depreciation which the law allows him, he should not be able, in a later year, to take that which he failed to take in the appropriate year.

Senator WILLIAMS. He has to pay the capital-gains tax under the existing law, as I understand it. For instance, if the property cost him $100,000, and he held it for 20 years, he is allowed $50,000 for depreciation in his return even though he never depreciated it, but if he is taking off $75,000 you still make him deduct it. I can understand one or the other but I can't understand both.

Mr. KIRBY. If he has taken off $75,000 during the earlier years, then the law requires, and the Department agrees, that the $75,000 must be subtracted from his cost in computing his profits. So if, during the earlier years, he took as a depreciation $75,000 even though the allowable depreciation might have been only $50,000 for those years, and let us say, the statute has run on adjusting tax liability in those years, and he sells it for $100,000, then he is taxed on the $75,000 gain. That seems fair, of course. I mean, you should not allow him to have a double deduction for depreciation.

Senator FREAR. It looks like in that case you are not only allowing him a double one but you are not allowing him a single one.

Mr. KIRBY. In the case Senator Williams stated, he assumed he bought the property for $100,000 and during the earlier years he deducted $75,000 for depreciation, and the statute ran on these years, and let us assume that he was overdepreciating it, taking too large

an amount and he should have only taken $50,000, then in computing the gain on the property when he sold it in a later year for $100,000 the statute requires that you deduct the $75,000. This very situation was one which the 1932 amendment here in question was intended to meet.

Senator FREAR. You take the position, if the property cost $100,000, that sometime during the life of that property, if he does not sell it, he is allowed to take in depreciation $100,000. He may not always take it. If he sets it up on a 25-year basis and he skipped a year 10 years ago, he can't go back and claim that, after it has run 3 years, as I understand it?

Mr. KIRBY. That is right.

Senator FREAR. But he always has the opportunity, within the 3-year period, of getting 100 percent back on his investment?

Mr. KIRBY. That is right.

Senator FREAR. Under any circumstances.

Mr. KIRBY. That is right. But if he allows a year to go by without taking any depreciation and the statute runs——

Senator FREAR. How far back? Three years?

Mr. KIRBY. Three years.

Senator FREAR. If he finds his mistake within 3 years he can go back and make an amended return for the year in which he did not take his allowable deduction?

Mr. KIRBY. That is right.

Senator WILLIAMS. What if it is a farmer who owns property and never took any depreciation and he should sell it, would you still go back and compute an imaginable depreciation in computing his capital gain?

Mr. KIRBY. Yes. When you say "imaginable," the computation is of the allowable depreciation, the depreciation he is entitled to take under the law and which has actually occurred. Moreover, it is sometimes a difficult thing to figure out how long the life of this barn is.

Senator FREAR. Who determines the life of the barn?

Mr. KIRBY. The taxpayer, in the first instance, and the revenue agent, in auditing his return.

Senator FREAR. When the revenue agent disagrees with the taxpayer, whose judgment is taken?

Senator WILLIAMS. The revenue agent's.

Mr. KIRBY. That is right, unless an agreement or compromise is possible.

Senator KERR. The taxpayer can go to court.

Mr. KIRBY. Yes; that is entirely right. He can go from the revenue agent, whose decision is final in the first instance, to the conferees, then to the appellate staff of the Department, then he can go to the tax court.

Senator FREAR. To the appellate staff in the Department at the regional level or in Washington?

Mr. KIRBY. At the regional level; yes.

Senator KERR. The record will show that Senator Millikin is in the meeting, that he has to leave to go to another committee but he will return.

Senator MILLIKIN. Will you be good enough to count me for quorum purposes?

Senator KERR. Thank you, Senator.

Senator MARTIN. Mr. Chairman.

Senator KERR (presiding). Senator Martin.

Senator MARTIN. Mr. Chairman, it seems to me that the questions of Senator Williams and Senator Frear, and the answers thereto, have brought out, in a general way, not as it pertains to this particular bill but in a general way, the difficulty that the ordinary taxpayer has in order to correct what he thinks is an error in his taxes. I am referring to the man who is too small in business or in an occupation to have expert bookkeepers and accountants, and as these two Senators from Delaware both state, in most of those cases the man does pay what the collector says he ought to pay, because he just can't afford to go through the different things, Mr. Kirby, that you refer to.

Now, the big corporations, the rich people can afford to have an accountant and an attorney, but the smaller taxpayer can't, and it seems to me we are just getting this thing entirely too complicated.

Now, this matter of depletion of property is a very serious matter, because farm buildings have to be replaced, small office buildings have to be replaced, and if a man is a prudent man he sets up depreciation for that purpose. It is a very important thing. What I am getting at, I think the Congress and the departments down here ought to set this thing up so it is easier to understand, so that it is less complicated.

Mr. KIRBY. Right on that point, I think this should be brought out, that this bill is really not at all for the little fellow. The little fellow will not be able really to operate under the bill to get back this possible excessive depreciation that he may have now in the loss years. It is an extremely complicated job. But, as I was indicating to the committee, for the future years the hardships that this bill is directed at—and I do not hesitate to say there were hardships that resulted from this rule—those hardships will not result in the future, as I pointed out, in view of the carry-over of losses over a 7-year period.

Senator KERR. This is the reason I cannot understand your opposition to the bill on the basis of principle, because you favor a principle which is either identical or similar to the one now in the law with reference to present occurrences of like kind or character, but oppose the application of that principle, which you endorse as being wholesome, to years in which it was not available and as the result of which, even though there may be a limited few, the sum total of those that suffer still are in a position to take advantage of the curative effect of the legislation.

Mr. KIRBY. It is exactly that, the uneven distribution of the benefits of this bill.

Senator KERR. Yet you say you would oppose making it available to all, even those who sold their properties and for that reason would not be in a position to take advantage of it. I do not understand you opposing it because it does not cover enough and at the same time opposing it because it covers them all. So I think it reduces itself to the place where your opposition is based on the revenue. You think it costs too much.

Mr. KIRBY. I won't say exactly that. I want to remind you that when I answered that question I said that the revenue lost from making that applicable to all, without regard to whether the taxpayer still owned the property with respect to which excessive depreciation was

obtained, or irrespective of whether the statute of limitations was still open in the earlier year.

If we gave relief without regard to those bars then the revenue loss would be very, very large. Moreover, it would be actual cash going out of the Treasury as refunds while providing the treatment prospectively results in lessened revenues only.

Senator KERR. It reminds of the monarch who took the position that those who had died because of oppression in the past should not be helped and those who still lived should not be relieved from the oppression because there had been those who suffered the same oppression and now being dead were beyond relief.

Mr. MARTIN. Could I add something to that statement, Mr. Kirby?

Mr. KIRBY. Yes.

Mr. MARTIN. Mr. Chairman, opening the statute of limitations, making it applicable to all——

Senator KERR. What is your name?

Mr. MARTIN. Martin, Assistant Commissioner of Internal Revenue.

Senator KERR. Your remarks will be put in the record.

Mr. MARTIN. Opening the statute and making this relief applicable to all taxpayers would make a tremendous administrative burden on the Bureau.

Senator KERR. Now, I would not want to do that. I would think we should be as tender in the matter of putting burdens on the Bureau in the collection of taxes as we are in putting burdens on the people who pay the taxes. I believe we should have that in mind.

Mr. KIRBY. With respect to the administrative problems, the tax benefit rule proposed by H. R. 3168 would operate with respect to excessive depreciation claimed since February 28, 1913, to the extent that property in existence during the intervening years, or with a substituted basis therefor still remains in the property account on the effective date of the bill. Claims submitted under the proposal would thus involve reexamining tax returns for taxable years beginning prior to 1948.

This is under the bill which is before the committee.

Senator KERR. Are not you constantly reexamining those returns?

Mr. KIRBY. No. There are some returns that have not been completely audited even much earlier than 1948, but this would require the Department to go back and look into returns that had closed long ago.

Senator KERR. This does not apply to all taxpayers, does it?

Mr. KIRBY. It would apply to all taxpayers who have any property now and which they owned in the years to which the bill applies.

Senator KERR. Don't you think that is a very limited number?

Mr. KIRBY. Yes.

Senator KERR. And did not you say there was a very limited number?

Mr. KIRBY. Yes.

Senator KERR. The extent to which this limited number would be reduced it would reduce the number you would have to go into.

Mr. KIRBY. Yes.

Senator KERR. And reduce the burden that you have.

Mr. KIRBY. As Mr. Martin said, if you open the statute completely then you would have to go into a lot more returns.

Senator KERR. Is there such amendment before the committee, or are we discussing such proposal, or are you objecting to something that has not been suggested?

Mr. KIRBY. No; it was in connection with the question that the chairman asked and that Mr. Martin commented upon.

Senator KERR. Proceed.

Mr. KIRBY. From the administrative standpoint, the bill would impose substantial problems, since many early returns may no longer be available and since it would be necessary to reaudit loss year returns carefully to determine whether there existed offsetting unreported income items and the accuracy of items claimed.

In other words, Senator, to determine the excessive depreciation that was claimed in the loss years—and those are basically the years between 1930 and 1935—you would have to go back and really carefully audit those returns, perhaps for the first time, to determine the exact excessive amount of depreciation taken, the amount that is in excess of the taxable income, and whether there was really tax benefit from its deduction.

Senator KERR. You would not have to audit anything but the depreciation account, would you?

Mr. KIRBY. Yes, you would have to audit really the whole return.

Senator KERR. Now, just a minute, Mr. Kirby. If a fellow claimed $10,000 excess depreciation had been taken in 1935 and he now wanted to take credit for that and have his tax return for that year, which was closed out, show he had lost $25,000, would the Treasury have to audit anything in that return except the depreciation account?

Mr. KIRBY. Well, let me ask Mr. Martin whether the Department would audit that return.

Mr. MARTIN. The nearer you get to a taxable income by making an adjustment the more verification would be required.

Senator KERR. Some day you boys are going to answer the questions that I ask you. It would be a new experience, but some day you will learn we will move faster if you just answer the questions that are asked you.

Mr. MARTIN. It would require an audit of the return in most cases.

Senator KERR. Now, the case I mentioned, where he had this $25,000 loss and where he claimed an excess of $10,000 depreciation and asked to have credit for that, how much of his return for that year would you have to audit to fill the requirements of this bill?

Mr. MARTIN. Senator, I can't answer that question without seeing the return. It may be a return on which there was a $30,000 deduction other than depreciation that is questionable. If the $30,000 deduction was improper, then it may well be that the excessive depreciation actually did result in tax benefit.

Senator KERR. This does not open up that question, does it?

Mr. MARTIN. Yes, it does.

Senator KERR. Show me where in this bill it might open anything but the depreciation account.

Mr. MARTIN. The bill says nothing about it directly, but to determine whether he has actually had losses in the loss years we are talking about losses that are properly deductible.

Senator KERR. I thought that had already been determined.

Mr. MARTIN. It has not been.

Senator KERR. It has been, and finalized.

Mr. MARTIN. We look at the returns——

Senator KERR. I am going to put you under oath in a moment.

Mr. MARTIN. I will be glad to be put under oath.

Senator KERR. I want you to show me in this bill where it would open up the return of the taxpayer for purposes other than to audit the depreciation account, in the situation I described.

Mr. MARTIN. It does not open the return for assessment or refund, if that is what you mean.

Senator KERR. What does it open it for other than to determine whether or not the depreciation was there?

Mr. MARTIN. To determine whether there was a tax benefit or not from excessive depreciation.

Senator KERR. If he had an over-all loss of $25,000 and that has been finalized, what part of this bill would enable you to go back and determine whether it was accurate or not? Now, read the bill to me and read to me the provision that either gives you that right or imposes that responsibility on you.

Mr. MARTIN. The first sentence, reading as follows:

> In respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed as deductions in computing net income and resulting in a reduction of the taxpayer's taxes (but not less than the amount allowable) under this chapter or prior income-tax laws.

Senator KERR. Mr. Stam, have you heard the question I asked this man?

Mr. STAM. Yes.

Senator KERR. Is there anything in this bill that would open up the general tax return of a taxpayer in the situation that I asked him about?

Mr. STAM. This would be the general result: When you went back and looked at the old return you would reexamine it, unless the statute specifically forbade you from doing that, and the statute does not specifically forbid you from reexamining the entire income deductions in that back year.

In order to determine whether or not there was a tax benefit involved, they would feel it incumbent upon them to reexamine their whole return, even though they could not make an assessment or make provision for a refund. That is the general principle in the law, and unless the bill itself would specifically prohibit them, I would think they would feel inclined to think that they would have to do that.

Senator KERR. Is not the sole purpose of the bill to give the taxpayer the benefit, in a taxable year, of an excess depreciation that he took in a year in which he had losses, and therefore did not owe any taxes?

Mr. STAM. You would have to determine in the first place——

Senator KERR. Isn't that the sole purpose of the bill?

Mr. STAM. That is right, but you have got to determine whether or not he really did get the benefit of that deduction in the prior year.

Senator KERR. If he did not get any deduction, would he still get the benefit?

Mr. STAM. Suppose he had taken an excessive deduction on another basis, say, and you come along and when you look at that return you find out that other deduction should not have been allowed, then that would cut his losses down and it might cut the benefit due to the depreciation deduction.

Senator KERR. But you are still looking at the depreciation account, aren't you?

Mr. STAM. Maybe so, but you are looking at the old return to determine whether he got a tax benefit from these other deductions. In trying to determine whether or not he might benefit from this depreciation deduction, you have got to look at the other deductions, to determine whether or not he got a benefit from the depreciation deductions.

Senator KERR. You mean, if he had an expense for lawyers' fees and interest on a loan to the bank, that if he claimed those and you could now determine that he did not have them, that you could reopen that part of his account under the bill?

Mr. STAM. You could reopen it under the general law, unless the Congress specifically prohibited you from doing that under this bill, which they have not done.

Senator KERR. I thought once a tax was closed and finalized, either by action of the Treasury or the statute of limitations, that it took the discovery of fraud, newly discovered, or an act of Congress for them to go back into that.

Mr. STAM. They could not make an assessment on that, but they could go back to determine whether or not the person had received a tax benefit as an offsetting item. They can always go back and offset one item against another, even though they cannot assess any additional tax. That has always been the case, unless the Congress should specifically provide in the law that they should accept the other items of the return as being correct and simply make this adjustment, and it has not done that.

Senator KERR. Instead of saying they could accept the other items as though they were correct, would it be difficult to put an amendment in here to the effect that the tax returns for those years are not otherwise open by this bill, except with reference to determining as to whether or not there was an excessive depreciation for which the taxpayer might get a tax benefit?

Mr. STAM. It could be done.

Senator KERR. Would that be unusual, or is there a precedent for it?

Mr. STAM. It would be unusual, but there is some precedent for it.

Senator HOEY. You would have to review his return to see whether he got a benefit or not.

Senator KERR. I think the only review he would have to make would be (1) to find out how much excess depreciation there was, and (2) whether or not the loss for that year was equal to or greater than that amount.

Senator HOEY. In order to determine that, would you not have to look over the return?

Senator KERR. I do not see how you would have to look over any part of the return except the final figure, that he had a $10,000 loss or a $7,000 loss.

Senator HOEY. I was assuming the return shows losses, and sometimes the right losses, of course, but suppose you took out of the depreciation account maybe $30,000 for depreciation that year, if you took that out, then you would have the question of looking at these others, to see whether or not these others should be allowed.

Senator KERR. I would not think this bill would either impose that burden upon them or give them that right with reference to the return which otherwise was closed, and it remained so for many years.

Senator HOEY. Mr. Chairman, I was not here when the hearing started, but I notice the bill as it passed the House carried it back to December 31, 1947.

Senator KERR. That carries it back with reference only to years subsequent to 1947.

Senator HOEY. That is right. Now the amendment proposed by Senator Gillette and Senator Hickenlooper would place it back to 1932.

Senator KERR. Yes.

Senator HOEY. Well, now, are we to consider both of these?

Senator KERR. Yes. The chairman placed them in the record.

Senator HOEY. I would like to ask Mr. Kirby with reference to this amendment proposed here, going back to 1932, is it correct that practically all of those returns for any time beyond 6 years to the present time had been closed, unless there had been a controversy.

Mr. KIRBY. Yes; that is right.

Senator HOEY. That goes back to 1932. That is 20 years back.

Mr. KIRBY. Yes.

Senator HOEY. Would not that disrupt a whole lot of things?

Mr. KIRBY. Even going back to 1932, it would only apply to those years that happen to have been kept open by the taxpayer. I don't think that it is really contemplated that there will be any tax refunds with respect to the years much prior to 1938, and even then that is an awfully long time for a taxpayer to keep his years open.

Senator HOEY. 1938 would be 14 years.

Mr. KIRBY. Yes. And in addition to that, the bill contemplates that in order to compute your excessive depreciation and to be sure that it is excessive depreciation, which is not given a tax benefit, it seemed to us that it was intended that you look at the loss year itself, which might have been 1930 or 1931, or 1932, those heavy loss years, and that it required us to look into those losses to see whether the deductions other than depreciation taken were appropriate and to determine the excessive depreciation which actually did not give a tax benefit.

Senator HOEY. Now suppose this amendment was adopted to put it back to 1932, what returns would be affected by that?

Mr. KIRBY. Well, it would affect all the tax returns which have been kept open by the taxpayer for recomputation of taxes, all other returns having loss years with excessive depreciation and all returns for those taxpayers in years subsequent to the loss years.

Senator HOEY. When you say "kept open by the taxpayer," does that mean that it is in controversy in some way?

Mr. KIRBY. Yes; either on a waiver of claims for refund or just due to the 3-year period, which, of course, only goes back to 1948.

Senator HOEY. Going back to 1932, what I was trying to get at was just to see how many folks would be affected by that sort of thing. Is that a very large volume of unclosed tax accounts?

Senator KERR. Between 1932 and 1942?

Senator HOEY. Yes.

Mr. KIRBY. I think the Senator is asking about the number of returns that have been kept open since 1932.

Senator HOEY. Just to get some idea. I know you don't have an accurate list of them.

Mr. MARTIN. There are quite a number of large cases kept open from World War years, but very few before the Second World War.

Senator HOEY. That is up to 1942?

Mr. MARTIN. Yes. There are very few before that.

Senator HOEY. 1942, are there many of those cases open?

Mr. MARTIN. No; but we would have to go back and look at the loss years to determine how this applies.

Senator KERR. Look at what?

Mr. MARTIN. Look at the loss years to determine how much deduction was made for depreciation and to see as to whether they got a benefit.

Senator HOEY. You would not go back to determine anything unless there was some controversy, something open?

Mr. MARTIN. That is right.

Senator HOEY. You would not go back to a tax return filed from 1932, say, up to the war, 1942, unless that tax return was open?

Mr. MARTIN. That is right; we would not recompute tax liability.

Senator HOEY. This bill would not affect them?

Mr. MARTIN. That is right.

Senator KERR. Nor the amendment?

Mr. MARTIN. Nor the amendment.

Senator HOEY. If you come back to the present bill, the bill runs back to 1947. How many would be affected there? A lot of those are still open, I guess, from 1947.

Mr. MARTIN. They all could file claims beginning in 1948. That would expire March 15, of course.

Senator KERR. They are all open?

Mr. MARTIN. They are all open.

Senator HOEY. In other words, in that period of 6 years they could go ahead and file claims?

Senator KERR. Three years.

Senator HOEY. Between 1947 and 1952?

Senator KERR. 1948.

Mr. MARTIN. 1948 is the first year, and they will expire on March 15.

Senator HOEY. Of this year?

Mr. MARTIN. Of this year.

Senator HOEY. If it was not taken before that time, they would not have any benefit from it?

Mr. MARTIN. Unless they filed a claim or the case is open on consent.

Senator HOEY. This bill that passed the House, do you have any estimate of what revenue will be lost by allowing this depreciation?

Senator KERR. Let me see if I can answer that by saying this, that the bill that passed the House, in view of other legislation which has been passed, would be rather meaningless on one hand, and it probably would not cost any additional money than the other measures which have been passed already. Is that substantially correct?

Mr. KIRBY. No, Senator.

Senator KERR. Did not you say one of the reasons you were against this was because they already had the benefit under the carry-over?

Mr. KIRBY. Yes; but let me say this: You see, what the bill is doing is picking up depreciation that was taken back, say, in the years 1930

to 1935, picking up that excessive depreciation, which did not give the taxpayer a tax benefit, and then carrying that forward over the years, and if that amount then still produces a tax reduction with respect to the years 1948 and thereafter because of the retention of that same property, then there will be a tax reduction.

Now, you see, that is a retroactive aspect. In other words, it is depreciation which was already taken many years ago, almost 20 years ago.

Senator KERR. It would not affect that unless his income-tax return 20 years ago was still open, would it?

Mr. KIRBY. No; that is not true. You see, under this bill you can get the benefit of that excessive depreciation taken in the loss year. So, picking the year 1930, even though that year is closed, you take that excessive depreciation and then work it out through the intervening years to the first year that is open, and under the bill that first year would be 1948, so that it is a part of this excessive depreciation that was taken in the early year 1930 that would be brought forward to 1948, and then you get a tax benefit if you still own the property.

It is, as I say, that retroactive aspect that produces this revenue loss that Mr. Martin will tell you of in a minute. In other words, the entire bill as passed by the House costs about $56,000,000, it is believed. That is in addition to anything that would be lost under the present law.

Senator HOEY. This says you can go back to any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, and so forth.

Mr. KIRBY. Yes.

Senator HOEY. Under this bill, could you go back and pick up depreciation anywhere back there and give benefits in connection with the returns since December 31, 1947, if this was passed? For instance, this says you can investigate these things about depreciation since February 28, 1913.

Mr. KIRBY. Yes.

Senator HOEY. This limits it to returns to after December 31, 1947, but in figuring the amount you can go back over this period since 1937.

Mr. KIRBY. Yes.

Senator HOEY. You can look into the returns to see where the excessive depreciation occurred?

Mr. KIRBY. Yes.

Senator HOEY. It even goes as far back as 1913.

Mr. KIRBY. Yes; to pick up the excessive depreciation which did not give you a tax benefit.

Senator KERR. Let me see if I can illustrate that. Let us say they find there was $100,000 of excessive depreciation on property which, we will say, was worth $500,000, and which, under the law, would be taken in 33 years, the depreciation taken in 33 years, that would mean if there was $100,000 excessive depreciation for which he had not received taxable credit it would increase the base to the extent of $3,300 a year. Is that right, Mr. Stam?

Mr. STAM. That is right.

Senator KERR. Now then, under this bill, he would not be entitled to that item of $3,300 a year for those years prior to 1948, and for the years subsequent to 1948 he would not be entitled to take the $100,000 but only the $3,300 a year for that number of years out of the 33 which occurred subsequent to January 1, 1948. Is that a correct statement?

Mr. MARTIN. If I understood you, I think it is.

Senator HOEY. Would not that involve then an examination of the return all the way back? You could not just examine it since 1948.

Senator KERR. It would entail an examination only of those returns in the loss years, and with reference to which some recouped depreciation was claimed.

Senator HOEY. That is what I say. It would necessary for the Treasury to go as far back as they had taken depreciation.

Senator KERR. On the items they are still taking depreciation on and with reference to which all depreciation had not been taken.

Senator HOEY. That is right. They would have to go back and see how much depreciation had been taken through the years, and then they have a memorandum where there was a loss, and then bring it down to 1948.

Senator KERR. But in 1948 and 1949 they will be entitled to receive a credit for only that part of the depreciation represented by 1 year, that is, in the 1948 return, only the depreciation which was allocable to 1948, which, if it was a 30-year depreciation, it would be 3 percent, a 50-year depreciation, it would be 2 percent, or a 20-year depreciation, it would be 5 percent.

Senator HOEY. That would be only to 1948. You do not get the accumulation under this bill?

Senator KERR. No, you do not get the accumulation under the bill.

Senator HOEY. You mean you only take it for 1 year?

Senator KERR. You take it year by year in a proportionate amount, and you cannot take it for those years which are closed.

Senator HOEY. You review this thing and find the loss years to 1913, where they had losses and where the depreciation was excessive, and you bring it down to 1948 and you see how much it is. Do you have to take it all in 1948?

Senator KERR. No, you cannot take anything in 1948 except that part which would ordinarily be allowed in 1948.

Senator HOEY. Would you have to take whatever would be allowed in 1948, or could you take more in 1949?

Senator KERR. Under our present law, you have got the carry-over and that means for the 5 percent allocable to 1948 you either change it from profit to loss or increase the loss and, therefore, you get no benefit for it in 1948.

Under the provision of the 5-year carry-over, you would be permitted to carry that over into the next year in which you had a taxable profit.

Senator HOEY. It could run through the whole 5 years intervening ever since 1948?

Senator KERR. The only part you could get credit for in a taxable year, an amount that he was not in a position to take credit for in the year that he did not owe any tax, would be by reason of the provision of the other law which gives the right to carry over any loss he may have had for 5 years.

Senator HOEY. That would be applicable to this?

Senator KERR. Yes.

Senator HOEY. So conceivably he could get benefit for every year since 1948.

Senator KERR. That is right.

Mr. KIRBY. For the remaining life of the property, Senator.

Mr. MARTIN. Mr. Chairman, there would probably have to be some examination of all the intervening years to trace the property through. You would have to reconstruct the depreciation schedules all the way, for instance, from 1933, if that is the loss year, to the taxable year you are working on.

Senator HOEY. I understand that.

Senator KERR. If I understand this bill, it says:

> To the extent allowed as deductions in computing net income and resulting in a reduction of the taxpayer's taxes (but not less than any amount allowable) under this chapter or prior income tax laws.

I mean that very definitely limits any credit—

> to the extent allowed as deductions in computing net income and resulting in a reduction of the taxpayer's taxes.

Mr. KIRBY. That really is the wording that requires, in our minds, the reexamination of the contents of this loss to really determine whether this excessive depreciation taken does not result in a tax benefit, in other words, it does not result in a reduction of the taxpayer's taxes..

Senator KERR. Now will you proceed with your statement?

Mr. KIRBY. I think, Senator, that you have brought out the points that we wanted to make with you.

Senator KERR. You don't think I made your case for you?

Mr. KIRBY. You brought the points out. First, there is the fact that it will result in a revenue loss, then the fact that it will result in administrative burdens which have been illustrated to you, then the fact that there is, in our minds, no real need for this legislation for the future, and then the fact that the uneven distributions of the relief are so spotty that I do not think you would produce more over-all equity by passing the bill than you would by leaving it where it is.

Senator KERR. You oppose it because it is wrong in principle, and you oppose it because it gives a benefit to some and denies it to others, and then you oppose it because it loses too much revenue, and then you oppose it because there is not a like loss of revenue with reference to those taxpayers who are not affected by it.

Mr. MARTIN. I would like to emphasize, Mr. Chairman, the administrative difficulties and the arguments that will ensue from endeavoring to determine how much depreciation was allowable for 1933, 1934, 1935, and so forth.

Senator HOEY. I believe you said the estimate of losses on this bill as passed by the House would be about $56,000,000.

Mr. KIRBY. That is without including any allowance for interest.

Senator HOEY. That is right, without allowing any loss for interest. That loss would be about $56,000,000.

Senator KERR. Do you understand, Senator, whether that would be in 1 year or over what period of time?

Senator HOEY. What is the fact?

Mr. KIRBY. It would be over the remaining period of time during which Virginian Hotel prospects remained in existence.

Senator KERR. How much time?

Mr. KIRBY. We don't really know exactly how long.

Senator KERR. Mr. Kirby, I don't know how you arrived at the figure, if you don't know how much it is per year and for how many years.

Mr. MARTIN. Until the property is fully exhausted.

Senator KERR. How much would it cost in 1952?

Mr. MARTIN. We had not computed it on an annual basis, because it is going to cost the tax benefit from whatever depreciation is still allowable after 1947.

Senator KERR. How did you come to the conclusion without some formula by which you arrived at it?

Mr. MARTIN. We estimated that 40 percent of the property was still in existence on December 31, 1947, and the whole 40 percent has yet to be allowed in some years.

Senator KERR. I would want to know whether that $56,000,000 loss was going to occur in 1952 or 1953 or 1962 or 1963.

Mr. MARTIN. It tapers off over a period of a few years.

Senator KERR. How many?

Mr. MARTIN. Depending upon how long is the life of the property.

Senator KERR. How many?

Mr. MARTIN. 20, 30, 40 years.

Senator KERR. Then the $56,000,000 loss in revenue you estimate would occur in a period of from 20 to 40 years?

Mr. MARTIN. The most of it is in the early years of that period.

Senator KERR. How much would it be in 1952?

Mr. MARTIN. It would be just a very wild guess.

Senator KERR. I think the whole thing is a wild guess.

Mr. MARTIN. If it is $56,000,000 from 1948 on, then in 1952 perhaps it might be $1,000,000.

Senator KERR. About $1,000,000 in 1952?

Mr. MARTIN. Yes; just as a guess.

Senator KERR. That is what you wanted to know, isn't it?

Senator HOEY. Yes. Now I want to know if the amendment is adopted, have you any estimate as to what the loss would be on it, taking it back to 1932?

Mr. MARTIN. We have estimated $7,000,000 more on that account.

Senator HOEY. Which would make it a total estimate of $63,000,000?

Mr. MARTIN. That is right.

Senator HOEY. All right, that is what I wanted to get at.

Mr. MARTIN. Plus interest

Senator HOEY. Yes.

Mr. KIRBY. I think it ought to be pointed out, in connection with the estimates, that they are, at the very most, really a guess. I mean the statement of $56,000,000 perhaps sounds a little more accurate than it really should be. The Bureau of Internal Revenue people who are familiar with these things have tried to give you the benefit of their judgment on it. That figure is the very best guess. It is really almost anybody's guess, in view of the large number of unknown factors. We don't know, for example, how many pieces of property there are in existence now that were held by the same taxpayer back in 1930–35 and were overdepreciated at that time.

I mean, that is just one of the factors that makes it so difficult.

Senator KERR. Thank you, gentlemen. We will probably call on you again.

STATEMENT OF HON. A. SIDNEY CAMP, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF GEORGIA

Mr. CAMP. Mr. Chairman, and members of the committee, I am the author of this bill which I introduced in the House. I have been extremely interested in the questions proposed here.

The Supreme Court, as you know, in the Virginian Hotel case, construed our amendment to the internal revenue laws which was passed in 1932. This decision of the Supreme Court, if I remember correctly, was a 5-to-4 decision. It resulted in the only instance in the administration of our tax laws where our Government denied a taxpayer the right to correct any error which had resulted in no cost to the Government. I thought it was unfair and unjust, and that is the reason I have such interest in it.

Now there is no taxpayer that I know of in my State that has one of these cases open. But I have taken the position, and have taken it in other legislation, that so long as our Government finds it necessary to tax our people at such high rates as we have now, the Government should give every taxpayer every consideration that was fair and reasonable.

I introduced this bill, and it came up for hearing. The Treasury appeared and made their sole opposition on the basis of the fact that to pass this bill as I originally introduced it—and if I may digress here, I will say, if these amendments which you have mentioned are passed here, the bill will be just as I originally introduced it—the Treasury estimated that it would cost a total of from $300,000,000 to $350,000,000.

The committee was in favor of the bill, but we had a conference, and they said this is going to cost $350,000,000 to make it retroactive to 1932.

Senator KERR. And that was the date which marked the beginning of the period in which the inequities had occurred?

Mr. CAMP. Yes, sir. The decision was later, but the statute dates to 1932.

Now we had a conference and the Treasury said that if it were not made retroactive they would withdraw their objection. They made that statement in open committee, and then the bill passed our committee unanimously.

Senator KERR. On the basis that they said they would not object to it?

Mr. CAMP. Yes, sir. Now I made all the study that a member of our committee could make seeking information from this source and that, and I questioned the Treasury representative with all the vehemence I could maintain, believing that this estimate of $350,000,000 was entirely wrong.

Senator KERR. It was too high?

Mr. CAMP. Too high; yes, sir. I asked, "What percentage of tax cases or tax returns are now open in these back years?"

I thought it could not be more than 5 percent of them. I understand now that the best estimate is less than 2 percent, and the only ones that are open now that this bill applies to when you pass the amendments, the only cases open that it would apply to is the cases that are open on other matters, that are already kept open by the tax-

payer or the Government, because they are still trying to ferret them out. Those are the only cases that go back.

Now I understand from the testimony to make it retroactive to 1932 would only cost an additional $7,000,000.

Senator KERR. Above what would be the cost of the bill as passed by the House?

Mr. CAMP. That is right.

Senator KERR. And with reference to which the Treasury said they had no objection.

Mr. CAMP. That is right, and they did not object to it. After we removed the $7,000,000 item, then they withdrew their objection, and the bill was voted by the committee unanimously and it passed the House.

Mind you, this $7,000,000 will not all occur in 1 year. They said it may take 10 years to absorb it. So the difference was very little.

Gentlemen, I feel that if these cases are open and these taxpayers have made an error, it is not costing the Government anything. They were in loss years and, in all fairness and justice, they should be allowed to file an amended return and correct that error.

Senator KERR. An amendment to an unaccepted or unapproved return, to finalize the return?

Mr. CAMP. That is it, exactly. My position was I could not see how we could say, "All right, this bill is good, this has corrected an injustice, but we are just going to let it apply to those in the future, and not apply to those who have been sorely hurt by the thing."

I just thought it ought to go back to all the cases that were open. I took the position at that time, supposing it is $350,000,000, if it is not right for the Government to keep it, then it should give it back.

The principle to me was the same as if a man goes to a merchant and says, "Here, you cheated me 19 cents on this invoice of goods, and you cheated me 48 on this one," and the merchant says, "I will give you the 19 cents back, but when you come to the 48, that is a different principle."

Gentlemen, I think the principle is the same, regardless of what is involved.

Now I have, Mr. Chairman, a written statement that I would like to read. It is a short one.

Senator KERR. We will be delighted to have it read.

Mr. CAMP. This bill concerns depreciation. Depreciation, in income tax language, signifies the writing off of the cost of income-producing property over the period of time during which the property wears out or depreciates. In an economic sense a taxpayer has no income to the extent that he is only recovering his capital cost. If we impose a tax on income without allowing a proper deduction for depreciation, we are not taxing income—we are appropriating capital.

With taxes as high as they have been for the past 10 years, capital has become a precious thing. It is hard for a taxpayer to accumulate capital of his own or to attract the capital of others. In your body of the Congress, as well as in the House, we have attempted to tax income fairly—never to appropriate capital, whether directly or by some devious means.

This bill corrects a situation never intended by Congress—a situation where certain taxpayers are denied the right to write off the costs of their property on a fair basis in figuring income. This result was

unfortunately approved by a 5 to 4 decision of the United States Supreme Court in Virginian Hotel Corporation v. Commissioner (319 U. S. 523).

The Supreme Court held in effect that a taxpayer could not deduct the amount of depreciation actually incurred in a taxable year if by mistake on a return for an earlier year he had erroneously overstated depreciation even though the error did not deprive the Government of any taxes. In other words, the effect of the decision is that the Commissioner can appropriate a portion of a taxpayer's investment in capital properties because of a harmless error made in an earlier loss year. Now, of course, this is harsh and unfair. So far as I have been able to ascertain it is the only instance in the whole history of Federal taxation where the Commissioner has sought to penalize a taxpayer for an error which had no tax effect. Unfortunately, this injustice occurred in a field that is somewhat complicated and so the real significance of it and the real injustice of it was not clearly understood by a great many people. When it is understood, I believe we will all agree that in computing a taxpayer's taxes for current years or for any past year that is not closed we do not want to deny him the right to recover depreciation actually sustained simply because of a harmless error made on his return in prior years. If we do this, the effect of it is that we tax more than his income and appropriate to the Treasury some of his capital.

Now, let's see more specifically how this unfair result came about and how H. R. 3168 is designed to correct it. Since 1932 the tax law has provided that the "basis" of property for determining depreciation or gain or loss upon sale is reduced by depreciation in prior years "to the extent allowed (but not less than the amount allowable)." The Virginian Hotel decision held that if a taxpayer erroneously enters on his tax return in a year of loss more depreciation than he should, the excessive amount is "allowed" within the meaning of the statute if it is never challenged and if the statute of limitations has run on the year of the error. The excessive depreciation deducted by the Virginian Hotel had not reduced taxes because the hotel's return would have shown a net loss even with the correct deduction for depreciation. It is the rule established by this decision that H. R. 3168 is designed to correct.

This rule has been reluctantly applied by the lower courts, and the Supreme Court has repeatedly denied certiorari in cases which clearly illustrate the absurdity of the rule. In the Blackhawk-Perry case, for example, here is what happened. When the Blackhawk-Perry Corp. took over a hotel in 1935, it relied on the Commissioner's own rulings in using a $216,000 cost basis for depreciation. The hotel in 1935 had a remaining useful life of 15 years, so that the annual deduction for depreciation shown in the taxpayer's returns was one-fifteenth of $216,000. The years 1935 through 1941 were loss years. In investigating the profit years of 1942 to 1944, the Commissioner, relying on a 1944 change in the regulations, reduced the 1935 cost basis from $216,000 to $67,000. Thus the correct deduction for depreciation was only one-fifteenth of $67,000 rather than one-fifteenth of $216,000. Nevertheless, the Commissioner took the position—and the Court was forced to agree in view of the Virginian Hotel decision—that the cost basis of $67,000 should be reduced by the excessive depreciation shown in the returns in the loss years, despite the

fact that the taxpayer got no benefit at all from the excessive deductions because its returns for those years would have shown a net loss even with the correct depreciation deduction. The result was that on January 1, 1942, the hotel in fact had a remaining useful life of 10 years, but the taxpayer was denied any deduction for depreciation actually incurred thereafter simply because of the harmless error in earlier loss years. He was forced to overstate his income for 1942 and later years.

The Virginian Hotel decision is based on a construction of the statute which is completely at variance with the intent of Congress as shown by the legislative history. Prior to 1932 the law required that basis be reduced by the amount of depreciation previously "allowable"—that is, by the correct depreciation. This provision left a rather obvious loophole. A taxpayer might deduct more than the allowable or correct depreciation, thus reducing his tax, and before the error was discovered the statute of limitations might have barred the collection of the correct tax.

And yet, under the old law, it was feared that the Commissioner could reduce basis only by the allowable or correct depreciation for the prior year. Thus it was feared that the taxpayer could reduce taxes by taking excessive depreciation without being required to reduce basis by the excess.

The committee reports on the 1932 act make it clear that Congress was merely attempting to prevent a taxpayer from getting such a double benefit when it inserted the present language—"to the extent allowed"—into the statute. Both committee reports referred only to this type of situation in explaining the amendment. The expressed purpose was to protect the Treasury and to prevent the taxpayer from getting a windfall—not to penalize the taxpayer by denying him the right at any time to correct an error which had no tax consequences whatsoever.

The Virginian Hotel decision has been universally criticized by tax commentators from the time it was rendered in 1943 to the present. The decision is recognized by everyone familiar with the field as being both unfair and a perversion of the intention of Congress. Promptly after the decision was rendered the American Bar Association and the American Institute of Accountants recommended that Congress correct the error and reassert its original intention.

It was to undo the injustice of the Virginian Hotel rule and to restore the law to what Congress intended that I introduced H. R. 3168 in the exact form recommended by the lawyers and the accountants. The bill provides that excessive depreciation reduces basis only to the extent that it reduced taxes in prior years. It applies the principle originally intended by Congress, and prevents a taxpayer from getting a double benefit.

As originally introduced, the bill applied to all open years back to 1932, the date of the original statutory provision involved. During the consideration of the bill by the Ways and Means Committee the Treasury stated that the bill might conceivably cost over $300 million. Though some of us thought the amount would be only a small fraction of this figure, no statistics were then available. Because of the uncertainty as to the amount involved the committee amended the bill to make it apply only to years after 1947, and reported it out

favorably by unanimous vote. There is now pending before your committee an amendment offered by Senators Gillette and Hickenlooper which will restore the bill to its original form. Even if the amount were large, the Commissioner should not compute deficiencies and overassessments in pending cases on the basis of a rule which is both unfair and contrary to the intent of Congress.

However, since last April, when H. R. 3168 was passed by the House, much study has been directed to the question of the amount involved in the Gillette-Hickenlooper amendment. I now understand that it is generally agreed that the amount involved in this amendment is a small fraction of the Treasury's original estimate and that the estimated cost of the amendment is in the neighborhood of $7 million.

When H. R. 3168 was before the House last April, Congressman Reed pointed out that it had been amended by the Ways and Means Committee to apply only to years after 1947. He then continued:

> I hope that when this bill is acted upon by the other body it will reach the conclusion that the injustice of the rule established by the Virginian Hotel case should be fully corrected.

I wholeheartedly share Congressman Reed's hope that this committee will report out H. R. 3168 after it has been made fully retroactive by the adoption of the Gillette-Hickenlooper amendment.

Senator KERR. Thank you very much. Do you have anything further?

Mr. CAMP. That is all I have, sir, unless somebody wants to ask a question. I think I have covered it.

Senator KERR. You have covered it very clearly, and we thank you.

Mr. KIRBY. Could I say this before Mr. Camp leaves?

The CHAIRMAN. Yes.

Mr. KIRBY. The Treasury Department, Mr. Camp, did not approve the bill even as revised by the House committee. The Department felt that the change was a very great improvement in the bill, in view of the limitation of the retroactive aspect. I wanted to clarify this.

The Department did not approve the bill as passed by the House, and I want to stress this, that we thought then it improved the bill as introduced very much, not to have it go back and permit refunds with respect to the World War II excess-profits tax, and at that time we thought that the saving in revenue would reduce the cost just by that change on the House side by a considerable amount.

Now since the hearing before the House committee, the Bureau of Internal Revenue has been asked to go fully into all data that they had, and carefully reexamine it.

Now that outside figure, which was presented as just a completely outside figure, as indicated by you, it was indicated that it could conceivably amount to a $354,000,000 loss. But the factors, as I indicated today, are uncertain, and the Bureau of Internal Revenue has looked at its figures again and now its best estimate—and it is still a guess—is far below that. It is something like $70,000,000 for the entire Camp bill, and only a part, $7,000,000, I believe, is attributable to the earlier period prior to 1948.

At the time that we were over in the Ways and Means Committee, as I say, we felt that perhaps more than 50 percent of the revenue cost would be saved by the amendment that was made in the Ways

and Means Committee, and that is borne out by the report that we gave the chairman back in June of this year.

Senator KERR. Your present estimate is that the bill as passed by the House would cost $56,000,000?

Mr. KIRBY. That is right, without interest. The interest, however, is not too much.

Senator KERR. And your present estimate is, if the bill is amended to conform to the language that it had when originally introduced, and that would be effected by the adoption of the Gillette-Hickenlooper amendment, that the additional cost occasioned thereby would be $7,000,000?

Mr. KIRBY. That is correct.

Mr. CAMP. May I say this: I am very, very grateful to the Treasury for having looked into it in making their revised estimates. They first said it would be $354,000,000 before the committee, and it certainly was my understanding that by making the amendment, that is, taking the retroactive feature from the bill, that when that was done it was certainly my understanding that the Treasury withdrew its objection.

Senator KERR. Thank you, Congressman Camp.

Mr. Kirby, does the Commissioner who is with you have anything further to say?

Mr. MARTIN. Mr. Chairman, I just want to stress the fact that I think the important point in this whole issue is the difficulty of determining what was allowable depreciation. As an illustration, a taxpayer who has taken 5-percent depreciation, we will say, from 1920 to 1930, and then had loss years from 1931 to 1934, or 4 years, then beginning 1935 they had profits again, when we got around to the examination for 1935 and later years the rate went from 5 percent to 4 percent, the greatest problem, as I see it, is what was properly allowable in those years 1931, 1932, 1933, and 1934.

That is where the administrative difficulty comes in. A taxpayer will say, of course, he was entitled in those years to the 4 percent, which was allowable in 1935 and later years. On the other hand, it is just as reasonable to say he was entitled to the 5 percent that he was getting prior to 1931 for the years up through 1934.

Senator KERR. Don't you have difficulties, which may not be as intense, or as great, but of like kind and character, in the operation of your business?

Mr. MARTIN. That is right, sir, and we have it all the time, but going back so far is what bothers us, in trying to put ourselves in the position that we had been in then, because the depreciation is supposed to have been determined as at the end of the taxable year, and when you have got 20 years or more to look back, it is most difficult to put yourself back in the position you were in at that time. I think that is the real objection of the Bureau of Internal Revenue to this legislation.

Senator KERR. I think if you took advantage of your hindsight; you would be more accurate then when you take advantage of your foresight.

Mr. MARTIN. This bill gives an advantage to some taxpayers that other taxpayers do not have.

Senator KERR. That is right. That is aside from the difficulties which you might have to administer it. Is there anything else?

Mr. MARTIN. That is all.

Senator KERR. All right. Thank you.

Mr. Walter T. Cardwell.

STATEMENT OF WALTER T. CARDWELL, MANAGER, TAX DEPARTMENT, S. D. LEIDESDORF & CO., NEW YORK CITY, N. Y.

Mr. CARDWELL. Mr. Chairman, and members of the committee. My name is Walter T. Cardwell. I am the manager of the tax department of S. D. Leidesdorf & Co., certified public accountants, New York. I am here as the representative of the firm, and also because of a personal equation. I will make my statement as brief as possible.

I have no written statement to file. For more than 20 years I was employed in the Bureau of Internal Revenue, and as the result of that, both in the administrative and technical positions, of course, I had something to do with the problem from the Bureau point of view.

The thing became very active early in 1933, when the returns for calendar year 1929, filed March 15, 1930, were about to be barred by the statute of limitations. Losses sustained by many corporations in 1929, 1930, 1931, and 1932 had been passed by the Bureau because of the practical aspects of the administration of the tax laws.

When it is perfectly obvious that the examination of the tax returns would produce no revenue, it was a waste of the Bureau's time and money to go in and make an intensive audit of those returns. They were simply based on the ground they would produce no revenue to examine them. That being so, the taxpayer had not called to its attention any question about the depreciation deducted in those returns.

It was at that time the position of some of us that, in all fairness to these corporations, the Bureau could issue some press release or notice that it was going to take this position, that unless they filed amended returns—and that is the only way the taxpayers could protect themselves—then the statute would run, and under the 1932 act the amount deducted would be treated as the amount allowed.

Actually, there was no quarrel with the provision of the 1932 act, if the Bureau examined each year promptly the returns as filed, and then the amount deducted in the return could be passed upon by the Bureau personally and, if proper, would be allowed.

The whole fault grows out of the situation where the returns for losses were not producing revenue and were passed without audit. Of course, there was a difference of opinion at that time and no press release was issued between 1933 and 1943, a period of 10 years. There was issued in 1935 the IT, stating the Bureau's position. In 1939 the Pittsburgh Brewing case came down.

Senator KERR. What was the position?

Mr. CARDWELL. That is in the statute. The depreciation deducted had, in fact, been allowed.

Senator KERR. And that the taxpayer would not be permitted to reclaim any portion?

Mr. CARDWELL. Exactly.

Now, I never dreamed in 1933 that I would be here today. I don't know any provision in the law that I feel more strongly about than this one. My position is that the Congress, through the Camp bill and its amendment, is doing nothing more to the 1932 act than it originally should have done and actually intended to do. The Congress has always tried to pass wise and sane tax legislation and to do fairly by the citizens. We believe that.

Senator KERR. Are you speaking now individually or do you represent a considerable number of people?

Mr. CARDWELL. I will limit that to my own case.

Senator KERR. It is acceptable on the other basis.

Mr. CARDWELL. I will be very glad to have that view endorsed by others, sir.

As to the cost of this bill, this is our feeling: Depreciation of property with short lives, machinery and equipment, 5, 10, 15, or even 20 years, has long since gone. A 10-year life obviously had no interest to people in the late 1940's. Much property with long life, buildings, has since changed hands through sales and new pieces of property acquired. We have no statistics, such as the Treasury has, to base the cost of this proposed measure on, but it is inconceivable to us that many 1932 tax returns could be open, 1932 and beyond, certainly before the war years. We cannot understand how there could be much revenue involved in them.

We urge the enactment of this bill, and we don't believe that the administrative difficulties envisioned by the Treasury will ensue here. As a matter of fact, the taxpayers seeking the benefit of this bill will have to appear before the Treasury and present their own cases. The burden of proof is going to have to be borne by the taxpayer to prove the excessive depreciation in the past year.

The difficulties of determining the life of the property, as you just pointed out, Senator, is no greater than any other problem. It is one of administration and judgment and good sense. So this bill should be enacted in all fairness to all people, and no loss will inure to the Treasury. It should have been enacted in the first place.

Senator KERR. Thank you, Mr. Cardwell.

Mr. Kilpatrick.

STATEMENT OF H. CECIL KILPATRICK, AMERICAN BAR ASSOCIATION

Mr. KILPATRICK. Mr. Chairman and gentlemen of the committee. I appear on behalf of the American Bar Association. I am a member of the council of the section of taxation and the chairman of that section asked me to appear.

The American Bar Association, shortly after the decision in the Virginian Hotel case, recommended the same bill that Mr. Camp has introduced and as this bill would be if the Gillette amendment were adopted, and we are here simply to urge that those amendments be approved by this committee and the bill restored to its original form.

Now, as the committee probably knows, the section of taxation customarily does not recommend a retroactive application of amendments to the revenue laws.

Senator KERR. Let me interrupt right there.

Mr. KILPATRICK. Yes.

Senator KERR. This does not create a retroactive feature with reference to any situation which is not a current matter, does it?

Mr. KILPATRICK. No; it applies only to open cases. You are correct, sir, it does not lift the bar of the statute of limitations. We discussed that and did not recommend that that be done.

Senator KERR. So actually when the statement was made that this was a retroactive measure, that would be subject to a misunderstanding on the part of one who did not realize that that feature of the amendment would make the bill apply only to tax cases which, by rea-

son of the operation of some other provision of the law, or some other act of the taxpayer or the Treasury, are still pending matters?

Mr. KILPATRICK. Yes, sir.

By use of the term "retroactive" I mean a change in the rules for computing income, which is applicable to years which are in the past, at the time that that act is passed, yes.

Senator KERR. And with reference to cases which are, by reason of some other factor, current matters?

Mr. KILPATRICK. Precisely.

Senator KERR. All right.

Mr. KILPATRICK. I merely want to state that the reason we varied our customary approach in this is the reason we have followed in other situations, where we found that either the courts by final judicial construction or the Government by administrative construction has reached the conclusion which we believe is clearly in conflict with the congressional intent and which, furthermore, results in what we conceive to be shocking results, and for that reason we think the "retroactive" enactment of this legislation is important, to restore the feeling of fair dealing at least between the Government and the taxpayer.

In these days of high rates it is of the utmost importance to the continued success of our self-assessing system that the taxpayer feel that his Government is going to deal with him decently and equitably.

Senator KERR. You are taking the position that the tax laws should have features in them that would be beneficial to the taxpayers?

Mr. KILPATRICK. I am afraid I am, Senator.

Senator KERR. Well, that is not a new position.

Mr. KILPATRICK. It is a litte old-fashioned, perhaps, sir.

Senator KERR. All right, Mr. Kilpatrick, we thank you.

(Mr. Kilpatrick submitted the following statement in extension of his remarks:)

STATEMENT OF H. CECIL KILPATRICK, ON BEHALF OF THE AMERICAN BAR ASSOCIATION

My name is H. Cecil Kilpatrick. I am an attorney practicing in the District of Columbia, and a member of the council of the section of taxation.

Shortly after the decision in *Virginian Hotel Corporation* v. *Commissioner of Internal Revenue* (310 U. S. 523 (1943)), the American Bar Association adopted a resolution, on the recommendation of the section of taxation, urging an amendment of the law to overcome the inequitable result of that case. The association's resolution directed the section of taxation to urge the adoption of that amendment upon the Congress, and this we have done on a number of occasions. I appear here at the direction of the chairman of the section of taxation, Mr. Morton P. Fisher, to present the same recommendation.

The rule laid down in the Virginian Hotel case and the unfair results of that rule are well understood by the members of this committee, and I can add little on that subject to what has been said by Mr. Camp and Mr. Sherwood.

The section of taxation has made a great many recommendations for changes in the tax laws during the past 10 or 12 years, and a number of these have been approved by you gentlemen and have become law. As you may have observed, our recommendations are usually that such changes be prospective in operation only. It is only in cases where we have felt that the courts or the Government have applied the law contrary to the clear congressional intent, with an extremely harsh and unfair result, that we have recommended retroactive changes. This is one such case.

The congressional intent seems clear that the 1932 amendment, which brought the "allowed" concept into the statute, was for only one purpose, to prevent a taxpayer from getting the tax benefit of excessive depreciation deductions by having his rate changed after it was too late for the Government to collect the deficiency resulting from such deductions (H. Rept. No. 708, 72d Cong., 1st sess., p. 22; S. Rept. No. 665, idem, p. 29).

Chief Justice Stone, in his dissenting opinion in the Virginian Hotel case, denounced the result as inequitable and incongruous, and said: "So inequitable a result cannot rightly be achieved by saying that a 'deduction' for depreciation which never has been deducted from gross income has nevertheless been 'allowed'."

In the same case, Mr. Justice Jackson, speaking for himself and Justices Roberts and Murphy in a separate dissenting opinion, said:

"The question comes simply to this: Whether the Commissioner, upon determining whether taxpayer has in good faith erred, may use a correction insofar as it helps the Government and adhere to the mistake insofar as it injures the taxpayer."

We submit that such is the shocking result of the interpretation placed upon the statute in the Virginian Hotel case, and we urge that justice be done by the adoption of this bill in the form in which it was originally introduced in the House.

STATEMENT OF WILLIAM T. SHERWOOD, FORMERLY ASSISTANT COMMISSIONER OF INTERNAL REVENUE, WASHINGTON, D. C.

Mr. SHERWOOD. Mr. Chairman, and members of the committee, I am William T. Sherwood, formerly Assistant Commissioner of Internal Revenue.

My interest in this matter stems from my service in the Bureau. While I was in the Bureau I was opposed to the Virginian Hotel rule. I argued against the issuance in 1935 of I. T. 2944, which first laid down the rule later affirmed by the Supreme Court in the Virginian Hotel case. In my opinion the rule was clearly contrary to the fair treatment which taxpayers should expect and, I think, generally receive in the Bureau.

There is no reason why the Commissioner should seek to hold a taxpayer to an error which did not affect taxes. The Supreme Court apparently considered that this result was required by the word "allowed" in the statute. The Court's opinion reasoned that depreciation was "allowed" if it was entered in a return and not challenged. This reasoning is obviously fallacious when applied to a year when the excessive depreciation shown on the return had no tax effect.

This Virginian Hotel rule is unjust and should be corrected for all open years. If the cost were large, that fact, in my opinion, would simply make more compelling the Government's obligation to correct this rule. However, statistical analysis has made it clear that the cost of applying the bill to open years prior to 1948 is not large. As a general proposition, I do not favor retroactive legislation. That is certainly so where there is a change in policy. But when a gross and obvious wrong has been done in clear violation of sound policy, and of congressional intent, I think Congress should reassert from the beginning what it always intended.

I. T. 2944 was not applied to all taxpayers falling within its terms. In the settlement of many cases to which it was applicable the depreciation was determined without invoking the rule. I know this from my own experience in the Bureau and from discussions with people in and out of the Government who were settling cases prior to the Virginian Hotel decision. Most depreciation schedules, particularly in the larger corporation cases, were adjusted by 1943. The I. T. was always obnoxious, and during the period from 1939 to 1943 the Third Circuit Court of Appeals decision in the Pittsburgh Brewing, rejecting the principle of the I. T., was the only court's decision

outstanding. Taxpayers who were at all competently advised would not have thought of settling their depreciation schedules on any such basis as the principles laid down in the I. T.

It was usually only small or medium-sized corporations without competent accounting advice to whom the rule was applied. It is my feeling that the amounts involved in the great majority of cases are not large enough to have been kept in mind over a period of years. It is my feeling that only a comparatively small number of corporations—only those who were badly hurt—are likely to make claims, even as to years still open. This is confirmed by inquiries made by the Committee on Federal Taxation of the American Institute of Accountants 3 years ago, which indicated that even at that time there would have been only a small number of taxpayers interested. I think, therefore, that the claims under this bill in its original form will be much smaller than some persons would contemplate and the actual cost to the Government much small than even proper statistical estimates would now indicate.

Senator KERR. All right, Mr. Sherwood. Thank you, sir.

Mr. SHERWOOD. You are entirely welcome.

Senator KERR. Mr. Wolfe.

STATEMENT OF PAUL V. WOLFE, CERTIFIED PUBLIC ACCOUNTANT, NEW YORK CITY, N. Y.

Mr. WOLFE. Gentlemen, I am Paul V. Wolfe, a member of the bar and a certified public accountant of the State of New York. I am also a partner in the public accounting firm of Harris, Kerr, Forster & Co., public accountants, of 18 East Forty-eighth Street, New York City, N. Y. My firm and the firm of Horwath & Horwath are consultants to the American Hotel Association. I am appearing here today on behalf of the American Hotel Association and my statement is concurred in by the firm of Horwath & Horwath in support of the Senate amendment to the House bill H. R. 3168.

The House bill H. R. 3168 is directed toward correcting the gross inequities that arise out of the 5-to-4 decision in the Supreme Court case of *Virginian Hotel Corporation* v. *The Commissioner*, cited in 319 U. S. 523. The majority opinion in the Virginian Hotel case has received severe criticism from the American Bar Association and the American Institute of Accountants, which two organizations are most highly respected in tax legislative matters. The majority opinion in the case has also been criticized in the June 1943 issue of the Harvard Law Review, as well as in many other periodicals specially devoted to tax matters. A brief summary of the important facts in the case are as follows:

From 1927 to 1937 the taxpayer on its income tax return deducted depreciation on certain of its assets on a straight line basis. No objection was taken by the Commissioner or his agents to the amounts so claimed and deducted. In 1938 the taxpayer claimed a deduction on its 1938 Federal income tax return for depreciation at the same rates as used in prior years. The Commissioner determined that the useful life of the equipment was longer than the petitioner claimed and that, therefore, lower depreciation rates should have been used. The depreciation, at the higher rates as deducted on returns prior to 1938, was subtracted from the cost of the property. The remainder

was taken as the new basis for computing depreciation and a lesser deduction for the year 1938 was accordingly allowed. For the years 1931 to 1936, inclusive, the taxpayer had sustained a net loss and hence, the depreciation deducted on said returns did not serve to reduce any taxable income of the taxpayer. The taxpayer did not challenge the new rates determined by the Commissioner for the year 1938. However, the taxpayer contended that the amount of depreciation claimed for the years 1931 to 1936, inclusive, which was in excess of the amount properly allowable as determined by the Commissioner in 1938 should not be subtracted from the depreciation basis since such excess did not serve to reduce the taxable income in the years 1931–36. The taxpayer won in the Tax Court and the circuit court of appeals reversed. The majority opinion in the Supreme Court affirmed the holding of the circuit court.

In summary, the issue before the Supreme Court was whether the taxpayer was obligated to reduce the cost basis of its assets for purposes of computing depreciation in 1938 by the amount of excessive depreciation determined in 1938 that was deducated on its tax returns for the years 1931 to 1936, inclusive, in view of the language of section 113 (b) (1) (B). The latter section provides in substance that the adjusted basis of the depreciable assets shall be its cost or other appropropriate value less depreciation to the extent allowed—but not less than the amount allowable. The majority opinion held that even though the taxpayer received no tax benefit for the excessive depreciation during the years 1931 to 1936, inclusive, the cost basis of the asset must be reduced by the amount of depreciation deducted on said returns in those years. The dissenting opinion of Chief Justice Stone labeled the position of the majority as being an incongruous result and concluded that the taxpayer should not be compelled to reduce its tax basis by the excessive depreciation taken on the return in 1931–36 since no tax benefit had been secured by the taxpayer for such excess. Mr. Justice Jackson wrote a dissenting opinion and joined in the dissent of Chief Justice Stone.

I believe that both the majority and the dissenting opinions are agreed that if the taxpayer had secured any tax benefits for the excessive deduction, the basis of the taxpayer's assets should be reduced by the amount of the excessive depreciation for which the taxpayer secured a tax benefit.

Section 113 (b) (1) (B) was amended by the Revenue Act of 1932 and added the word "allowed" to the statute. A careful reading of the legislative history of section 113 (b) (1) (B) clearly indicates that Congress had no intention in 1932 of amending the law so as to result in the conclusion of the majority opinion in the Virginian Hotel Corporation case. It is respectfully submitted that the congressional intent fully supports the dissenting opinion of Chief Justice Stone in that case.

The Senate amendment to House bill H. R. 3168 now before you restates the intention that Congress had in 1932 when section 113 (b) (1) (B) was revised so as to leave no doubt as to what the congressional intent was at that time.

The deduction for depreciation permitted by the Internal Revenue Code must necessarily be based on an estimate of the useful life of the depreciable asset. The estimate of useful life must be based on such facts as can be ascertained at the time the estimate is being made.

A taxpayer can be guided by norms developed for similar type assets, but to a great extent, the useful life of any specific asset will be affected by a number of factors, such as, the attention and repairs given to it, the extent of use causing wear and tear, climatic conditions, type of material, constructive or component parts, obsolescence factors, and so forth.

When a taxpayer has made an estimate of useful life and has computed and deducted depreciation on the basis of the known facts at that time, the provisions of H. R. 3168 would not permit a subsequent adjustment of such a deduction whether or not tax benefit had been derived therefrom. The proposed bill would only permit the adjustment of depreciation deductions in prior years when it was subsequently determined that such prior deductions were erroneous and the excessive depreciation deduction was not justified by the known facts at the time of the deduction. The adjustment of such excessive and erroneous depreciation deductions is limited to the extent that a taxpayer did not realize tax benefit.

It is with great emphasis that I urge upon you favorable consideration to the Senate amendment to House bill H. R. 3168 which does nothing more than to restate with clarity the intent of Congress in the Revenue Act of 1932 so that justice will be done to the taxpayers of this country who have been caught in the tax crossfire result of the majority opinion of the Supreme Court in the Virginian Hotel Corporation case.

I would like to add a few further comments that I think are important for you gentlemen to have in mind, in your consideration of the bill before you.

Senator KERR. All right.

Mr. WOLFE. On the subject of depreciation, going back to the years in the 1930's, we all recognize what the dollar was worth at that particular time. In the 1930's, properties were erected with real hard dollars, and it is only upon those dollars that the taxpayers are entitled to depreciation.

We know what the dollar is worth today. The dollar has declined in value tremendously. It was at that time the position of some of us that, in all fairness to these corporations, the Bureau could issue some press release or notice that it was going to take this position, that unless they filed amended returns—and that is the only way the taxpayers could protect themselves—then the statute would run, and under the 1932 act the amount deducted would be treated as the amount allowed.

Senator KERR. What you say is even though the bill is passed by the inclusion of the Gillette-Hickenlooper amendment the taxpayer would still be recouping hard dollars with those not so valuable.

Mr. WOLFE. That is right, sir.

Senator KERR. All right.

Mr. WOLFE. Both the Virginian Hotel and Perry Black Hawk are cases dealing with hotels. We have had requests from the membership to direct our atttention to the inequity in those cases, and that is why I am here.

I do not have any cases on the subject before the Bureau, and I am merely appearing here in an effort to point out to you gentlemen the gross inequities in principle that are involved in the decided cases mentioned.

Picture the situation of a taxpayer who is obligated to put a life on an asset. Anybody might differ on the life established. These two cases which have come down on that particular point illustrate the squeeze in which the taxpayers are put. They estimate a life, and many times the Bureau goes along and does not examine their returns, with the result when they do arrive at a period where there is a taxable net income the Bureau comes in and they change the life, by reducing the life so as to create greater taxable income for the period. I speak with experience on the subject, having represented many taxpayers before the Bureau. Ordinarily, where there was a loss, the Bureau was not concerned with giving attention to the subject of depreciation, but as soon as the taxpayer gets in a position where there is a taxable income the Bureau scrutinizes the deductions taken for depreciation.

The result is the Bureau claims a smaller amount, and the taxpayer invariably has got a fight on its hands, or had to accede to it. The Virginian Hotel Company case and the Perry Black Hawk case particularly point out the difficulty that the taxpayer is under.

All this bill is intended to accomplish is to do equity in that where there is an excessive amount of depreciation, where both the Bureau and the taxpayer recognize that there is an excessive amount of depreciation for which the taxpayer received no tax benefit, the idea is to endeavor to make him whole. Of course, in the period where he had been taking the larger amount of depreciation the Bureau claimed that it was much less. In the actual application of the act there is part of it that even the taxpayer does not get, because he is actually charged with allowable depreciation in any event.

Now, insofar as the administrative difficulties of this bill are concerned, this is a relief measure for taxpayers. The taxpayers must take the move in order to get relief. If they just sit idly by and do nothing about the provisions of this act the Treasury has nothing to pay out and has nothing to do with the adjustment of depreciation.

Senator KERR. You say the burden of proof is on the taxpayer?

Mr. WOLFE. That is exactly right, and he is the one that must assemble the information that is necessary to implement the intent of this act.

Senator KERR. He must meet the burden.

Mr. WOLFE. He must meet the burden. So that when the Department of the Treasury comes around, those things are lined up for the agent and it is set forth before him clearly, because that is the obligation of the taxpayer under this bill.

Insofar as the open years are concerned, I don't think the fact should be overlooked that the only years that are open are years wherein there were some taxes due. If there were no taxes due there was no need for the Bureau to go into it.

Senator KERR. The Bureau, however, engaged in the audit of the return?

Mr. WOLFE. Precisely, sir. This bill is only intended to cover the situation where there was no tax benefit. For the years covered surely there were some tax disputes. So I do not see anything in the point that administratively you have got to go back over all these years. This bill does not relate to any situation where the taxpayer does not secure a tax benefit. Since those years are open, then under those circumstances the matter is before the Bureau and can be very easily

corrected if there is an excessive amount of depreciation on that return. If there is no excessive depreciation then the matter goes by and the other issues are determined.

Now, so much for my comment with respect to administrative difficulties.

There is one item, however, that I would like to point out, that has not been repeated but it has been brought out in the discussion, as to what the attitude of the Bureau may be in the case where a taxpayer claims now or has shown that there is an excessive amount of depreciation where there was no tax benefit in prior years. There may be an attempt on the part of the Bureau to go back into some of the other items claimed in the return and say, "You are not entitled to that deduction," with an effort to cut down an excessive amount which the taxpayer would ordinarily get.

So I think that in this bill there should be an effort made to restrict any adjustment with respect to prior years solely to the question of the excessive amount of depreciation and not to put the taxpayer in the position of meeting counterissues by the Bureau, wherein they might say there are certain traveling and entertaining expenses, or there might have been some interest deduction was was not properly allowable, solely to cut down the excessive amount of depreciation. The Bureau has always maintained where items put on returns, and they are not audited by the Bureau, that those are the amounts that are allowed. This is the only item that people have to contend with in the determination of the taxable income that is not certain and fixed to a great extent, that depends upon opinion. Every other item I think you gentlemen are acquainted with, whether it has to do with interest, rent, salaries, wages, supplies, or what have you, is very well fixed, but when it comes to the subject of depreciation, that is a matter of opinion.

If at some particular time, at any time, in my opinion, it is determined that the amount claimed by the taxpayer in the past on depreciation was excessive I believe that any adjustment with respect to prior years should relate solely to that excessive amount.

In good conscience and equity I cannot understand why the Treasury, or the Bureau, opposes this bill.

Senator KERR. You do not need to go into that.

Mr. WOLFE. Gentlemen, those are the added comments that I wanted to make on this subject, together with those that are contained in my written memorandum.

Senator KERR. All right, Mr. Wolfe, thank you.

Mr. Sutherland.

STATEMENT OF WILLIAM A. SUTHERLAND, WASHINGTON, D. C.

Mr. SUTHERLAND. Mr. Chairman, you have been very patient here this morning and I will not take any more than a few minutes. I would like to comment on just a few things.

Senator Kerr asked about the necessity of investigating these prior returns in order to see whether there were other items in them or whether the Commissioner should confine himself solely to the depreciation item. My own belief is that in most of the cases no attention would have been given to the returns where the loss was large enough to make it clear that any reasonable adjustments would not result in income.

That was true in the only two little cases which I have had personally where this question was involved. There might be a case where there was a claim of excessive depreciation where it was close enough to the line so the Commissioner might have to investigate other items. I don't think it is serious as a practical matter. If you wanted to amend the bill as just suggested to make clear that you would only want the Commissioner to go into this item, I don't think any injustice would be done to the Government.

Senator KERR. Don't you think the intense desire on their part to expand into something else is by reason of not liking this feature, that actually there is no problem there that needs any recognition?

Mr. SUTHERLAND. There is no problem. The problem that Mr. Martin mentioned does not impress me at all. The depreciation which is determined to be excessive in 1935 was determined to be excessive on the basis of studies which were being made in the late 1920's and early thirties, and they would have changed the 5 percent to 4 percent on one of those earlier years if there had been any investigation made for that year.

It is also true in the few little cases I have seen that there has been no dispute with the Government as to what was the proper rate of depreciation in those preceding loss years.

Senator KERR. In other words, if the principle of its recognition should be established, you think the matter of how much it involves is not subject to any great controversy?

Mr. SUTHERLAND. The Bureau would handle that problem, Senator, just like they handle most problems. You can conjure up theoretical difficulties here but no practical difficulties exist in the usual case. Of course, you will find a case where there will be some difficulties. I don't mean there never will be any difficulties, but, as a general administrative proposition, it presents no difficulties.

Senator, there is one word or two that should be said about the presentation that the Treasury makes of this problem, which is an attempt to confuse it.

Senator KERR. I would suggest that you discuss the merits of the bill only.

Mr. SUTHERLAND. I think that the merits have been pretty well discussed. There were a few matters where there was some confusion in the presentation that I thought might be cleared up.

The only time that this rule was ever applied its application did not depend on how much time had elapsed between the loss year in which the excessive depreciation occurred and the time when the adjustment was made. There has never been any effort to set up any time limit on making the correction in the loss year. It has been made to depend solely on whether or not the statute of limitations happened to be open on that preceding loss year, at the time the adjustment was finally made. So that it has been pure happenstance as to whether the rule has been applied to a particular taxpayer or not.

If the return for the loss years had been kept open on waiver, which was true in the cases of most of the larger corporations, so I am informed—if for example the returns were open for loss years 1930 to 1934 when the 1935 adjustment was made—it might have been adjusted in 1938 or 1939—they would not have applied the Virginian rule to that situation. They would have adjusted the preceding loss years to the correct basis, just as they adjusted the profit year to the

correct basis. And in the case of a taxpayer in the same situation, the same plant, the same machinery, if it happened that the statute of limitations had barred the assessing of additional taxes for the loss year, then if the Virginian Hotel rule was applied it would bar the correction in the loss year.

Now, the running of the statute of limitations on a loss year, assuming it is a real loss year, is absolutely meaningless. The only thing the statute of limitations runs against is the collection of taxes, and if there are no taxes due there is nothing upon which the statute of limitations can truly run.

When the 1932 act was passed Congress wanted to enact a statutory estoppel against the taxpayer claiming the second time a deduction from which he had already derived a benefit. The committee report states that the situation Congress was interested in was a situation where a man may have claimed excessive depreciation and the statute of limitations may have barred the Government from the collection of taxes due. There was never any intention, never any reason, why the statute should have been enacted except where the statute of limitations had actually barred taxes that the Government was entitled to.

The CHAIRMAN. Was not one of the purposes of the 1932 amendment to simply prevent the taxpayer from taking double depreciation?

Mr. SUTHERLAND. That is exactly right. If you save taxes by this error they want you to reduce the basis by the same depreciation by which you saved taxes. The Commissioner never would come here and ask you to do any more than that.

To my mind the Commissioner's position here seems quite immoral. There are one or two other situations similar to this that should be brought before the committee. However, there is none more shocking than this. I refer to situations where the Commissioner has come to you with a perfectly just complaint as to a situation where he may be cheated and he comes before you and asks you to keep him from being cheated. Then he uses that very statute which you have enacted to protect him against being cheated, to cheat taxpayers out of taxes they do not owe and where there is no equitable right whatever for him or the Government to have it.

This is one of the situations that I have been deeply interested in since I was, unfortunately, the loser in the 5-to-4 decision in the Supreme Court in the Virginian Hotel case. I determined then that if there was any way on earth for me to make clear that Congress did not intend to do that sort of thing I would do it. The dissenting opinions stated clearly that the amendment had never been intended to cover such a situation.

The CHAIRMAN. Who wrote the dissenting opinions?

Mr. SUTHERLAND. Mr. Justice Stone wrote one and Mr. Justice Jackson another.

The CHAIRMAN. Mr. Justice Stone wrote a pretty strong opinion.

Mr. SUTHERLAND. There is one last thing I want to say. Even in the situations where the statute had run on the loss years and where technically, under the misconstruction in the I. T. and Virginian Hotel case, the 1932 amendment was applicable, even in the cases where it was clearly applicable if it is to be applied to a loss year, I understand that it was only in a small minority of those cases that it was ever actually applied. So there has been a small group singled out for discrimination, and it seems to me a very weak argument that we should

bar the ones in that small group who now have open years and keep them in the minority group instead of bringing them over where they should be, with the majority group.

Now, I have some letters that I would like to submit for the record.

The CHAIRMAN. You may submit them.

(The letters referred to are as follows:)

LYBRAND, ROSS BROS. & MONTGOMERY,
Washington, D. C., September 12, 1951.

Re proposed legislation correcting effect of Virginian Hotel decision

Hon. COLIN F. STAM,
Chief of Staff, Joint Committee on Internal Revenue Taxation,
New House Office Building, Washington, D. C.

DEAR MR. STAM: First, I would like to express to you my sincere appreciation for the time granted by you and Mr. Oram in allowing me to present my point of view relative to the proposed legislation which would ameliorate, at least to some extent, the unfortunate and inequitable results of the decision of the Virginian Hotel case.

For purposes of the record, it seems appropriate that I attempt to summarize in writing the points which I discussed with you to the extent that they presently seem pertinent.

First, and of major importance, I would like to express my belief that, based upon studies previously made and upon all available at the present time, the Treasury estimates of the possible financial effect of the proposed corrective legislation seem completely out of line. Even the estimates presented by Mr. Sutherland at the time of our conference seem to me to indicate a revenue effect much greater than would be my opinion of the amount involved.

Secondly, the question has been raised as to whether retroactive legislation now enacted would not give certain taxpayers whose past years are open an advantage over most others who have had depreciation cases closed in the past, particularly during the 1930's and early 1940's, preceding the decision in the Virginian Hotel case. It has been implied that practically all cases in the field were settled on a basis which accorded with that ultimately upheld by the Supreme Court in the Virginian Hotel case. This is definitely not my recollection of the facts. Subsequent to the depression period in the early 1930's, it was recognized by revenue agents and taxpayers' representatives alike that excessive depreciation had been taken, without tax benefit, by many taxpayers during the loss years. At the time of examination of returns covering the years for which most corporations again began to make profits, adjustments were made in the field to give effect to such excessive depreciation. Many taxpayers at that time had restored to basis by examining agents the excessive depreciation previously taken by them in loss years. I personally settled cases upon this basis.

In order to make sure that my own recollection of this procedure was not based upon isolated instances, I have discussed the matter with individuals who at the time were in responsible positions in the field offices of the Bureau and they have confirmed my recollection. I understand also that Mr. Sutherland is making available to you correspondence indicating that agents in the field much more generally followed the rule subsequently known as that of the Pittsburgh Brewing Co. case than the apparent official Bureau policy as ultimately stated in the Virginian Hotel case. In view of this situation, there does not appear to be much merit to the thought that retroactive legislation, if presently enacted, would give taxpayers who now have returns open for 1947 or prior years a break not enjoyed by most others.

It seems appropriate to reiterate that my interest in this matter stems from my service as chairman of the Committee on Federal Taxation of the American Institute of Accountants and the suggested legislative action proposed by that committee and not from the specific point of view of any present client which I know is interested in the matter.

Again, thank you for your extreme courtesy in listening to those of us who have felt for so long that this legislation is necessary.

Sincerely yours,

MARK E. RICHARDSON.

CANN & LONG,
Washington, D. C. September 10, 1951.

Hon. WALTER F. GEORGE,
United States Senate, Washington, D. C.

MY DEAR SENATOR: Bill Sutherland has been discussing with me H. R. 3168, which is now pending before the Finance Committee. I have no personal interest whatever in the bill and have no client which, so far as I know, will be in the slightest degree affected by it. I have, however, been interested in the principle since it first came to my attention.

The Virginian Hotel case first came to my attention when it reached the Supreme Court shortly after my appointment as Assistant Commissioner of Internal Revenue. [illegible]nsidered the circuit-court decision grossly unfair. I felt strongly that the Co[illegible]missioner should not wish to sustain any such position, and I so informed Commissioner Helvering. It was my view that the case should be closed on the basis of the Pittsburgh Brewing Co. case, which laid down the same rule as is now embodied in H. R. 3168. I then felt, as I now feel, that any other view was wrong and ill becomes a government seeking fairly to administer a tax system.

From my own personal knowledge, I know that some in the Bureau shared my feeling and it was certainly the feeling of many of the agents in the field. This was quite important in connection with a subject like depreciation, where a considerable amount of discretion is generally exercised in the field with limited review in Washington. When agents in the field adjusted depreciation rates downward in any profit year, they naturally felt they should make the same adjustment in immediately preceding loss years which were then, for the first time, receiving consideration. Prior to the decision in the Virginian Hotel case in 1943, depreciation schedules were being adjusted in the field by restoring to basis amounts of depreciation erroneously claimed in any group of loss years immediately preceding the first profit year for which adjustment was made, where conditions were unchanged and where the loss years would have been adjusted if the statutory period of limitation had not expired. This was generally true before the decision in the Pittsburgh Brewing Co. case as well as thereafter.

I left the office of the internal revenue agent in charge in Atlanta in 1936. At that time we were adjusting depreciation schedules on the fair basis above outlined, and I am informed the same practice continued there until the decision in the Virginian Hotel case, and I know from other sources that the same thing was happening in other sections of the country. In my opinion, the fact that these schedules were being adjusted on a fair basis rather than on the basis of the rule later approved in the Virginian Hotel case serves in a large part to explain why so comparatively few taxpayers suffered from the injustice of the rule and why the protests that have been made have been so few in comparison with what would have been expected. There is no way of measuring it mathematically, but I feel that only a fairly small percentage of the persons against whom the Virginian Hotel principle might have been applied actually suffered the injustice of its application.

It follows from the above that the application in all open years prior to 1948 of the principle stated in H. R. 3168 will not result in any unfair singling out for special treatment of taxpayers against whom the Virginian Hotel principle was applied and who happened to have such open years. Rather, these taxpayers will be placed in the same position with the large majority of the taxpayers to whom the Virginian Hotel rule theoretically was applicable.

If you should desire to talk with me regarding this particular matter, please feel free to call me at your convenience.

With warm regards.

Very truly yours,

NORMAN D. CANN.

SUTHERLAND, TUTTLE & BRENNAN,
Washington, January 18, 1952.

Mr. COLIN F. STAM,
Joint Committee on Internal Revenue Taxation,
Washington, D. C.

DEAR MR. STAM: Since our last discussion regarding H. R. 3168, I have received information from several sources which confirms my impression that the rule laid down in I. T. 2004 in 1935 and affirmed ni the Virginian Hotel case in 1943 was not generally applied prior to 1943 in the settlement of depreciation schedules, most of which were handled in the field and most of which were ad-

justed prior to 1943. Consequently, it seems clear that the retroactive application of H. R. 3168 to taxpayers having open returns for 1947 or prior years will not discriminate in favor of such taxpayers as compared with the large majority of taxpayers against whom the Virginian Hotel rule might have been, but was not in fact, applied.

The Acting Secretary of the Treasury stated in his letter to Senator George of June 21, 1951, as follows:

"The fact is that prior to the Supreme Court's decision in the Virginian Hotel Corp. case the cases of most taxpayers owning property of any significance were closed by agreement with the taxpayers concerned in accordance with the provisions of I. T. 2044, supra, which had been issued some 8 years prior to the decision."

It is an ascertained fact that most of these cases were closed prior to 1943. It stands to reason, however, that generally no taxpayer having involved an amount considered by him to be consequential would have agreed to an unfavorable result that was inconsistent with the prevailing court-of-appeals decision in Pittsburgh Brewing Co. and lower-court decisions as well as text authorities following and approving it. This is borne out by the attached letters.

Our office in Atlanta has checked with one revenue agent in charge and with a former chief conferee, both of whom were with the Government during the period in question, and we find that according to their experience the following was true.

(1) Revenue agents exercise a great deal of discretion in the field in handling depreciation.

(2) Prior to 1943 cases in this field office were generally being settled by restoring to basis excessive depreciation deducted for loss years which immediately preceded a profit year in which the revenue agent reduced basis.

(3) The restoration to basis generally was not made for any depreciation deducted in a loss year where a profit year in which the depreciation was allowed intervened between the loss year and the first profit year in which the revenue agent proposed the adjustment.

(4) Where these matters were closed prior to the Virginian Hotel decision they generally were not reopened after that decision. The usual practice in depreciation was to start working from the schedule set forth in the preceding revenue agent's report. This was the policy approved by the agent in charge and the agents were discouraged from taking the initiative in reopening questions disposed of in earlier reports.

In addition to the above, I am attaching copies of letters from George Pennington, an accountant in Atlanta of wide experience; from Leo J. Leonard, a former revenue agent of very high standing who is now practicing accounting in Columbus, Ga.; from Arthur Kent, Esq., in San Francisco; from W. T. Cardwell, Esq., who was with the Bureau for many years and was head of the technical staff in New York when he returned to private practice a few years ago; and from Leland A. Sutherland, Esq., of Price Waterhouse & Co., New York City. Mr. Norman Cann has written a letter to Senator George to which you will no doubt have access. Mr. Cann has confirmed to me personally substantially what is stated by the other persons mentioned. Mr. Mark Richardson has written to you direct.

I trust that this information will cause you to feel, as I do, that making H. R. 3168 retroactive to all open years will certainly not result in making a favored few out of those taxpayers who took excessive depreciation in loss years and who now have open returns for 1947 or prior years. Many taxpayers prior to 1943 obtained the relief which, at best, can now be obtained only in part under the pending bill.

You know how strongly I feel about the unjustness of the Virginian Hotel rule. I think any violation of the clear intention of Congress which results in inequity as drastic as this should be corrected retroactively, even in the absence of the facts set forth above, unless there is some compelling conflicting principle involved. The only such principle in this case is the principle of repose which would not be violated by the bill as originally introduced since returns closed by the running of the statute of limitations would not be opened. Within the limitations imposed by the principle of repose, I feel that complete justice should be done.

I certainly appreciate your kindness and that of Mr. Oram in hearing us so fully in connection with this matter. I trust it will be a long time before I will have to bother you again about such a sore thumb.

Very sincerely yours,

W. A. SUTHERLAND.

GEORGE A. PENNINGTON & CO.,
Atlanta, Ga., August 31, 1951.

SUTHERLAND, TUTTLE & BRENNAN,
First National Bank Building, Atlanta, Ga.
(Attention of Mr. Joseph B. Brennan.)

GENTLEMEN: In reply to your inquiry of recent date, I beg to advise that prior to the decision in the Virginian Hotel Co. case, wherein it was decided that all depreciation claimed by a taxpayer on its returns should reduce the basis of the depreciable assets, I settled with the revenue agents several substantial cases on an entirely different basis, and these cases were allowed to stand unchanged by subsequent action of the Bureau.

The basis upon which these cases were settled was to limit the amount of depreciation to a reasonable amount even though a larger amount was claimed on the returns; provided this larger amount of depreciation was for loss years and did not reduce the tax for said years.

I have been in active auditing and tax practice since 1921 with offices located in this building.

Yours very truly,

GEORGE A. PENNINGTON,
Certified Public Accountant.

LEONARD, WEST & FAVORS,
Columbus, Ga., September 7, 1951.

Mr. WILLIAM A. SUTHERLAND,
Washington, D. C.

DEAR MR. SUTHERLAND: Your Atlanta office has advised me of your interest in getting as much information as you can with reference to the practice of revenue agents prior to the Virginian Hotel decision in 1943 with regard to excessive depreciation in prior loss years.

As you know, I was a revenue agent working in and out of the Atlanta office from 1937 to 1945 and have been engaged in the practice of public accounting here since 1946.

In the course of my work with the agent's office I handled a great many cases where depreciation was involved, and handled a number of cases where adjustments were necessary in the depreciation schedule. I have handled a number of cases where depreciation was claimed at excessive rates and where the rates were reduced upon investigation. Oddly enough I do not remember working on any case in which any question arose as to the restoration of excessive depreciation claimed in loss years. I must have had a few such cases, but I do not now recall them. I do recollect very well reading the decision of the circuit court of appeals in the Pittsburgh Brewing Co. case which came out in 1939. The case appealed to me as being so clearly right I would not have thought any revenue agent in our office would have considered following a different principle. I feel confident, if I handled any such cases prior to the decision in the Virginian Hotel case in 1943, that I would have handled them upon that basis. If I had been compelled to handle a case upon a contrary basis, I believe I would certainly remember it, because I would have considered it so manifestly unfair to reduce depreciation rates in a later profit year and to deny a similar adjustment for excessive depreciation charged off in immediately preceding loss years without benefit to the taxpayer. The returns in loss years generally were not examined due to the fact that such depreciation adjustments as might be made would not produce a change in tax liability.

I was very much surprised by the Virginian Hotel decision and felt it was manifestly unfair and I know this view was shared by others in our office. I trust that Congress will adopt H. R. 3168 and make it retroactive to cover all years. So far as I am aware, none of my present clients were penalized under the Virginian Hotel rule and I would not expect any one of them to benefit under H. R. 3168. The present rule is manifestly unjust and breeds discontent wherever it is applied and it should be changed.

With best wishes,

Sincerely yours,

LEO J. LEONARD.

KENT AND BROOKES,
San Francisco 4, September 17, 1951.

WILLIAM A. SUTHERLAND, Esq.,
Sutherland, Tuttle & Brennan,
Washington 6, D. C.

DEAR BILL: You have asked me, in relation to the bill which has passed the House and is now pending before the Finance Committee in the Senate, the effect of which would be to abrogate the doctrine of the unfortunate Virginian Hotel decision, for any information I could give you which would cast light upon the extent to which the doctrine laid down by the Bureau in 1935, in I. T. 2944 and approved in the Virginian Hotel case in 1943, was applied by the Bureau in this area prior to the Virginian Hotel decision.

I cannot speak on the basis of my own experience for the question does not happen to have been involved in any case which has come to our office. However, I have made inquiries among some of the leading accountants here with the following results:

It seems clear that prior to the Virginian Hotel decision in 1943, the Pittsburgh Brewing Co. case, despite the formal nonacquiescence of the Bureau therein, was in fact generally followed in this area in the disposition of cases where excess depreciation was taken in loss years. Also, I have found no evidence of any general readjustment after the Virginian Hotel case was decided of depreciation schedules thus adjusted prior to that decision. It does not appear that the I. T. was generally followed prior to the Pittsburgh Brewing Co. case.

Restoration to basis of excessive depreciation claimed in loss years apparently has been denied in cases where the inequity is less apparent or nonexisting, as where one or more profit years have intervened between the loss year and the first year in which the revenue agent proposed to adjust the depreciation rate downward.

Since the decision in the Virginian Hotel case, of course lip service at least has been paid to the principle therein laid down. But information coming to me indicates that revenue agents have exercised a considerable measure of discretion in its application to particular cases and have sought by various adjustments to avoid or minimize the inequitable hardships which would result from right and unalloyed application of the doctrine.

I understand that there are at least one or two open cases pending in the Bureau offices here, the disposition of which may depend upon the enactment of the pending bill with a retroactive clause. I am not acquainted, however, with their details. They are apparently being held up pending the final action upon this bill. I find nothing, however, to indicate that in this area the retroactive application of this doctrine would affect any substantial number of cases.

You are free to use this letter with Mr. Stam or anyone else.

With best wishes, I am

Sincerely yours,

ARTHUR H. KENT.

S. D. LEIDESDORF & CO.,
New York 17, N. Y., September 14, 1951.

WILLIAM A. SUTHERLAND, Esq.,
Sutherland, Tuttle & Brennan,
Washington 6, D. C.

DEAR MR. SUTHERLAND: I was Chief of the Conference Section of the Income Tax Unit, Bureau of Internal Revenue, in 1935 at the time of the issuance of I. T. 2944 which laid down the rule later approved in 1943 in the Virginian Hotel decision. I was opposed then, as now, to the treatment required by I. T. 2944, and this view was shared by many of my associates who were dealing with practical problems in the Bureau at that time. In addition, I may add that as early as March 1933, some of us advocated the issuance of a Bureau press release putting taxpayers on notice as to the position of the Bureau and thereby affording taxpayers the opportunity to file protective amended returns for prior loss years, but we were unsuccessful in our efforts to do this.

In October, 1936, I resigned from the Bureau to accept the position of assistant comptroller with the M. A. Hanna Co., Cleveland, Ohio, and assistant general auditor of National Steel Corp. and subsidiaries, Pittsburgh, Pa. In March 1939, I returned to the Bureau to organize and serve as the initial head of the newly created Eastern Division of the Technical Staff comprising the States of Pennsylvania and New Jersey. I served in that capacity until the end of Sep-

tember 1941, at which time I was transferred and designated head of the New York Division of the Technical Staff and served in that capacity until the end of February 1944, when I resigned from the Bureau to accept the position I now hold as head of the tax department of S. D. Leidesdorf & Co., New York, N. Y.

On various occasions from 1935 until the Virginian Hotel decision in 1943 I came in contact with situations where depreciation had been deducted at clearly excessive rates and it was necessary to adjust rates downward. On such occasions, as I now recall the matter, prior to the Virginian Hotel decision, the principle stated in I. T. 2914 was not rigidly applied in loss years where no tax benefit had been derived from the deduction of excessive depreciation and such loss years immediately preceded the profit year in which the rate was first adjusted downward. As to such years, whether or not the statute of limitations had run at the time of the investigation, the rates in the loss years were usually adjusted in the same way as they were adjusted in the profit year under investigation, and the excessive depreciation deducted was restored to basis. Any other treatment would have been so obviously unjust and contrary to the general principles prevailing in the income tax field that settlements could not usually have been made upon any such basis. This was especially true after the decision in the Pittsburgh Brewing Co. case in 1939 and prior to the Virginian Hotel decision in 1943.

I cannot state of my own knowledge what happened in cases with which I had no contact, but from such knowledge as I do have, I have the distinct impression that prior to the Virginian Hotel decision in 1943, the rule of the I. T. was not generally applied to immediately preceding loss years where conditions had not materially changed between the loss years and the first profit year for which investigation was made. I have the very distinct impression that the rule was very sparingly applied in such situations. I would be quite surprised if there were many cases to which H. R. 3168 would have much practical application. Certainly any persons benefited by the bill would not, in my opinion, be especially favored as compared with most taxpayers to whom the Virginian Hotel rule might have been applied.

Very truly yours,

W. T. CARDWELL.

PRICE WATERHOUSE & CO.,
New York, 5, September 24, 1951.

Mr. WILLIAM A. SUTHERLAND,
Washington, 6, D. C.

DEAR MR. SUTHERLAND: I have been associated with Price Waterhouse & Co. since 1920 and have worked largely on Federal income taxes. I have been generally familiar with the tax cases of clients of the firm which involved the matter of depreciation, particularly during the period from 1931 to 1945 when I was in charge of the Washington office of our firm. Prior to 1943, those of our cases which involved excessive depreciation in loss years were generally settled on a basis which was satisfactory to the taxpayer and which avoided the burden of the rule promulgated by the Bureau in 1935 and finally adopted by the Supreme Court in 1943 in the Virginian Hotel case.

It has also been my experience as to the years after 1943 that in no case were the previously established depreciation schedules changed by reason of the Virginian Hotel decision.

A few years ago I made inquiry at a meeting of the tax men from various offices of our firm and from their response it appeared that we had no clients who were interested in relief from the Virginian Hotel decision. So far as I have ascertained, the experience of my associates confirms my own experience that the Virginian Hotel rule was not widely applied.

If I can furnish any further information, please call on me.

Yours very truly,

L. G. SUTHERLAND.

The CHAIRMAN. Mr. Rollin Browne.

STATEMENT OF ROLLIN BROWNE, SATTERLEE, BROWNE & MATHEWS, NEW YORK, N. Y.

Mr. BROWNE. Mr. Chairman and Senators, my name is Rollin Browne, of the firm of Satterlee, Browne & Mathews, New York.

I have a prepared statement, which has been passed around, and I would like to incorporate it in the record and then add a few remarks.

The CHAIRMAN. That may be done.

(The statement referred to is as follows:)

STATEMENT OF ROLLIN BROWNE

H. R. 3168 makes a long overdue amendment to section 113 (b) of the Internal Revenue Code to correct a harsh and inequitable interpretation which was placed upon it by the Supreme Court in the *Virginian Hotel case* (319 U. S. 523).

The statute provides that a taxpayer's basis for computing gain or loss on the sale of property must be reduced by depreciation and depletion "to the extent allowed (but not less than the amount allowable)" during the period the property was owned by the taxpayer. H. R. 3168 provides that the taxpayer's basis need not be reduced by any "allowed" depreciation or depletion from which he did not get a tax benefit.

However, the requirement of the existing statute that the taxpayer's basis must be reduced by all "allowable" depreciation and depletion, whether or not it was claimed or allowed, is not changed by the bill. That provision was originally inserted in the statute in order to require the taxpayer to claim all the depreciation and depletion to which he was entitled each year and to require his basis to be reduced by all such depreciation and depletion, whether or not he had claimed it. In some cases, however, including at least one now pending before the Tax Court, the Commissioner has required taxpayers to reduce their basis by amounts of depreciation or depletion which they had tried to claim in prior years, but which the Commissioner, for one reason or another, had refused to permit them to deduct. The Commissioner has attempted to justify his actions in such cases on the theory that when the property was sold he was required to determine how much depreciation or depletion was correctly allowable under the law for prior years and to reduce the taxpayer's basis accordingly, irrespective of the amount he had previously held to be allowable.

There is dictum in the Supreme Court's old opinion in *U. S.* v. *Ludey* (274 U. S. 295), which lends some color of support to such a harsh interpretation of the statute. However, it is believed that such an application of the statute would be entirely inequitable and never could have been intended by Congress. The Federal courts have so held in at least one later case, *Perkins* v. *Thomas* (86 F. (2d) 954). That case was decided by the Fifth Circuit Court of Appeals and, although the Government carried the case to the Supreme Court, it did not question the decision of the Court of Appeals on this particular point (*Thomas* v. *Perkins*, 301 U. S. 655). In a very recent case, the Tax Court refused to allow the Commissioner to adjust a taxpayer's basis for "allowable" depreciation for certain prior years in excess of the amount of depreciation which the Commissioner had actually allowed for those years and which had been confirmed by an earlier decision of the Board of Tax Appeals. The Tax Court held that the earlier decision of the Board had fixed the amount of depreciation properly allowable, as well as the amount actually allowed, for the earlier years (*C. D. Johnson Lumber Corporation*, 10 T. C. 1400). In an administrative matter such as determining the amount of allowable depreciation or depletion, a final determination by the Commissioner should give the taxpayer as much protection as a decision of the Tax Court.

It is, therefore, respectfully urged that H. R. 3168 be amended so as to eliminate the possibility of the Commissioner taking any such unjust position in other cases. This can be done quite easily by adding to the bill a new section (c), reading as follows:

"(c) Subparagraph (1) (B) of section 113 (b) of the Internal Revenue Code is further amended by inserting in the first sentence thereof, after the word 'allowable', a comma followed by the words 'ascertained for each taxable period in accordance with any court decision or determination or ruling of the Commissioner relating to the taxpayer and given effect in the final computation of the taxpayer's net income for such period'."

As thus amended, subparagraph (1) (B) of section 113 (b) of the Internal Revenue Code, as amended by the bill, would read as follows:

"(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed as deductions in computing net income and resulting in a reduction of the taxpayer's taxes (but not less than the amount allowable, *ascertained for each taxable period in accordance with any court decision or determination or ruling of the Commissioner relating to the taxpayer and given effect in the final computation of the taxpayer's net income for such period*) under this chapter or prior income tax laws."

This amendment refers to a "ruling" of the Commissioner as well as a "determination," so as to make certain of covering the case where a taxpayer obtained a ruling as to how much, if any, depreciation or depletion he was entitled to claim and then followed that ruling in making his returns, as well as the case where the taxpayer claimed the amount of depreciation or depletion he thought he was entitled to and such amount was later adjusted by the Commissioner in connection with a formal "determination" of additional taxes.

H. R. 3168, as introduced, would have been applicable to all past years covered by the Internal Revenue Code still open under the statute of limitations on the theory that the amendment relating to allowed depreciation and depletion would not effect any change in existing law as enacted by the Congress but would merely eradicate an unjust result erroneously grafted on it by the Supreme Court. In the House the bill was amended so as to be applicable only to taxable years beginning after December 31, 1947.

Irrespective of what the effective date of the bill may be with respect to allowed depreciation and depletion, it is entirely clear that the amendment herein proposed, relating to allowable depreciation and depletion, would not effect any change in the law but would merely place the stamp of congressional approval on the judicial interpretation of the existing law, and thus should apply to every year governed by the Revenue Act of 1920, which first employed the test of allowability, or any later act, which is still open under the statute of limitations. Therefore, if section (b) of the bill should be enacted in the form approved by the House, so as thus to restrict the applicability of the amendment relating to allowed depreciation and depletion, it is respectfully requested that there be inserted in section (b) of the bill, before the words "this Act", the words "section (a) of", and that there be added to the bill another section, (d), reading as follows:

"(d) The amendment made by section (c) of this Act is declaratory of the meaning and effect of section 113 (b) (1) (B) of the Internal Revenue Code and corresponding provisions of prior Revenue Acts as heretofore in effect and, subject to statutory periods of limitations governing assessments, collections, refunds and credits, shall be applicable with respect to taxable years beginning after January 31, 1924."

Precedents for such a provision may be found in section 1331 of the Revenue Act of 1921, validating the regulations requiring consolidated returns under prior acts and section 1208 of the Revenue Act of 1926, relating to installment sales under prior acts. Congress went much further in the Technical Changes Act of 1949, in which the bar of the statute of limitations was lifted.

If for any reason the committee should not wish to add such a provision to the bill, it is respectfully requested that the committee include in its report accompanying the bill a statement somewhat as follows:

"The amendment made by the bill, so far as it relates to allowable depreciation and depletion, is merely clarifying and declaratory of existing law, which has been properly interpreted by the courts as requiring the taxpayer's basis to be adjusted for only such unallowed depreciation and depletion as would have been allowed by the Commissioner if the taxpayer had claimed it. Accordingly, despite the provisions of section (b) of the bill, the amendment will to that extent be fully applicable to all years still open to adjustment."

No loss of revenue is involved in this amendment. It has not been the Commissioner's established policy to attempt to adjust a taxpayer's basis for "allowable" depreciation which he previously has ruled to be unallowable. Only very rarely has he taken such an unjust position, and then only through the irresponsible action of subordinates, which the courts have disapproved. The purpose of theamendment is,and its only effect will be, to make the matter so clear that no taxpayer will ever again be compelled to resort to litigation to defeat such an arbitrary and unjust claim.

Aside from questions of phraseology, it is believed that there can be only one possible ground for Treasury opposition to the amendment proposed herein, namely, that the Commissioner does not sanction the unconscionable results herein complained of and the statute should not be cluttered with a complicated amendment simply to compel subordinate Bureau personnel to administer the law correctly in every individual case. Our reply to such a suggestion would be that the maladministration of the existing law is the Commissioner's responsibility, especially since he has issued no regulation, Treasury decision, or ruling instructing his subordinates otherwise. It is conceded that such an instruction, if issued immediately by proper authority and in unambiguous language, might render unnecessary the amendment amendment herein proposed, but if the committee should fail to approve an amendment on the ground that the matter should be taken care of by administrative action, it is respectfully requested so to state in its report, and in the absence of administrative action Congress clearly should grant relief.

There can be no higher goal of legislation than the protection of individual citizens from admittedly unlawful and arbitrary official acts, by whomsoever and howsoever seldom committed.

Mr. Browne. I propose to change the line of discussion a little bit. The Camp bill now pending before this committee cures only one of the very bad defects in this section requiring a taxpayer to reduce his basis on account of depreciation.

You may recall that in 1924 the Congress passed a law that first required the basis to be reduced by all depreciation allowed. The Commissioner came back in 1926 and said that would not work; that the basis ought to be reduced by all depreciation allowable, whether it was allowed or not. Then in 1932 he came back and said neither one would work; that you better put it in both ways.

So since 1932 the basis has been required to be reduced by all depreciation allowed but not less than the amount allowable, getting it that way both ways. The reason it referred to all allowable depreciation as in the 1926 act, it was made clear by this committee's report it was to say to the taxpayer he must claim his depreciation in the proper amount as it accrued, and even if he did not claim it that his basis would have to be adjusted by the depreciation which accrued. It was to deprive him of an allocation or option of whether or not to claim his depreciation each year and thus to reduce his basis, depending on whether he had any income against which to use that depreciation.

It was not intended by the bill to say that if the taxpayer came in and claimed the amount of depreciation which he thought he was entitled to and the Commissioner disallowed it in full or in part, then his basis would have to be adjusted for the amount that the Commissioner should have allowed theoretically under the law but had held on full consideration was not allowable.

Nevertheless, there are some cases in which the Commissioner, after telling the taxpayer, "No, you cannot take a certain amount of depreciation; it is not allowable under the statute," nevertheless, when the taxpayer later sold the property and the Commissioner had to determine the gain or loss from the sale and therefore had to determine the adjusted basis, the Bureau people said, "Well, now, we must consider this question. If we mistakenly held that some depreciation was not allowable for an earlier year we must now say it was allowable and, therefore, your basis must be reduced."

He would say, "We made a mistake; it is too bad, but we must now decide it all over again."

Senator Kerr. The taxpayer paid for the Bureau's mistakes; is that right?

Mr. BROWNE. That is right. That sort of result was not within the scope of the 1926 act which first laid down the allowable basis. As I pointed out, this committee made it clear that was to make the taxpayer pay the full amount or reduce his basis by the correct amount whether he claimed it or not. It does not say to the Commissioner, "You must hold depreciation not allowable in one claim and then treat it allowable in reducing the basis."

Senator KERR. The bill had it "allowable"?

Mr. BROWNE. That is right. We say when the Commissioner determines the amount of allowable depreciation in computing income for a certain year and that has become final, that not only determines the taxpayer's tax liability for that year and his net income for that year but it also ought to finally determine the amount his basis ought to be reduced on account of depreciation for that year. That is what usually happens. I have not found a single responsible official in the Bureau who will defend this practice I am complaining of; nevertheless, every now and then a case comes up and some subordinate in the Bureau will make this contention.

The courts have overruled them when they made that contention; the courts have agreed with the taxpayer in the two cases that I cite in my memorandum and in one other which I have just been informed of, which I will give the committee now.

The CHAIRMAN. Why do you want any amendment, Mr. Browne? You haven't got any live cases pending?

Mr. BROWNE. Yes; there are live cases now.

The CHAIRMAN. You mean open cases?

Mr. BROWNE. Yes.

The CHAIRMAN. The courts have been holding with you?

Mr. BROWNE. The courts have been holding with me, but the officials of the Bureau won't give up. They keep trying it occasionally in cases, putting taxpayers to the expense and uncertainties of litigation.

The CHAIRMAN. Mr. Browne, you are asking us to go to another field here. This goes beyond the Virginian Hotel case and considers this whole question of depreciation.

Senator KERR. And the administration of it.

The CHAIRMAN. And the administration of it.

Mr. BROWNE. But you have got a double standard in the bill, allowed or allowable.

The CHAIRMAN. That might be, but if the courts have been holding with you, I don't see why you should be complaining. The Bureau officials will recognize what the court holds.

Mr. BROWNE. We haven't been able to get them to give it up. We think the point is pretty obvious and clear. These tax cases are administered throughout the country, in the field; they are not administered by the Commissioner himself in Washington. We are on the firing line.

The CHAIRMAN. I appreciate that, and I am sure the committee will appreciate that fact, but if the decisions that have gone to the Supreme Court have been in favor of the taxpayer on the point you now raise, it looks like you better wait until you are really hurt.

Mr. BROWNE. Don't you think, Senator, we are hurt when we are required to litigate the point? The courts have repeatedly decided it but the Commissioner keeps raising the point in case after case.

The CHAIRMAN. Yes; that is true. It all comes back to what Mr. Justice Joseph Schulte once said when a client wished to fix a fee before the final determination of the case. He said:

I don't know how many times I will have to take this case up to the Supreme Court and have the Supreme Court reverse itself before you finally get justice in this case, and therefore I can't fix the fee. We are dealing here with one specific matter and that has been troublesome enough.

Mr. BROWNE. May I call your attention to one thing?

The CHAIRMAN. Yes.

Mr. BROWNE. I am really asking this committee to do something that it should have done in 1932, and almost did. In your report on the 1932 act, when you finally fixed up this section to the Commissioner's satisfaction to make sure of bringing in the revenue, you said this in your report:

Your committee has not thought it necessary to include any express provision against retroactive adjustments for depreciation on the part of the Treasury as the regulations of the Treasury seem adequate to protect the interests of taxpayers in such cases.

That has turned out to be true in some cases, but not in others. Now, if this committee really believes that the present law is clear enough and the present court interpretation of the law was correct, would this committee go so far as to say in the report on this bill why it does not consider an amendment necessary?

That might give us protection, Senator, and we do need it. We can't get it from the Treasury.

The CHAIRMAN. We appreciate that fact, but at the same time I hope you will not press your amendment on this bill. This is a House bill and the House hasn't considered this point.

Mr. BROWNE. No; it was not submitted to them.

The CHAIRMAN. If we pass this bill with an amendment on it and it goes to conference, the House people are not disposed to pass something that they have not had full opportunity to review and consider.

Mr. BROWNE. It seems to me there is some obvious injustice done in the case I am talking about, and this is certainly the proper place to correct it.

The CHAIRMAN. You are just threatened with an injustice.

Mr. BROWNE. Well, it has actually been claimed. The tax has been imposed, the issue has been presented to the court.

The CHAIRMAN. You have not finally exhausted all your remedies. The courts might let you out, and probably would.

Mr. BROWNE. That is the purpose of clarifying the amendment.

The CHAIRMAN. I believe you have the suggested amendment in your paper.

Mr. BROWNE. Yes, sir.

The CHAIRMAN. We will deal with that.

Mr. BROWNE. Thank you.

Senator KERR. Mr. Kirby, did you submit for the record the letter from the Treasury Department under date of June 21, 1951?

Mr. KIRBY. I did not, but it should be part of the record, if the committee would like to have it.

Senator KERR. I think it should be made a part of the record.

(The letter referred to is as follows:)

TREASURY DEPARTMENT,
Washington, June 21, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
United States Senate, Washington, D. C.

MY DEAR MR. CHAIRMAN: Further reference is made to your letter of April 17, 1951, requesting the views of this Department with respect to H. R. 3168 and to your letter of May 4, 1951, requesting information which would enable you to arrive at an estimate of the effect upon the revenue of such bill, which your committee now has under consideration. You also request a brief explanation of the basis for the opinions or estimates.

If enacted, H. R. 3168 would amend section 113 (b) (1) (B) of the Internal Revenue Code by inserting after the word "allowed" the words "as deductions in computing taxable net income and resulting in a reduction of the taxpayer's taxes." As introduced in the House, the amendment would have been effective for the purposes of the Revenue Act of 1932 and subsequent revenue acts as if it were a part of such acts on the date of their enactment. As passed by the House, the bill would apply to taxable years beginning after December 31, 1947. The practical effect of the proposed amendment would be to extend the so-called tax-benefit rule to such of any depreciation, depletion, etc., deduction as is in excess of the amount allowable. In so doing, it would reverse the Supreme Court decision in the case of *Virginian Hotel* v. *Commissioner* (319 U. S. 523 (1943)). Thus, when excessive depreciation has been claimed against certain property, the basis of the property would be reduced by the amount of depreciation allowable, and by the amount claimed in excess of the amount allowable only when such excess has reduced the taxpayer's taxes.

By way of illustration it may be assumed that a taxpayer in 1928 purchased, for $100,000 a factory building. He commenced depreciation of the building, on the basis of a 20-year useful life and took a $5,000 depreciation deduction in each of the years 1928, 1929, and 1930. He continued to take a $5,000 depreciation deduction in each of the years 1931, 1932, and 1933. His losses in those years were so large that even had he taken no depreciation deduction there would have been no tax. It may be assumed also that it can be established that under the facts known in 1931, 1932, and 1933, the life of the building should have been determined to be 25 years, so that the amount of allowable depreciation was only $4,000 instead of $5,000. Under the amendment of H. R. 3168, no reduction in basis would be effected by the $1,000 claimed which was in excess of the amount allowable, even though the taxpayer had included that amount in the depreciation taken in his return and it was allowed by the Bureau of Internal Revenue, since no reduction in the taxpayer's taxes resulted from the excessive portion of the depreciation deduction. It should be noted that even under H. R. 3168, the basis of the building would always be reduced by the $4,000 of depreciation allowable, even though the taxpayer receives no tax benefit by its deduction.

Under present law, as set forth in the above-mentioned case of *Virginian Hotel* v. *Helvering*, the $1,000 each year in the example above which was in excess of the amount allowable as a depreciation deduction, would reduce the basis of the building by that amount, if it was included in the depreciation taken by the taxpayer in his return and allowed by the Bureau. It should be noted that the Commissioner of Internal Revenue in IT 2944 (XIV-2 CB 120, 1935) took the position ultimately confirmed by the Supreme Court in the above case. Moreover, this postition was supported, prior to the Supreme Court decision, by the Board of Tax Appeals (*Sample-Durrick Co.*, 35 BTA 1186 (1937)) and by three circuit courts of appeal (*Commissioner* v. *Kennedy Laundry*, CCA-7 1943; *Douglas* v. *Commissioner*, CCA-8, 1943; *Virginian Hotel* v. *Commissioner*, CCA-4, 1943).

While the bill pending before your committee would entail administrative difficulties for the Bureau of Internal Revenue, and would result in revenue loss, these features are present to a substantially lesser degree than in the bill as introduced in the House. As your letter of May 4, 1951, refers to the letter of this Department to Representative Hobbs under date of June 28, 1948, it is assumed that this letter is available to your committee and that the Department's views as there set forth as to the retroactive aspects of such legislation are known.

The Bureau of Internal Revenue has never had occasion to determine the effect of the above Supreme Court decision revenue-wise, other than on an over-all estimated basis. There have been only isolated occasions where individual claims were presented in the matter as that decision simply sustained the above-noted ruling of the Commissioner issued 8 years prior to such decision.

A few taxpayers have, for purposes of their own, made an estimate of the tax consequences of the decision as it related to them. For example, the Bank of America National Trust and Savings Association, in a brief filed with the Court of Appeals for the Ninth Circuit, stated that it stands to lose approximately $600,000. Its income-tax returns and excess-profits tax returns are open on claims for refund for all years subsequent to 1940, and if H. R. 3168 in its original form becomes law, the corporation will recover approximately $600,000, plus interest which may amount to as much as $150,000, or more. In this case, the taxpayer has already determined the approximate amount it would secure in the way of benefit, and a somewhat similar benefit would be applicable in a large number of cases including returns involving excess-profits tax, as well as returns filed in years subsequent to the repeal of the excess-profits tax.

The fact is that the Bureau of Internal Revenue does not have within its possession sufficient information to make a definitive estimate. H. R. 3168, even as it passed the House, affects all prior loss years if excessive depreciation has been claimed and assets in the taxpayer's possession at that time remained in his possession in 1948 or subsequent years. Accurate information as to these facts is, of course, available only to those taxpayers involved. The Bureau of Internal Revenue does know, however, that excessive depreciation was widely claimed prior to 1935, that a number of these prior years were loss years generally, and that a substantial number of years prior to 1948 are open years. It was on this basis that the estimate contained in the letter to Representative Hobbs, to which you refer, was made. That letter endeavored to make it clear that while no definitive estimate of the revenue effect under the proposed bill was available, it would, nevertheless, be substantial and could conceivably amount to as much as $334 million.

At the bottom of page 1 and in the three numbered paragraphs on page 2 of your letter, certain inferences were drawn as to the assumptions on which was based the Treasury estimate made in the letter to Mr. Hobbs. It is believed desirable to make some comment with respect to those assumptions.

Concerning paragraph No. 1—In making the estimate, it was assumed that in some year subsequent to the loss years depreciation was reduced (the reduction being restored to basis) in that and succeeding years by an average of about 10 percent, and that taxpayers would expect that, for the purpose of adjusting the basis under the provisions of code section 113 (b) (1) (B), the reduction in depreciation rates would be applied retroactively through the loss years in determining depreciation allowances in the income tax returns which reported net losses. That, it is believed, is what the taxpayers will expect H. R. 3168 to accomplish if it becomes law, since that has been the taxpayer's objective in those cases which have been litigated. The estimate of 10 percent was based on the opinion of Bureau officials who have had close contact with the problem of depreciation allowances since the issuance of T. D. 4422 (Commissioner's Mimeograph 4170, February 28, 1934). That a 10 percent restoration appears conservative may be suggested by the fact that in 1934 the Ways and Means Committee indicated that depreciation deductions generally had been excessive by as much as 25 percent.

Concerning paragraph No. 2—Contrary to the inference in your letter, the elimination from basis of the excess depreciation deducted by corporations in loss years during the period 1930-35 resulted largely, not from the application of the Supreme Court decision in the Virginian Hotel Corporation case, but from the application of the Bureau policy contained in I. T. 2944 (Cumulative Bulletin XIV-2, 1935), which had been issued some 8 years prior to the date the decision was rendered and which was upheld by that decision.

Concerning paragraph No. 3—Your inference that taxpayers would benefit by adding the entire amount of excessive depreciation back to basis and obtain refunds for years not yet finally closed, is correct. While some of the property on hand as indicated in the income tax returns which reported net losses would have been retired, fully depreciated or otherwise disposed of in years now closed, on the other hand, a large number of corporations which sustained losses in years subsequent to 1935 were not included. Furthermore, taxpayers other than corporations were likewise not included, since statistics concerning losses and

depreciation deductions were available only in the case of corporations. The years 1930-35 in the example were selected for the reasons indicated in your letter.

The questions raised with respect to the estimated loss of revenue, in the numbered paragraphs on pages 2 to 6 of your letter, are answered or commented on below:

1. In making the estimate of June 28, 1948, no weight was given to cases in which excessive depreciation was added back to basis, in accordance with mimeograph 4170, where the taxpayer or a revenue agent made the adjustment before the statute had run against the loss year. The statute of limitation had run with respect to the great majority of the income tax returns filed for years indicating net losses, and there was a large number of corporations which sustained net losses subsequent to 1935 which were not included in the total in which the estimate was based.

2. In making the estimate, no allowance was made for the possibility that prior to the Virginian Hotel decision in 1943, some cases may have been adjusted in the field on a basis inconsistent with that decision. As a matter of fact, the decision sustained the rule followed by the Bureau agents as stated in I. T. 2944. There may have been a few taxpayers, whose depreciation deductions in loss years, upon which the statute of limitation had run, were erroneously adjusted downward in accordance with the reduced amounts found to be allowable in some succeeding year. Such cases are believed to have been so few in number that consideration of the amounts involved would have little effect on the estimate.

It is noted that you have been informed that while some few large taxpayers were affected by the Virginian Hotel rule, on the whole "it was the small and unadvised taxpayer having a succession of loss years which was penalized by its error in deducting excessive depreciation." The fact is, that prior to the Supreme Court's decision in the Virginian Hotel Corp. case, the cases of most taxpayers owning property of any significance were closed by agreement with the taxpayers concerned in accordance with the provisions of I. T. 2944, supra, which had been issued some 8 years prior to the decision. It is the considered opinion of those employees who have had most to do with this problem that the depreciation deductions of at least 50 percent of all corporate taxpayers have been reduced in some years subsequent to the loss years. The reductions include all classes of taxpayers. They cover the small, medium-size, and large corporations. We have no statistics which would give an accurate picture representing the percentages applicable to small, medium-size, and large corporations, but, on the basis of available information, it is believed that this problem was not by any means confined to small and unadvised taxpayers.

3. You inquire what proportion of the excess depreciation for the period 1930-35, which was eliminated from basis on the Virginian Hotel principle, would, if restored to basis, have been exhausted in years beginning prior to January 1, 1948, and what proportion would extend into later years.

Officials in the Bureau who are best informed on the subject have given their opinion that on the average approximately 35 percent to 45 percent of the so-called excess depreciation, if restored to the basis for the period 1930-35, would remain in the depreciable property account as of December 31, 1947, and would be subject to depreciation allowances in later years. In other words, 55 percent to 65 percent of the excess would apply to property which is no longer subject to depreciation by December 31, 1947. The relief afforded by the bill, as amended, effective for taxable years beginning on or after January 1, 1948, would doubtless be less than 50 percent of that granted by H. R. 3168 in its original form, and the administrative problem, which is a matter of serious concern since the staff of the Bureau is already overburdened, would be substantially reduced.

It is noted you suggest that relatively few capital additions were made in the 1930-35 period, and that the major part of the useful life of properties acquired in the 1920's or earlier would have been exhausted prior to 1948 (or sold or otherwise disposed of). In the latter connection it might be indicated that in 1948 it was estimated that the average depreciation rate for depreciable property of all corporations was slightly more than 3¼ percent or an average useful life of somewhat less than 30 years. For noncorporate depreciable property, the average useful life was estimated at from 25 to 27 years. This would suggest that a considerable number of assets purchased in the 1920's would still be subject to depreciation today. In connection with the volume of acquisitions 1930-35, it should be noted that the volume of expenditures for new plants and equipment for all business was $7.6 billion in 1930, $4.7

billion in 1931, $2.6 billion in 1932, $2.2 billion in 1933, $3 billion in 1934, $3.7 billion in 1935. This may be compared with $6.5 billion in 1940. Thus, while acquisitions of new plants and equipment during the 1930–35 period did fall off, they ran in excess of $2 billions at all times and in 1930 at a higher rate than in 1940.

4. You inquire what proportion of the total number of income tax returns filed by corporations for years ending after December 31, 1935 and prior to January 1, 1948, are still open on waiver, and what proportion are still open on claims for refund.

A precise answer to this question is not available, but it is estimated that of the corporate income tax returns still open for the taxable years 1936–47, 25 percent are open on waiver and 75 percent are open on claim for refund.

The starting point for this estimate is the fact that on June 30, 1950 there were still open for the taxable years 1936 to 1947, inclusive, as reported to the Bureau by the offices of internal revenue agents in charge, 91,156 corporation income tax returns, Form 1120.

A definite breakdown of the number of open returns on the basis of those open on waiver and those open on claim is not available. There were, however, pending on June 30, 1950, a total of 68,690 corporate claims for refund filed on Forms 843. For the purpose of an estimate we may disregard the fact that this amount includes a relatively small number of refund claims which were filed for taxable years prior to 1936 and for taxable years subsequent to 1947, and we may assume (*a*) that it represents only claims for the years 1936 to 1947, inclusive, (*b*) that each claim represents a separate return, and (*c*) that in no case were two claims filed for refund of tax reported on a particular return. On the basis of these assumptions, the total number of open returns for the years 1936 to 1947, or 91,156, may be taken as 100 percent, the number open on claim, 68,690, represents 75 percent of the total, and the number open on waiver is the difference between these two amounts, or 22,446, which is 25 percent of the total.

Although question No. 4 makes no reference to the number of open excess profits tax returns, this information would be pertinent, since H. R. 3168, if enacted in its original form, may have a considerable effect upon the revenue through refunds of excess profits tax. It is estimated that of the excess profits tax returns still open for the years 1940 to 1946, inclusive, 53 percent are open on waiver and 46 percent are open on claims for refund.

The starting point for this estimate is the fact that on June 30, 1950, there were 25,499 open corporation excess-profits tax returns for the taxable years 1940 to 1946, inclusive. As in the case of the income-tax returns, there is no available breakdown of this amount on the basis of the number of returns open on waiver and the number open on refund claims. However, the number of claims for relief from excess-profits tax, Form 991, filed under section 722 of the Internal Revenue Code and pending as of June 30, 1950, totaled 11,809, or 46 percent of the number of open excess-profits tax returns. Assuming that there were no pending claims for refund of excess-profits tax based on issues other than relief under code section 722, the difference between the number of open returns, 25,499, and the number of section 722 claims, 11,809, would be 13,690 or 53 percent, which would represent the number of returns open on waiver.

It should also be noted that an additional unknown number of cases are still "open" for prior years since a taxpayer may file a claim for refund within 2 years after payment, even though payment may not occur until several years after the year in which the tax arose.

5. You inquire what proportion of all corporate income-tax returns filed during the period January 1, 1943, through December 31, 1947, were filed by corporations which were in existence prior to January 1, 1936.

Since the information requested in questions 3, 4, and 6 involves the taxable year 1947, it is presumed that you likewise desire the reply to question 5 to include data for the year 1947 (the returns for which were filed during 1948). Accordingly your question is interpreted as relating to returns filed "for" the period January 1, 1943, through December 31, 1947.

The total number of income-tax returns filed by active corporations for the period January 1, 1943, through December 31, 1947, was 2,297,072 and of this number it is estimated that 1,231,962 or 54 percent were filed by corporations which were in existence prior to January 1, 1936.

The starting point for this estimate was the Bureau's compilation, in part 2 of Statistics of Income for the years 1945 and 1946, of the number of corporations which filed income tax returns for 1945 and 1946, classified by the year of incorporation. The corporation income-tax return provides for reporting

the date of incorporation, and this information was utilized in compiling the data for 1945 and 1946. Statistics relating to the corporation returns filed and classified by year of incorporation were not compiled for any years other than the taxable years 1945 and 1946.

The number of income-tax returns filed by corporations in existence prior to January 1, 1936, is estimated to be as follows:

For taxable years	With net income	With no net income	Total
(a) Data compiled:			
1945	185,476	58,979	244,455
1946	186,151	49,170	235,321
Total	371,627	108,149	479,776
(b) Data estimated:			
1943	185,476	83,587	255,689
1944	185,476	70,213	269,063
1947	186,151	41,303	227,454
Subtotal	557,103	195,103	752,206
Grand total	928,730	303,252	1,231,98

The information for 1945 and 1946 is an accurate compilation of data taken from the corporation income tax returns. The information for 1943, 1944, and 1947 is an estimation based on the statistics compiled for the years 1945 and 1946.

In arriving at the figures for 1943, 1944, and 1947, the following assumptions were made:

(1) Since the variation between the number of corporate returns with net income filed for 1945 and for 1946, by corporations in existence prior to January 1, 1936, is less than one-half of 1 percent, it is assumed that there is no substantial change in the number of such returns filed (*a*) for the years 1943, 1944, and 1945, and (*b*) for the years 1946 and 1947, the number for 1945 and for 1946 being actual returns filed.

(2) The number of corporate income-tax returns filed by corporations with no net income, which had been in existence prior to January 1, 1936, decreased approximately 16 percent from 1945 to 1946. It is assumed that the percentage of decrease in the number of this type of return filed for the year 1943 to 1947, inclusive, remain constant over these years. Accordingly, the actual figures for 1945 and 1946 have been so adjusted to reconstruct the figures shown for 1943, 1944, and 1947.

It is felt that the percentage figures used for these adjustments is not unreasonable, since statistics indicate that as the corporations advance in age, a much smaller percentage of the total returns filed show no net income. Furthermore, except for the year following the year of incorporation, this trend is much more prominent in those cases in which corporations have been in existence more than 5 years. On the other hand, since the variation of 16 percent between the figures for the years 1945 and 1946 for this type of return is large, and since the base to which this percentage is applied varies from year to year, the margin of error in making the adjustment may be substantial. Accordingly, the degree of accuracy in the results obtained for returns with no net income will not approach that obtained for returns with net income.

6. You inquire as to the proportion of all corporation income-tax returns now open (either by waiver or refund claim or otherwise) for the period 1936–47, inclusive, in which the question of the application of the Virginian Hotel principle has been raised.

This information is not readily available to the Bureau, nor is there any available data upon which a reasonably accurate estimate may be made. Such information could be furnished only after a detailed examination is made by our field forces of all open cases for these years, to determine whether the issue was involved for the years in question. The much larger question which cannot be answered definitively, as pointed out earlier, is the number of open cases in which the issue could be raised if H. R. 3168 were effective retroactively.

You also request, with respect to questions 4, 5, and 6 that the answers be furnished in terms of the proportion of the total corporate tax involved as well as in terms of proportion of returns.

No information is readly available as to the total corporate tax or the proportion involved in the answers in the above questions. In question No. 4,

the tax involved in returns still open has not been totaled by field personnel; in question No. 5, the information was statistically compiled from answers to questions on the returns without relation to the tax involved; and, as indicated, no information is available with respect to question 6. This information could be furnished only after a detailed investigation of every case in which the Virginian Hotel principle is involved.

I regret that the statistics which we have found possible to furnish you in the limited time available are not more complete and that in some instances we have had to resort to opinions which reflect the judgment of those officials of the Bureau most familiar with the problem. However, I trust the information will be helpful in your consideration of the bill.

The Director, Bureau of the Budget, has advised the Treasury Department that there is no objection to the presentation of this report.

Very truly yours,

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

Senator KERR. Mr. Oran, do you have any statement with reference to the estimate of what this bill would cost?

Mr. ORAN. My estimate would be very different from the $334 million. It is very close to the revised Treasury estimate. It depends very largely on the weight you give to this aspect or that aspect. I am not seriously questioning the latest estimate of the Treasury.

Mr. STAM. You think it would be about $10 million?

Mr. ORAN. The retroactive feature of it. They have now given $7 million. It is merely a guess anyway. I don't believe the Treasury, or I, or anybody can tell you with any degree of certainty that it will inevitably be this, that, or anything else.

Senator KERR. Generally speaking, we can proceed on the basis of the estimates given us this morning?

Mr. ORAN. I would say there is no material criticism that I would want to make of those figures.

The CHAIRMAN. I think the next hearing will be on Thursday.

(The following were subsequently supplied for the record:)

WASHINGTON, D. C., *January 21, 1952.*

Senator WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building:

The National Coal Association, spokesman for the producers of approximately three-fourths of the Nation's commercial bituminous coal, urges the Finance Committee to approve H. R. 3168. Where excessive depreciation or depletion is erroneously taken and is "allowed" because it results in no tax benefit, there is no valid reason why the taxpayer should subsequently be penalized by denial of tax-free recovery of that portion of his capital investment. As a matter of fact, it would be equitable to require reduction of the basis only where depreciation or depletion (even if "allowable") results in a tax benefit. While H. R. 3168 does not go that far, it is obviously a step in the right direction. Tax-free recovery of capital must be safeguarded as far as possible to continue to offer incentive for investment in our free-enterprise system. We hope this telegram will be entered in the record of the hearing being held on this bill by the Finance Committee, and that it will be brought to the attention of the other members of the Finance Committee.

ROBERT E. LEE HALL,
Counsel, National Coal Association.
W. B. O'BRIEN,
Secretary, National Coal Association Special Tax Committee.

ASSOCIATION OF AMERICAN RAILROADS,
Washington, D. C., January 25, 1952.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

MY DEAR SENATOR GEORGE: H. R. 3168, which passed the House on April 12, 1951, and is now before the Committee on Finance for consideration, would amend section 113 (b) (1) (B) of the Internal Revenue Code by applying the tax-benefit rule in part to the adjustment of the basis of property for depreciation, obsolescence, amortization, and depletion. In its present form the bill is limited to a correction of the inequitable situation resulting from the decision of the Supreme Court of the United States in *Virginian Hotel Corporation* v. *Helvering* (319 U. S. 523 (1943)). Briefly, that decision requires that basis be adjusted for excessive depreciation taken in loss years, even though no tax-benefit resulted from the excessive deduction.

In its present form the bill fills a long-standing need for equitable treatment in the limited situation to which it applies. It has the support of all interested taxpayer groups, and the railroads support it; but the bill is so limited that it does not provide the full relief which ought to be afforded.

Railroads and all other taxpayers are vitally interested in the extension of the tax-benefit rule in full to depreciation deductions. It is extremely important that industry maintain, renew, replace, and expand its productive facilities. With normal and surtax rates on corporations now at 52 percent, it is impossible to do this if the full investment is not recovered. There simply will not be enough earnings left after taxes to do the job unless provision is made for deducting from income by way of depreciation all expenditures for plant and equipment.

Nothing is more fundamental than that business expense should be recovered from business income before the imposition of any tax based on net income. Under present procedures this does not always occur when capital expenditures, which must be recovered through depreciation charges over a number of years, are charged off in the part in loss years.

The corporate rate has been increased from 38 percent to 52 percent, or more than one-third, in a period of 18 months. During this same period the time for paying the tax has been advanced. The result of the combination of higher tax rates, and at the same time, more rapid payments, has inevitably been a very great strain on the cash position of corporate taxpayers. The Committee on Finance has recognized the great burden of the high tax rates and has also recognized the difficulties of finding available cash funds to pay taxes resulting from the application of these high rates to profits which may be tied up in property investment, or inventory, or badly needed for working capital purposes. This burden underscores again the absolute necessity for the recovery of capital investment against income.

The situation of the corporation which has a steady level of income through the years as compared with the corporation whose income picture varies between loss and profit years has been described on numerous occasions. This difference has an important effect with respect to depreciation charges. The corporation with a steady level of income recovers capital investment out of that income before taxes, while the corporation with up and downs of loss and income years does not. The inequity between the situation of these two groups of taxpayers has been corrected by the application of the tax-benefit rule to the recovery of most, if not all, deductions except those for depreciation, obsolescence, amortization, and depletion. There is no reason why the tax-benefit rule should not be extended to include the recovery of these charges now excepted from the rule. We ask, therefore, that the bill now before the committee be amended to provide that basis shall be adjusted only for depreciation, obsolescence, amortization, and depletion allowed or allowable as a deduction in income years.

The loss carry-over and carry-back provisions provide substantial but not complete relief for this situation. Our proposal would remove the inequity for those taxpayers not covered by the loss carry-over and carry-back and extend the same relief to all taxpayers.

Furthermore, there would appear to be every reason for an effective date of January 1, 1932, as provided in the bill as originally introduced.

It is respectfully requested that this letter be made a part of the record of the hearings on H. R. 3168 before the Senate Finance Committee.

Respectfully,

THOMAS L. PRESTON,
General Solicitor, Association of American Railroads.

AMERICAN INSTITUTE OF ACCOUNTANTS,
New York 16, N. Y., January 23, 1952.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: The American Institute of Accountants, through its committee on Federal taxation, respectfully offers its endorsement of H. R. 3168, which would amend section 113 (b) (1) (B) of the Internal Revenue Code (relating to the adjustment of the basis of property for depreciation, obsolescence, amortization, and depletion) to provide that the adjusted basis of property is to be reduced by excessive depreciation shown in a return only to the extent that such excessive depreciation resulted in a reduction in the taxpayer's taxes. However, the committee on Federal taxation recommends that the amendment be applicable to all open taxable years rather than limiting its effect to taxable years beginning after December 31, 1947.

The requirement that excessive depreciation previously allowed be deducted in determining the basis of assets was included in the statute in order to prevent a taxpayer from obtaining a double deduction, with double tax benefit, of the same capital investment. However, that rule should not be applied if the excessive depreciation has resulted in no tax benefit. The reason for avoiding the inequitable result that formerly arose from the taxation of recoveries of bad debts and taxes, where no tax benefit had been obtained from the original deduction, is equally applicable to excessive depreciation.

Section 113 (b) (1) (B) of the Internal Revenue Code provides that, in determining the basis of property, "proper adjustment in respect of the property shall in all cases be made * * * in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this chapter or prior income-tax laws * * *"

From the Bureau's own instructions it appears that "where it is clearly evident that no taxable income will be developed," the Bureau does not even attempt to judge whether the depreciation deducted by taxpayers in loss years is properly allowable, but simply postpones examinations until years which show profits. Yet, when the Bureau eventually finds that the depreciation deductions taken were improper and excessive, it contends that its own failure to examine a "loss return" at the proper time constitutes an "allowance" and approval of such improper and excessive deductions taken by the taxpayer.

The legislative history of section 113 (b) (1) (B) clearly discloses that Congress introduced the distinction between "allowable" and "allowed" without any thought of changing the law in force prior to 1932, being intent solely upon codifying the already well-established equitable principle of estoppel. (See S. Rept. No. 665, p. 29, 72d Cong., 1st sess.; H. Rept. No. 708, p. 22, 72d Cong., 1st sess.). However, where a past error had no consequences at the time when it was committed, no inequity can have arisen, which would call for the application of any principle of estoppel. Where no tax would have been due even if the return had been correct, the Commissioner cannot obviously have "allowed" something merely by doing nothing.

Since the Bureau's position has been supported by a five-to-four Supreme Court decision in *Virginian Hotel Corporation of Lynchburg v. Guy T. Helvering, Commissioner of Internal Revenue* (63 S. Ct. 1260), only remedial legislation can effectively correct the situation. Such legislation should provide that the adjustment for depreciation theretofore "allowed" should be for only such part of the depreciation deductions as reduced taxes otherwise payable.

H. R. 3168, which is now being considered by the Committee on Finance, will provide the necessary relief and, therefore, should be enacted into law with the modification that the amendment to section 113 (b) (1) (B) of the Internal Revenue Code be made applicable to all open taxable years.

It is our desire that this letter shall become part of the official record of hearings on H. R. 3168.

Respectfully submitted.

THOMAS J. GREEN,
General Chairman, Committee on Federal Taxation.
WALLACE M. JENSEN,
Chairman, Subcommittee on Current Tax Legislation.

STATEMENT SUBMITTED BY JOSEPH A. MALONEY, PEAT, MARWICK, MITCHELL & CO., CHICAGO, ILL.

H. R. 3168

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) subparagraph (1) (B) of section 113 (b) of the Internal Revenue Code, entitled "Adjusted basis", is amended by inserting after the word "allowed" the words "as deductions in computing net income and resulting in a reduction of the taxpayers' taxes" to cause the first sentence thereof to read as follows:

"(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed as deductions in computing net income and resulting in a reduction of the taxpayer's taxes (but not less than the amount allowable) under this chapter or prior income tax laws."

(b) The amendment made by this Act shall be applicable with respect to taxable years beginning after December 31, 1947.

MEMO RE H. R. 3168

It is one of the fundamental rules of Federal income taxation that in computing the amount of annual taxable income there be permitted as a deduction from income a reasonable provision for the wear and tear and obsolescence of depreciable property used in the taxpayer's business.

The basis for computing such deduction is usually cost reduced by the aggregate amount of depreciation "allowed or allowable," whichever is greater in each prior year. Such remaining basis is then allocated over the remaining years of useful life in order to compute the current year's allowable depreciation, and in the event of a sale or abandonment or loss of such property such adjusted basis is the basis for determining gain or loss on such sale or disposal.

There is probably no disagreement that the basis of such property is to be reduced by the annual amount of depreciation allowable. Similarly, there is probably no serious disagreement with the principle that where a deduction in excess of the amount allowable has been deducted and allowed as a deduction in computing the net taxable income for a prior year, that for subsequent years the remaining basis should be reduced by the amount allowed and not merely by the amount allowable.

However, there is strong objection to the principle that the basis of property is to be reduced by an erroneous computation in an earlier year in excess of the amount allowable for such year when such excess resulted in no tax benefit due to a net loss for such year.

This principle was laid down by the United States Supreme Court, with four Justices dissenting, in the case of the *Virginian Hotel Corp. of Lynchburgh* v. *Helvering*, decided June 7, 1943 (63 S. Ct. 1260; 30 A. F. T. R. 1304).

In that case, the taxpayer from 1927 through 1937 computed depreciation on a straight-line basis, with net losses for the years 1931 to 1936. For 1938, the Commissioner of Internal Revenue determined that the useful life was longer than that claimed by the taxpayer, and computed a deficiency in tax. The depreciation theretofore claimed as deductions was subtracted from the cost of the property and the remainder was taken as a new basis for computing depreciation. On the basis of such extended life of the properties, the excessive depreciation claimed in the loss years was $31,400.25. The taxpayer claimed that the remaining cost to be depreciated should not be reduced by such excess, for the reason that it had not been allowed within the meaning of the statute. The majority of the court held that it had been allowed, on the premise that a deduction shown on a tax return is allowed unless challenged by the Commissioner.

Mr. Chief Justice Stone, in a vigorous dissent, said in part:

"No reason is suggested why the taxpayer's tax for future years should be increased by reducing his depreciation base by any amount in excess of the depreciation 'allowable,' unless the excess has at some time and in some manner been deducted from gross income. So inequitable a result cannot rightly be achieved by saying that a 'deduction' for depreciation which never has been deducted from gross income has neverthless been "allowed'."

The purpose of H. R. 3168 is to correct the inequity created by the Supreme Court in the Virginian Hotel Corp. case. The enactment of this bill will correct thousands of inequities throughout the country. The burden of heavy taxation is already great, and in this time of higher and higher tax rates the Congress should be more and more alert to remedy situations of inequity.

To those who understand and work with the Federal income-tax laws, the decision of the Supreme Court came as a surprise, and was received with much disappointment. It has been expected annually that Congress would as a matter of course remedy the situation.

In connection with the amendment as it is now worded, it is anticipated that litigation would immediate follow its enactment over ambiguity of the term "allowable." Since the useful life of property is a matter of opinion, which may change from time to time, it may well be argued that as to certain years a particular asset had a 12-year life and therefore 8⅓ percent was allowable, and perhaps in the seventh year it may be determined that the remaining life is 8 years, and in the fourteenth year it may be determined that there is a remaining year of 6 years. Unless clarified, it might be held that as to the earlier years 8⅓ percent was "allowable" and there was no deduction in excess of the amount allowable, althought based upon final determination the total useful life is 20 years, and the average rate allowable was only 5 percent.

It is therefore recommended that the bill be clarified by an addition as follows:

"(l) For the purposes of this subparagraph the term 'allowable' means the amount computed upon the basis of the total useful life as most recently determined for tax purposes."

It is further recommended that subparagraph (b) of the bill be amended to read as follows:

"(b) The amendment made by this act shall be applicable with respect to all taxable years for which claims for refund may be filed under section 322."

(Whereupon, at 12:42 p. m., the committee adjourned.)

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