"USEFUL LIFE" HAS OUTLIVED ITS USEFUL LIFE: TAX DEPRECIATION AFTER *SIMON* AND *LIDDLE*

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INTRODUCTION

Richard and Fiona Simon were professional violinists with the New York Philharmonic Orchestra.[1] In 1985, the Simons purchased two violin bows made by Francois Tourte, a premiere nineteenth-century violin bow maker, which they used in their musical careers.[2] Although the bows suffered wear and tear through their use, the bows appreciated in value due to their worth as collectibles.[3] On their 1989 federal income tax return, the Simons claimed a depreciation deduction for the bows under the Accelerated Cost Recovery System (ACRS) of depreciation.[4] The Internal Revenue Service (Service) denied the deduction and assessed additional taxes due.[5]

Brian Liddle, another professional musician, played the bass viol with various musical groups, including the Philadelphia Orchestra and the Baltimore Symphony.[6] In 1984, Liddle purchased a viol made by Francesco Ruggeri, a renowned seventeenth-century instrument craftsman, for use in his profession.[7] Liddle's use of the viol subjected

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1 See Simon v. Commissioner, 103 T.C. 247, 249 (1994) (en banc), aff'd, 68 F.3d 41 (2d Cir. 1995).

2 See id. at 250-51.

3 In 1985, the bows had appraised values of $35,000 and $25,000. See id. at 252. By 1990, the bows were appraised at $45,000 and $35,000, respectively. See id.

4 The depreciation deduction represents a recovery of the cost of an asset over time due to the exhaustion, wear and tear, or obsolescence experienced by the asset through its use in a trade or business or investment activity. See Treas. Reg. § 1.167(a)-1(a) (as amended in 1972). For a discussion of the Accelerated Cost Recovery System (ACRS) of depreciation, see infra Part II.C. Historically, however, wear and tear on an asset alone was not certain grounds for recovery. A determinable useful life was necessary for depreciability, and wear and tear was a key factor in determining an asset's useful life. See *Simon*, 103 T.C. at 254.

5 See *Simon*, 103 T.C. at 248.

6 See Liddle v. Commissioner, 103 T.C. 285, 286-87 (1994) (en banc), aff'd, 65 F.3d 329 (3d Cir. 1995).

7 See id. at 287.

it to some wear and tear.[8] Like the Simons' bows, the value of the viol increased over time despite its use.[9] On his joint 1987 federal income tax return, Liddle claimed a depreciation deduction for the Ruggeri viol under ACRS.[10] The Service denied the deduction based on the instrument's appreciating value and assessed additional taxes due.[11]

Both the Simons and Liddle petitioned the United States Tax Court for a redetermination of their tax liabilities. In two decisions reviewed by the entire court,[12] the court allowed the depreciation deductions, holding that under ACRS, a tangible asset is depreciable if it is: (1) used in a trade or business or held for the production of income (business or investment asset) and (2) subject to exhaustion, wear and tear, or obsolescence.[13] In arriving at this test for depreciability, the court effectively eliminated the long-standing requirement that a tangible asset must have a determinable "useful life" to be depreciable.[14] The Second and Third Circuits affirmed.[15]

In deciding these cases, the tax court addressed a fundamental issue relating to tax depreciation: What types of assets should be depreciable? By eliminating the useful life requirement for depreciability, *Simon* and *Liddle* opened the door to allowing depreciation of assets previously considered nondepreciable. Although the amounts at issue in the two cases were not significant,[16] applying their holding to other assets could significantly reduce the tax revenues collected by the government.

This Note analyzes the tax court's decisions in *Simon* and *Liddle* and applies their holding to assets previously considered nondepreciable. This Note concludes that the *Simon* and *Liddle* decisions are con-

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8 See id. at 287-88.

9 In 1984, the viol was appraised at $38,000. In 1991, Liddle exchanged the Ruggeri viol for a viol manufactured by Domenico Busan in the eighteenth century, which had an appraised value of $65,000 at the time of the exchange. See id. at 287.

10 See supra note 4.

11 See *Liddle*, 103 T.C. at 288 (stating that deduction was disallowed by Service due to viol's appreciating value).

12 The chief judge of the tax court has the authority to require a reviewed opinion. See I.R.C. § 7460(b) (1994). Reviewed opinions are likely if the opinion seeks to invalidate a regulation, overrule a tax court precedent, or address an issue that was overruled by a court of appeals where the tax court must decide whether to follow its original holding in other circuits. See Richard A. Levine et al., Tax Court Litigation, 630 Tax Management Portfolio, at A-41 (1992).

13 See Simon v. Commissioner, 103 T.C. 247, 259-60 (1994) (en banc), aff'd, 68 F.3d 41 (2d Cir. 1995); *Liddle*, 103 T.C. at 293-94 (1994).

14 See infra text accompanying notes 56-58.

15 See Simon v. Commissioner, 68 F.3d 41 (2d Cir. 1995); Liddle v. Commissioner, 65 F.3d 329 (3d Cir. 1995).

16 The Simons and Liddle claimed $10,815 and $3,170, respectively, in depreciation deductions for the years in question. See *Simon*, 103 T.C. at 251; *Liddle*, 103 T.C. at 288.

trary to the legislative history of ACRS depreciation, but argues that eliminating the useful life requirement for tangible assets is nevertheless fundamentally sound, as it better promotes the basic policies and practical considerations underlying modern tax depreciation.

Part I of this Note contains a brief discussion of the policies underlying the depreciation deduction. Part II describes the evolution of the depreciation deduction since 1981 due to various acts of Congress and the *Simon* and *Liddle* cases. Part III critiques *Simon* and *Liddle*, proposes that Congress codify the holding of these cases to avoid future confusion and litigation, and applies the holding of these cases to assets previously considered nondepreciable.

I
Policies Underlying the Depreciation Deduction

The Internal Revenue Code[17] (Code or I.R.C.) allows a taxpayer to recover the costs of long-lived, income-producing assets over time through the depreciation or cost-recovery deduction.[18] This deduction has been justified as a means "to encourage taxpayers to purchase depreciable property, to induce certain investment activities deemed socially desirable, and to regulate the economy."[19] However, "the primary purpose of depreciation is the allocation of the cost of the property"[20] over time, and this purpose is justified on two grounds: the matching of revenues and expenses to reflect more clearly taxable income (matching concept)[21] and the recovery by the taxpayer of an allowance for wear and tear on the asset.[22]

[17] 26 U.S.C. All section references in this Note are to the Internal Revenue Code.

[18] See I.R.C. § 167 (West Supp. 1997) (providing for depreciation deduction); id. § 168 (explaining means of calculating depreciation deduction).

[19] Henry J. Lischer, Jr., Depreciation Policy: Whither Thou Goest, 32 Sw. L.J. 545, 573 (1978).

[20] Id.

[21] See Hertz Corp. v. United States, 364 U.S. 122, 126 (1960) ("[T]he purpose of depreciation accounting is to allocate the expense of using an asset to the various periods which are benefited by that asset."); Massey Motors, Inc. v. United States, 364 U.S. 92, 104 (1960) ("[T]he primary purpose of depreciation accounting [is] to further the integrity of periodic income statements by making a meaningful allocation of the cost entailed in the use (excluding maintenance expense) of the asset to the periods to which it contributes.").

[22] See Detroit Edison Co. v. Commissioner, 319 U.S. 98, 101 (1943) ("The end and purpose of [depreciation] is to approximate and reflect the financial consequences to the taxpayer of the subtle effects of time and use on the value of his capital assets."); United States v. Ludey, 274 U.S. 295, 300 (1927) ("The depreciation charge . . . for any year represents the reduction, during the year, of the capital assets through wear and tear of the plant used."). Depreciation also has been viewed as a means to reflect the change in the value of an asset over time and as a method to account for a fund to replace the asset at the end of its life. See Lischer, supra note 19, at 571-73 (stating that depreciation has been viewed as change in value of property over time, as replacement fund, as method of matching reve-

The matching concept requires that a taxpayer deduct the costs of an activity during the period in which revenues from that activity are earned. For example, a taxpayer should deduct the costs of raw materials used to manufacture a product in the year the product is sold (and thus generates income) and not when the materials are initially purchased.[23] As the following textbook example illustrates, however, application of the matching concept is more complicated for business and investment assets that generate income over several years.[24]

Suppose a business taxpayer purchases a $100,000 machine that produces widgets. The taxpayer expects that the machine will be productive for ten years and that the taxpayer will earn $15,000 per year from the sale of the widgets. There are at least three alternative means of providing a cost-recovery deduction to the taxpayer for this machine. First, the taxpayer could be allowed an immediate deduction for the full cost of the machine in the year of purchase. This would result in a loss of $85,000 in year one[25] and $15,000 of taxable income per year for the nine remaining years of the asset's income-producing life. Second, the taxpayer could be required to sell or otherwise dispose of the asset before being allowed to recover the cost of the property. In our example, this alternative would give the taxpayer taxable income of $15,000 per year for the first nine years and a loss of $85,000 in year ten.[26] Both of these methods result in a distortion of income, as they do not reflect the use of the asset over the ten-year period. The third alternative corrects this distortion by allowing

nues and expenses, and as cost recovery device). However, the view that depreciation should reflect the exact change in the value of an asset was rejected for tax accounting purposes due to the valuation problems that would result. See id. at 572. Also, the Supreme Court has rejected the replacement fund theory as a primary justification for depreciation. See Commissioner v. Idaho Power Co., 418 U.S. 1, 11 (1974) (rejecting replacement fund theory as "strict and sole purpose of depreciation").

23 See I.R.C. § 263A (1994) (requiring capitalization of certain direct and indirect costs as inventory costs); Treas. Reg. § 1.61-3(a) (as amended in 1992) (interpreting section 61 to exclude cost of goods sold from gross income).

24 It is a fundamental principle of our tax system that the cost to purchase or create an asset can be recovered tax free. See I.R.C. § 1001(a) (1994) ("The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis . . . ."); Marvin A. Chirelstein, Federal Income Taxation: A Guide to the Leading Cases and Concepts § 2.01, at 25 (7th ed. 1994) (stating that only excess of sales proceeds over cost of property is included in gross income of taxpayer); Paul R. McDaniel et al., Federal Income Taxation: Cases and Materials 205 (3d ed. 1994) ("Income . . . contemplates the realization of gain after recovery of the taxpayer's original capital investment."). Depreciation rules affect only the timing of this cost recovery.

25 The loss equals the $15,000 in income less the $100,000 cost of the machine. In these examples, it is assumed that the machine will be disposed of for no consideration.

26 The loss in year 10 again equals the $15,000 in income generated from the sale of the widgets less the $100,000 cost of the machine.

the cost of the machine to be recovered over the life of the machine. If the cost is recovered evenly over the income-producing life of the machine, the taxpayer would have taxable income of $5,000 per year for ten years.[27] In this way, the revenue generated from the machine is better "matched" with the cost of the machine,[28] thereby more accurately measuring net income.

In addition to the matching concept, courts have also justified the depreciation deduction as an allowance for the wear and tear experienced by an asset as it is used in the production process.[29] The current Code also includes this "allowance for . . . wear and tear" language in describing the depreciation deduction.[30]

The matching concept and the allowance for wear and tear provide accepted policy rationales for allowing a deduction under any system of depreciation. Once depreciation is recognized as an appropriate tax deduction, issues arise related to the method of calculating the depreciation deduction and the types of assets which should be depreciable. These issues have been addressed in recent years by both Congress and the courts.

II
Recent Evolution of Tax Depreciation Rules

Over the past twenty years, three major pieces of legislation have significantly impacted tax depreciation: the Economic Recovery Tax Act of 1981 (ERTA),[31] the Tax Reform Act of 1986 (TRA86),[32] and the Omnibus Budget Reconciliation Act of 1993 (OBRA).[33] These acts, along with the *Simon* and *Liddle* decisions, provide the foundation for the current depreciation system. This Part first discusses the general statutory framework for depreciation, including the changes

27 Taxable income equals the $15,000 in income less a $10,000 cost-recovery deduction per year for 10 years. The cost-recovery deduction equals the total cost of the machine divided by its income-producing life. Here, this is $100,000 divided by 10 years, or $10,000 per year.

28 See Laurie L. Malman et al., Federal Income Taxation: Problems, Cases, and Materials 452 (1994) (noting financial distortions that occur when asset's cost is not spread over life of asset).

29 See supra note 22.

30 See I.R.C. § 167(a) (West Supp. 1997) (stating that "[t]here shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)" of a business or investment asset).

31 Pub. L. No. 97-34, 95 Stat. 172 (codified as amended in scattered sections of 26 U.S.C.).

32 Pub. L. No. 99-514, 100 Stat. 2085 (codified as amended in scattered sections of 26 U.S.C.).

33 Pub. L. No. 103-66, 107 Stat. 312 (codified as amended in scattered sections of 26 U.S.C.).

that resulted from congressional action. It then describes the tax depreciation systems in place prior to and immediately after the passage of ERTA. Finally, it discusses the impact of the *Simon* and *Liddle* cases on tax depreciation before noting the current state of the law.

A. *Statutory Framework for Depreciation*

The sole provision in the Code authorizing the depreciation deduction is section 167.[34] This section grants taxpayers a depreciation deduction if certain conditions are met[35] and is applicable to both tangible and intangible assets.[36] Prior to 1981, section 167 also determined the method for calculating the depreciation deduction.[37]

In 1981, ERTA added section 168 to the Code.[38] This section provided a new method of calculating the depreciation deduction, known as the Accelerated Cost Recovery System (ACRS).[39] In general, ACRS is applicable to tangible property placed in service between January 1, 1981[40] and December 31, 1986.[41] In enacting ACRS, Congress had two primary goals: simplifying the depreciation system

34 See Chirelstein, supra note 4, § 6.08, at 142 (stating that section 167 "still supplies the basic authorization" for depreciation).

35 See infra Part II.B.

36 See Treas. Reg. § 1.167(a)-2 (as amended in 1960) (discussing depreciation of tangible assets under section 167); Treas. Reg. § 1.167(a)-3 (as amended in 1960) (discussing depreciation of intangible assets under section 167).

37 See Robert R. Smyers, Depreciation: General Concepts; Non-ACRS Rules, 530 Tax Management Portfolio, at A-7 (1992) (listing permissible methods of calculating depreciation under section 167); see also Malman et al., supra note 4, at 453 ("Prior to [1981] . . . § 167 defined the annual depreciation deductions.").

38 See Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 201(a), 95 Stat. 172, 203-18 (codified as amended at 26 U.S.C. § 168 (West Supp. 1997)); see also Staff of Joint Comm. on Taxation, 99th Cong., General Explanation of the Tax Reform Act of 1986, at 99 (Joint Comm. Print 1986) [hereinafter 1986 Blue Book] (stating that ERTA enacted ACRS); Chirelstein, supra note 4, § 6.09, at 151 (noting that "1981 Tax Act . . . added § 168 to the Code").

The Joint Committee on Taxation is a joint congressional committee created under section 8001. See I.R.C. § 8001 (1994). The Joint Committee is charged with, inter alia, investigating the impact of the federal tax system, proposing measures to simplify the tax system, and publishing reports. See id. § 8022. The Joint Committee issues general explanations, known as "Blue Books," interpreting major pieces of tax legislation. The Blue Books complement the House and Senate reports in determining the congressional intent behind a tax bill.

39 See Staff of Joint Comm. on Taxation, 97th Cong., General Explanation of the Economic Recovery Tax Act of 1981, at 75 (Joint Comm. Print 1981) [hereinafter 1981 Blue Book] ("[ERTA] replaces the prior law depreciation system with the Accelerated Cost Recovery System (ACRS).").

40 See I.R.C. § 168(e)(1) (1982) (amended 1986, 1995, 1996, 1997) (stating that ACRS version of section 168 does not apply to property placed in service before January 1, 1981).

41 As stated infra, see text accompanying note 43, section 168 was changed in 1986. See also 1986 Blue Book, supra note 38, at 99 (stating that ACRS was modified for assets placed in service after December 31, 1986, except for transition rule property).

and providing an economic stimulus to businesses by encouraging investment in depreciable assets.[42]

In 1986, section 168 was modified by TRA86.[43] The amended section 168 created the Modified Accelerated Cost Recovery System (MACRS).[44] In general, MACRS applies to tangible assets placed in service after December 31, 1986.[45]

In 1993, OBRA added section 197 to the Code.[46] Section 197 generally applies to certain intangible assets, defined in section 197(d), acquired after August 10, 1993.[47] For intangible assets not covered by section 197, section 167 determines whether such assets are amortizable[48] and the amount of the deduction.[49]

In summary, the depreciation deduction for a tangible asset is generally determined on the basis of when the asset was placed in service: section 167 is used for assets placed in service before December 31, 1980; the ACRS version of section 168 controls assets placed in service between January 1, 1981 and December 31, 1986; and the MACRS version of section 168 applies to assets placed in service after December 31, 1986. Section 197 determines the amortization calculation for certain intangible assets acquired after August 10, 1993. For all other intangibles, the amortization deduction, if any, is still governed by section 167.

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42 See 1981 Blue Book, supra note 39, at 75 ("The Congress concluded that prior law rules for determining depreciation allowances . . . needed to be replaced because they did not provide the investment stimulus that was felt to be essential for economic expansion. The Congress also concluded that prior law rules were unnecessarily complicated.").

43 See Tax Reform Act of 1986, Pub. L. No. 99-514, § 201(a), 100 Stat. 2085, 2121-37 (codified as amended at 26 U.S.C. § 168 (West Supp. 1997)). Section 168 remains substantially unchanged since 1986.

44 See James Edward Maule, Depreciation: MACRS and ACRS, 531 Tax Management Portfolio, at A-1 (1994) (calling post-1986 depreciation system "Modified ACRS ('MACRS')").

45 See supra note 41.

46 See Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13261, 107 Stat. 312, 532-38 (codified at 26 U.S.C. § 197 (1994)).

47 See Reuven S. Avi-Yonah, Amortization of Intangibles, 533 Tax Management Portfolio, at A-1 (1997) ("Section 197 is generally effective for [intangible assets acquired] after August 10, 1993 . . . and acquisitions before that date are governed by pre-§ 197 law.").

48 When discussing the cost recovery of tangible assets, the Code refers to "depreciation." However, when discussing the cost recovery of intangible assets, the Code refers to "amortization." Both concepts refer to the recovery of the cost of an asset over a specified period of time. See I.R.C. § 168 (West Supp. 1997) (discussing depreciation deduction for tangible property); id. § 197 (1994) (discussing amortization of section 197 intangible assets); see also Malman et al., supra note 4, at 480 n.* ("The word 'amortization' is used to describe the depreciation of intangible assets.").

49 Examples of intangible assets not covered by section 197 include self-created patents and the cost of leases of tangible property. See McDaniel et al., supra note 4, at 453-54 (discussing assets amortizable under section 197).

B. Depreciation Under Section 167

Four general requirements determine whether an asset is depreciable under section 167.[50] First, the asset must be a business or investment asset.[51] This requirement is justified by the policy consideration that taxpayers should not be allowed a deduction for personal expenses.[52] Hence, taxpayers are not allowed to depreciate the cost of items such as personal automobiles or residences. Second, the asset must have a basis.[53] Third, the asset's salvage value must be determinable.[54] An asset's "salvage value" is defined as the estimated amount for which an asset can be sold upon its retirement from service.[55]

The fourth and final requirement is that the asset must have a determinable useful life.[56] An asset's "useful life" is defined as "the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of income."[57] An asset's useful life is crucial in the depreciation scheme

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50 For a general discussion of the depreciation system under section 167, see Chirelstein, supra note 24, § 6.08, at 141-49; Malman et al., supra note 4, at 452-61.

Once an asset satisfies the general requirements of depreciability under section 167, the taxpayer must choose a method of depreciation. A taxpayer may select "[a]ny reasonable and consistently applied method" to depreciate the asset. See Treas. Reg. § 1.167(b)-0 (as amended in 1960). For assets covered by sections 168 and 197, the method of depreciation is determined by statute.

51 See I.R.C. § 167(a)(1), (2) (West Supp. 1997).

52 See Chirelstein, supra note 24, § 7.01, at 157 ("Personal consumption expenses must obviously be treated as non-deductible on the whole; if they were allowed, the individual tax base could be eliminated through expenditures on personal living items and the notion of a tax on economic gain would have been abandoned."). The disallowance of personal expense deductions is codified in section 262, which states that, in general, "no deduction shall be allowed for personal, living, or family expenses." I.R.C. § 262(a) (1994).

53 The "original" or "unadjusted" basis of a property is generally "the cost of such property" to the taxpayer. I.R.C. § 1012 (1994). However, "in some situations (e.g., property received by gift or bequest, as compensation, or in a tax-free exchange) [basis] is fixed by a special statutory, administrative, or judicial rule." Boris I. Bittker & Martin J. McMahon, Jr., Federal Income Taxation of Individuals 29-2 (2d ed. 1995). The basis of an asset is recovered (reduced) through the depreciation deduction. See I.R.C. § 1016(a)(2) (West Supp. 1997) (requiring basis of property to be reduced by depreciation deduction allowable). An asset's "adjusted" basis is its basis after adjustment for items such as depreciation. See id. § 1011(a) (1994) (defining adjusted basis for determining gain or loss on sale or other disposition of property).

54 See Treas. Reg. § 1.167(a)-1(a) (as amended in 1972) ("An asset shall not be depreciated below a reasonable salvage value under any method of computing depreciation.").

55 See Treas. Reg. § 1.167(a)-1(c)(1) (as amended in 1972) ("Salvage value is the amount (determined at the time of acquisition) which is estimated will be realizable upon sale or other disposition of an asset when it is no longer useful... and is to be retired from service by the taxpayer.").

56 See Chirelstein, supra note 24, § 6.08, at 142 ("Property is depreciable . . . for purposes of § 167 if its useful life is definite and predictable.").

57 Treas. Reg. § 1.167(a)-1(b) (as amended in 1972).

under section 167 since it not only determines the time period over which the cost of the asset may be recovered, but also determines, in part, whether the asset is even depreciable.[58]

The determination of the useful life of an asset has been the subject of much litigation.[59] In an attempt to minimize the disagreements between taxpayers and the Service over an asset's useful life, the Service has in the past explicitly set forth the useful lives of certain assets. For example, in 1971, the Service enacted the Asset Depreciation Range (ADR) system, in part to promote administrative convenience by reducing useful life disputes.[60] This system was in place immediately preceding the addition of section 168 to the Code. The Joint Committee on Taxation[61] described the ADR system as follows:

> Assets eligible for ADR were grouped into more than 100 classes, and a guideline life for each class was determined by the Treasury. Taxpayers could claim a useful life up to 20% longer or shorter than the ADR guideline life. For assets not eligible for ADR and for taxpayers who did not elect ADR, useful lives were determined according to the facts and circumstances pertaining to each asset or by agreement between the taxpayer and the Internal Revenue Service.[62]

The ADR system did not resolve all of the controversies between taxpayers and the Service over assets' useful lives, however, and section 168 was added to the Code, in part, to eliminate these controversies.[63]

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[58] The factors considered in determining the useful life of an asset include:

> (1) wear and tear and decay or decline from natural causes, (2) the normal progress of the art, economic changes, inventions, and current developments within the industry and the taxpayer's trade or business, (3) the climatic and other local conditions peculiar to the taxpayer's trade or business, and (4) the taxpayer's policy as to repairs, renewals, and replacements.

Id.

[59] See 1981 Blue Book, supra note 39, at 75 (noting that depreciation rules under section 167 "required determinations on matters, such as useful life . . . which are inherently uncertain and, thus, too frequently resulted in unproductive disagreements between taxpayers and the Internal Revenue Service"); see also Simon v. Commissioner, 103 T.C. 247, 258-59 (1994) (en banc) (noting that "ERTA was enacted partially to address and eliminate the . . . disagreement[s] between taxpayers and the Commissioner over the useful lives of assets that were used in taxpayers' trades or businesses"), aff'd, 68 F.3d 41 (2d Cir. 1995); Liddle v. Commissioner, 103 T.C. 285, 296 (1994) (en banc) (stating that Congress enacted ERTA, in part, to "[a]void constant disagreements over the appropriate useful lives of assets"), aff'd, 65 F.3d 329 (3d Cir. 1995). For a listing of cases illustrating various useful life controversies, see 1997 CCH Standard Federal Tax Reporter, vol. 3, at 25,535-42.

[60] See Lischer, supra note 19, at 568.

[61] See supra note 38.

[62] 1981 Blue Book, supra note 39, at 67.

[63] See supra note 59.

C. Depreciation Under ACRS

Under ACRS, the original version of section 168, tangible personal property is classified into one of four "recovery periods" of three, five, ten, or fifteen years.[64] These assets generally are depreciated using the 150% declining balance method over the assets' recovery periods.[65] In contrast, real property is assigned a recovery period of fifteen years and is depreciated using the 175% declining balance method over the asset's recovery period.[66]

ACRS differs from its predecessor, the section 167 depreciation system, in at least three major respects. First, the salvage value requirement is eliminated.[67] Second, ACRS "minimizes the number of elections and exceptions, and so is easier to comply with and to administer."[68] Finally, under ACRS, the concept of useful life is "de-emphasize[d]."[69] The extent to which the useful life requirement is de-emphasized was the key issue in *Simon* and *Liddle*.

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64 Assets are generally classified into their recovery periods based on their Asset Depreciation Range (ADR) lives. See I.R.C. § 168(c)(2) (1982) (amended 1986, 1995, 1996, 1997). An asset's ADR life was determined by the Treasury. See supra text accompanying note 62.

65 See id. § 168(b)(1) (amended 1986, 1995, 1996, 1997) (providing tables with "applicable percentage[s]" to be applied to unadjusted basis of property, which reflect 150% declining balance deduction).

The declining balance method is an accelerated method of computing the depreciation deduction. The deduction is calculated by multiplying a constant percentage to the asset's adjusted basis at the beginning of the tax year. Since the adjusted basis is reduced each year by the amount of the depreciation deduction, the constant percentage is applied against a "declining balance." See I.R.C. § 1016(a)(2) (West Supp. 1997) (requiring reduction of asset basis by amount of depreciation deduction allowable). The constant percentage equals a factor divided by the useful life or recovery period of the asset. See Malman et al., supra note 4, at 459-60. The factor is identified in the name of the method (e.g., for the 200% (or double) declining balance method, the factor is 2, while under the 150% declining balance method, the factor is 1.5). Hence, the constant percentage under the 200% declining balance method for an asset with a recovery period of five years is 40% (the factor divided by the recovery period, or 2/5).

66 See I.R.C. § 168(b)(2) (1982) (amended 1986, 1995, 1996, 1997); see also Bittker & McMahon, supra note 53, at 14-22 (discussing ACRS depreciation of real and personal property).

67 See I.R.C. § 168(f)(9) (1982) (amended 1986, 1995, 1996, 1997) ("No salvage value shall be taken into account in determining the [depreciation deduction]."); see also 1981 Blue Book, supra note 39, at 76 ("The entire cost or other basis of eligible property is recovered under [ACRS], eliminating the salvage value limitation of prior law.").

68 1981 Blue Book, supra note 39, at 75.

69 Id.

D. *Depreciation After* Simon *and* Liddle[70]

In allowing the Simons and Liddle to depreciate their antique musical instruments, the tax court interpreted ERTA as creating a two-part test for determining the depreciability of a tangible asset (*Simon-Liddle* Rule).[71] First, the asset must be a business or investment asset. Second, if the taxpayer can establish that the asset is subject to exhaustion, wear and tear, or obsolescence (wear and tear requirement), then no determinable useful life need be proven for the asset to be depreciable.[72] However, if the asset suffers no discernible exhaustion, wear and tear, or obsolescence, the taxpayer must prove that the asset has a determinable useful life for the asset to be depreciable.[73]

The *Simon-Liddle* Rule effectively substitutes the wear and tear requirement for the useful life requirement that was necessary for depreciability under section 167.[74] "Exhaustion, wear and tear, or obsolescence" describes the actual physical deterioration or decline in usefulness of the asset, while "useful life" is a measure of the time period over which the "exhaustion, wear and tear, or obsolescence" of the asset will render it unusable.[75] While these concepts both attempt to ensure that a depreciable asset is a "wasting asset," the wear and tear requirement is broader than the useful life requirement. For example, many assets, like antique musical instruments, will suffer wear and tear but have no determinable useful lives, while very few assets that have determinable useful lives will not suffer wear and tear.

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70 *Simon* and *Liddle* were affirmed by the Second and Third Circuits, respectively. See Simon v. Commissioner, 68 F.3d 41 (2d Cir. 1995); Liddle v. Commissioner, 65 F.3d 329 (3d Cir. 1995). However, since the appellate decisions add little to the discussion of the depreciability of assets with no useful lives, this Note focuses on the tax court decisions.

71 In *Simon* and *Liddle*, the tax court interpreted ERTA and the ACRS depreciation system. Since ACRS generally applies only to assets placed in service between January 1, 1981 and December 31, 1986, the holding of the two cases is limited to assets placed in service during that time period. However, the *Simon-Liddle* Rule has been applied to assets depreciable under MACRS. See Selig v. Commissioner, 70 T.C.M. (CCH) 1125, 1128 (1995) (applying *Simon-Liddle* Rule to MACRS). Because of this, no further distinctions are made in this Note between the application of the *Simon-Liddle* Rule to the ACRS version of section 168 as opposed to the MACRS version of section 168.

72 See Simon v. Commissioner, 103 T.C. 247, 262-63 (1994) (en banc) (rejecting need for taxpayer to prove useful life for asset's depreciability), aff'd, 68 F.3d 41 (2d Cir. 1995); Liddle v. Commissioner, 103 T.C. 285, 296 (1994) (en banc) (same), aff'd, 65 F.3d 329 (3d Cir. 1995).

73 See *Simon*, 103 T.C. at 264 (stating that taxpayer must prove useful lives of business or investment assets that suffer no discernible wear and tear, but once assets are shown to be subject to wear and tear, their recovery periods under ACRS can be determined).

74 See supra text accompanying notes 56-58.

75 See supra text accompanying note 57 (defining useful life). Indeed, the factors listed in the treasury regulations to determine an asset's useful life all relate to the physical or technological state of the asset. See supra note 58.

Therefore, although the *Simon-Liddle* Rule provides that an asset that does not suffer wear and tear may still be depreciable if it has a useful life, this alternative test generally will not cause many tangible assets to be depreciable. Hence, the *Simon-Liddle* Rule has effectively eliminated the useful life requirement, and the wear and tear requirement has become the key factor in determining an asset's depreciability.

With the wear and tear requirement as the threshold for depreciation, the issue arises as to what level of wear and tear is sufficient to trigger a depreciation deduction. Historically, "[t]he 'wear and tear' concept relate[d] to the physical life of tangible property. The physical life must be lessened by wear and tear that cannot be corrected by regular maintenance."[76] In *Simon* and *Liddle*, while the dissenters questioned the sufficiency of the wear and tear on the instruments,[77] it was clear that the taxpayers incurred repair and other maintenance expenses to maintain their instruments. An evidentiary rule that can be inferred from these cases is that any regular repair and maintenance cost expended to maintain a business or investment asset is strong evidence of the depreciability of that asset. Therefore, "wear and tear" of an asset for tax depreciation purposes can be defined as that amount of "wear and tear" sufficient for a taxpayer to incur regular repair and maintenance expenses on the asset.

E. Current State of the Law

Currently in the Second and Third Circuits, the depreciation deduction for tangible assets is governed by the *Simon-Liddle* Rule[78] and the MACRS version of section 168. The *Simon-Liddle* Rule determines whether a tangible asset is depreciable,[79] and MACRS determines the amount of the deduction.[80] Though the continued validity of the useful life requirement has not been raised as an issue in other circuits, the tax court will likely follow the *Simon-Liddle* Rule outside the Second and Third Circuits.[81] Unfortunately, this situation is not

[76] *Liddle*, 103 T.C. at 300 (Hamblen, C.J., dissenting).

[77] See *Simon*, 103 T.C. at 276-78 (Hamblen, C.J., dissenting) (concluding that bows did not suffer "substantial" wear and tear); *Liddle*, 103 T.C. at 299-300 (Hamblen, C.J., dissenting) (arguing that viol suffered less wear and tear than the Simons' bows).

[78] As stated previously, *Simon* and *Liddle* were affirmed by the Second and Third Circuits, respectively. See supra note 15.

[79] See supra Part II.D.

[80] See I.R.C. § 168 (West Supp. 1997) (describing depreciation calculation).

[81] Under the "Golsen Rule," the tax court is obligated to follow the decisions of the court of appeals that has direct jurisdiction over the taxpayer. See William A. Raabe et al., West's Federal Tax Research 117 (3d ed. 1994) (discussing Golsen Rule). If the circuit with jurisdiction over the taxpayer has yet to decide the tax issue in question, the tax court will decide the case based on its own views. See id. Hence, while the issue of whether ERTA

stable. After the Second and Third Circuits affirmed the tax court's decisions, the Service issued an Action on Decision (AOD) nonacquiescing to the *Simon* holding.[82] The AOD clearly stated the Service's position that "the enactment of ACRS merely shortened the recovery period over which an asset is depreciated to stimulate economic growth but did not convert assets that formerly were not depreciable into assets that are depreciable."[83] The Service stated its intention to pursue this issue in other circuits.[84] Consequently, without congressional action, future litigation on this issue is inevitable.

III
Evaluation and Implications of the *Simon-Liddle* Rule

The adoption of the *Simon-Liddle* Rule of depreciation raises two immediate questions. First, did ERTA really eliminate the useful life requirement? That is, are *Simon* and *Liddle* correctly decided? Second, are the decisions good policy? This Note concludes that *Simon* and *Liddle* were wrongly decided and were contrary to the legislative history of ERTA. The holding of the cases, however, is justified on policy grounds because assets with no determinable useful lives should be depreciable under section 168. This Note offers a theory to justify this conclusion and demonstrates how the *Simon-Liddle* Rule will apply to assets previously considered nondepreciable.

A. Simon *and* Liddle *Were Wrongly Decided*

The majority and dissenting opinions in *Simon* and *Liddle* focused on whether the bows and viol were "recovery property" under

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eliminated the useful life requirement is closed in the Second and Third Circuits (assuming no resolution of the issue by the Supreme Court), it still may be litigated elsewhere.

82 See A.O.D. 1996-009 (July 15, 1996), 1996 WL 390088 (I.R.S.); see also 1996-29 I.R.B. 4 (announcing A.O.D. 1996-009). An AOD is a memorandum prepared by the Assistant Chief Counsel (Tax Litigation) of the Service and represents "the Service's litigating posture on controversial issues in a specific case and provide[s] the legal basis for the Service's position on those issues." 5 Internal Revenue Manual: Administration (CCH) ¶ 8642, at 25,785-5 (1997); see also Lisa Marie Starczewski, IRS National Office Procedures—Rulings, Closing Agreements, 621 Tax Management Portfolio, at A-31 (1996) (defining AOD as document announcing Service's acquiescence or nonacquiescence on judicial decision).

83 A.O.D. 1996-009 (July 15, 1996), 1996 WL 390088 (I.R.S.); see also 1996-29 I.R.B. 4.

84 See A.O.D. 1996-009 (July 15, 1996), 1996 WL 390088 (I.R.S.); see also 1996-29 I.R.B. 4. For a noncorporate taxpayer, a tax court decision is appealed to the United States Court of Appeals for the circuit in which the taxpayer resides. See I.R.C. § 7482(b)(1) (1994) (listing venues for appeal for different types of taxpayers); see also supra note 81 (discussing Golsen Rule).

section 168.[85] An asset must be "recovery property" to be depreciable under ACRS.[86] Recovery property is defined as assets that are: (1) tangible; (2) placed in service after 1980; (3) of a character subject to the allowance for depreciation; and (4) used in a trade or business or held for the production of income.[87] The key disagreement between Judge Laro, author of the majority opinions, and the dissenters centered on whether antique musical instruments were property "of a character subject to the allowance for depreciation."[88] Judge Laro and the dissenters focused on five issues to support their differing conclusions: (1) the legislative history of ERTA; (2) statutory interpretation of sections 167 and 168; (3) legal precedent; (4) the definition of "works of art;" and (5) the matching concept.

These issues will be discussed separately below. This Note argues that the legislative history of ERTA is dispositive in favor of the dissenters' position that ERTA did not eliminate the useful life requirement for depreciation. The remaining issues do not undermine the validity of the *Simon-Liddle* Rule given the clear legislative history.

1. *Legislative History Argument*

In discussing the legislative history of ERTA, Judge Laro noted that a reason Congress enacted ERTA was "to avoid constant disagreements over the useful lives of assets."[89] Judge Laro asserted that by requiring the taxpayer to first prove an asset's useful life before classifying the asset as three-year or five-year property under ACRS, the court would be returning to "pre-ERTA law and reintroduc[ing]

[85] See Simon v. Commissioner, 103 T.C. 247, 259-60 (1994) (en banc) ("Inasmuch as section 168(a) allows a taxpayer to deduct depreciation with respect to 'recovery property', [taxpayers] may deduct depreciation on the Tourte bows if the bows fall within the meaning of that term."), aff'd, 68 F.3d 41 (2d Cir. 1995); id. at 268-69 (Hamblen, C.J., dissenting) (arguing that Tourte bows are not recovery property); Liddle v. Commissioner, 103 T.C. 285, 292-93 (1994) (en banc) ("Inasmuch as section 168(a) allows a deduction with respect to 'recovery property', [taxpayer] may claim such a deduction on the viol if it falls within the meaning of that term."), aff'd, 65 F.3d 329 (3d Cir. 1995); id. at 301 (Halpern, J., dissenting) (discussing depreciability of recovery property).

[86] See I.R.C. § 168(a) (1982) (amended 1986, 1995, 1996, 1997) ("There shall be allowed as a deduction for any taxable year the amount determined under this section with respect to recovery property."). When section 168 was modified by the Tax Reform Act of 1986, Pub. L. No. 99-514, § 201(a), 100 Stat. 2085, 2121-37 (codified as amended at 26 U.S.C. § 168 (West Supp. 1997)), the recovery property requirement was eliminated.

[87] See *Simon*, 103 T.C. at 259 (defining recovery property); *Liddle*, 103 T.C. at 292-93 (same); see also I.R.C. § 168(c)(1) (1982) (amended 1986, 1995, 1996, 1997) (same).

[88] *Simon*, 103 T.C. at 259; id. at 268 (Hamblen, C.J., dissenting); *Liddle*, 103 T.C. at 292-93; id. at 301 (Halpern, J., dissenting).

[89] *Simon*, 103 T.C. at 263.

the disagreements that the Congress intended to eliminate by its enactment of ERTA."[90]

In contrast, the dissenters relied on the actual language of the committee reports, which explicitly state that "'assets that do not have a determinable useful life and that do not decline in value predictably are not depreciable.'"[91] Moreover, the committee reports state that ERTA "'does not change the determination under prior law as to whether property is depreciable or nondepreciable.'"[92] Given this language, the dissenters concluded that it was not the intent of Congress to eliminate the useful life requirement.[93]

Given the clear language of the legislative history, the dissenters' arguments are convincing. The Joint Committee's explicit statement that "[ERTA] does not change any determination under prior law as to whether property is tangible or intangible or depreciable or nondepreciable"[94] is compelling. The "prior law" referred to in this passage is the depreciation system under section 167.[95] Since an asset must have a determinable useful life to be depreciable under section 167, this language indicates that an asset must also have a useful life to be depreciable under ACRS.

Moreover, the legislative history states that ERTA was intended to simplify the complexities of the ADR system by de-emphasizing the useful life issue.[96] In *Simon*, Judge Laro explained that ERTA deemphasized useful life by:

> (1) Reducing the number of periods of years over which a taxpayer could depreciate his or her property from the multitudinous far-reaching periods of time listed for the ADR system to the four short periods of time listed in ERTA . . . , and (2) basing depreciation on an arbitrary statutory period of years that was unrelated to, and shorter than, an asset's estimated useful life. This minimization of

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[90] Id.; see also *Liddle*, 103 T.C. at 296.

[91] *Simon*, 103 T.C. at 270 (Hamblen, C.J., dissenting) (emphasis omitted) (quoting S. Rep. 97-144, at 39 (1981), reprinted in 1981 U.S.C.C.A.N. 105, 145).

[92] Id. at 271 (Hamblen, C.J., dissenting) (quoting 1981 Blue Book, supra note 39, at 77).

[93] In affirming *Simon*, the Second Circuit noted that the legislative history of ERTA states that "'[a]ssets that do not decline in value on a predictable basis or that do not have a determinable useful life . . . are not depreciable.'" Simon v. Commissioner, 68 F.3d 41, 46 (2d Cir. 1995) (quoting H.R. Conf. Rep. No. 97-215, at 206 (1981), reprinted in 1981 U.S.C.C.A.N. 285, 296). However, that language only gave the court "slight pause" and it gave little weight to this part of the legislative history, stating that "[i]n light of the overriding legislative intent to abandon the unnecessarily complicated rules on useful life, we cannot employ two sentences in a legislative report to trump statutory language and a clearly stated legislative purpose." Id. at 46.

[94] 1981 Blue Book, supra note 39, at 77.

[95] See id. at 67-68 (describing depreciation system under section 167).

[96] See id. at 75.

the useful life concept through a deemed useful life was in spirit with the . . . main issues that ERTA was designed to address . . . .[97]

Judge Laro's analysis, however, suggests that ERTA eliminated the useful life requirement altogether by stating that the ACRS recovery periods are unrelated to an asset's useful life. This is problematic because, as stated previously, useful life has at least two key functions under section 167: (1) determining whether an asset is depreciable and (2) determining the time period over which an asset is depreciable.[98] Judge Laro correctly noted that under ACRS, useful life is no longer necessary to determine the time period over which an asset is depreciable due to the statutorily determined recovery periods. However, useful life as a threshold for depreciability must have survived the passage of ERTA. Otherwise, the legislative history would have indicated that the useful life requirement was eliminated by ERTA and not merely de-emphasized.[99] Therefore, the legislative history is virtually conclusive evidence that Congress did not intend to eliminate the useful life requirement when it created the ACRS depreciation system and that *Simon* and *Liddle* were wrongly decided.

2. *Statutory Interpretation Argument*

Judge Laro's statutory interpretation argument compared the definition of "recovery property" under the ACRS version of section 168(c)(1)[100] with the language of section 167(a).[101] Judge Laro reasoned that the similar language used in these two statutes suggests that the term "depreciation" in section 168(c)(1) refers to the phrase "exhaustion, wear and tear (including a reasonable allowance for ob-

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[97] *Simon*, 103 T.C. at 257.

[98] See supra text accompanying note 58.

[99] As Judge Oakes noted in his Second Circuit dissent in *Simon*, "[d]e-emphasis . . . is quite different from destruction." Simon v. Commissioner, 68 F.3d 41, 48 n.1 (2d Cir. 1995) (Oakes, J., dissenting).

[100] I.R.C. § 168(c)(1) (1982) (amended 1986, 1995, 1996, 1997) defined recovery property as follows:

> [T]he term "recovery property" means tangible property of a character subject to the allowance for depreciation—
>
> (A) used in a trade or business, or
>
> (B) held for the production of income.

[101] I.R.C. § 167(a) (1981) (amended 1986, 1996, 1997) provided as follows:

> General rule.—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—
>
> (1) of property used in the trade or business, or
>
> (2) of property held for the production of income.

solescence)" in section 167(a).[102] Judge Laro concluded that this wear and tear requirement makes an asset "of a character subject to the allowance for depreciation."[103]

In contrast, the dissenters concluded that since the definition of "recovery property" in section 168(c)(1)[104] is virtually identical to the definition of depreciable property in section 167(a),[105] the principles underlying section 167 must govern the definition of "recovery property" under section 168.[106] That is, since a depreciable asset under section 167 must have a determinable useful life, a determinable useful life must also be a requirement for an asset to be depreciable under section 168.[107] Additionally, the dissenters noted that the definition of recovery property refers to "section 1245 class property."[108] Section 1245 class property is defined as "tangible property described in section 1245(a)(3),"[109] which includes "any property which is or has been property of a character subject to the allowance for depreciation provided in section 167."[110] Since property depreciable under section 167 must have a determinable useful life to be depreciable, the dissenters concluded that recovery property must also have a useful life to be depreciable.[111] Finally, the *Simon* dissenters cited a proposed regulation issued under section 168 to support their conclusion that property must be depreciable under section 167 to be depreciable

102 See *Simon*, 103 T.C. at 260 (comparing sections 168(c)(1) and 167(a)); Liddle v. Commissioner, 103 T.C. 285, 293-94 (1994) (en banc) (same), aff'd, 65 F.3d 329 (3d Cir. 1995).

103 *Simon*, 103 T.C. at 260 ("[Taxpayers] will meet the final requirement under section 168 if the Tourte bows are subject to exhaustion, wear and tear, or obsolescence.").

104 See supra note 100.

105 See supra note 101.

106 See *Simon*, 103 T.C. at 268-69 (Hamblen, C.J., dissenting) (comparing ACRS's definition of "recovery property" with pre-ACRS depreciable property); *Liddle*, 103 T.C. at 301-02 (Halpern, J., dissenting) (comparing section 167 with section 168).

107 See *Simon*, 103 T.C. at 269-70 (Hamblen, C.J., dissenting) ("[U]seful life remains a hallmark of the basic concept of depreciation in both sections 167 and 168."); *Liddle*, 103 T.C. at 302 (Halpern, J., dissenting) ("[N]o property for which a depreciation deduction would be unavailable under section 167 can qualify for a deduction under section 168.").

108 I.R.C. § 168(c)(2) (1982) (amended 1986, 1995, 1996, 1997).

109 Id. § 168(g)(3) (amended 1986, 1995, 1996, 1997).

110 Id. § 1245(a)(3) (amended 1984, 1986, 1995, 1996, 1997).

111 See *Simon*, 103 T.C. at 270 (Hamblen, C.J., dissenting) (stating that "an asset, such as a Tourte bow, that has an indeterminable useful life is not depreciable"); *Liddle*, 103 T.C. at 298 (Hamblen, C.J., dissenting) (arguing that since section 168 is rooted in section 167, useful life requirement was not eliminated).

In affirming *Simon*, the Second Circuit stated that the Commissioner's statutory interpretation argument was flawed since by design ACRS is an entirely new depreciation system. See Simon v. Commissioner, 68 F.3d 41, 45 (2d Cir. 1995) ("Because the ACRS is different by design, there is no logic in the Commissioner's suggestion that depreciation practice under the old Section 167 calls for the imposition of a determinable useful life requirement after ERTA.").

under section 168. The proposed regulation "provides in part: '[p]roperty is considered recovery property only if such property would have been depreciable under section 167.'"[112]

The conflict between Judge Laro and the dissenters arose from the ambiguity in the relationship between section 167 and section 168 since section 167 is the statutory authorization for the depreciation deduction under section 168.[113] Hence, it was reasonable for the dissenters to conclude that the requirements for an asset to be depreciable under section 167(a) should be implied into the definition of recovery property in section 168(c)(1). However, it was also reasonable to conclude, as Judge Laro did, that "property of a character subject to the allowance for depreciation" means assets which suffer exhaustion, wear and tear, or obsolescence because of the similar language of section 167(a) and section 168(c)(1). Given the ambiguity in the statutes, little basis exists for favoring one statutory interpretation over the other.

3. *Legal Precedent Argument*

Judge Laro distinguished *Simon* from two previous tax court cases relied upon by the dissenters that addressed the issue of the useful life requirement under ACRS and the depreciability of antique musical instruments. In *Clinger v. Commissioner*,[114] the tax court held that a professional portrait artist must prove that a painting displayed in her studio for business purposes had a determinable useful life to be depreciable. Since the taxpayer did not make such a showing, her depreciation deduction was disallowed.[115] In *Browning v. Commis-*

112 *Simon*, 103 T.C. at 271 (Hamblen, C.J., dissenting) (quoting Prop. Treas. Reg. § 1.168-3(a)(1)(ii), 49 Fed. Reg. 5957 (1984)). Although proposed regulations are not binding authority, they are indicative of the Treasury Department's interpretation of a statute. See Raabe et al., supra note 81, at 81 (stating that proposed regulations "do not have the effect of law"); see also id. at 577 (defining proposed regulation as "[a]n interpretation or clarification of the provisions of a portion of the Internal Revenue Code, issued by the Treasury and available for comment (and possible revision) in a public hearing").

113 See I.R.C. § 167(a) (1982) (amended 1986, 1996, 1997) ("[T]he deduction allowable under section 168 shall be deemed to constitute the reasonable allowance provided by this section."). See also supra note 34 and accompanying text.

114 60 T.C.M. (CCH) 598 (1990). The taxpayer was a professional portrait artist who purchased a painting by her former teacher, a well known portrait artist. This painting was displayed in the taxpayer's studio, and the taxpayer believed that the painting would help her both in her studies as a painter and in her business as a portrait artist. The taxpayer claimed depreciation deductions under ACRS. See id. at 598-99.

115 See id. at 600 (denying depreciation deduction since taxpayer failed to show useful life of asset). In the tax court, the taxpayer has the burden of proving that the Commissioner's determination of the taxpayer's tax liability is incorrect. See Raabe et al., supra note 81, at 115.

sioner,[116] the tax court held that a professional musician did not present sufficient evidence at trial to establish the useful lives of his antique violins, and hence, a depreciation deduction was disallowed.[117] In *Simon*,[118] Judge Laro distinguished *Clinger* and *Browning* by stating that, unlike the two earlier cases, the record in *Simon* contained sufficient evidence to show that the bows suffered substantial wear and tear while used in a trade or business.[119]

The dissenters claimed that *Browning* and *Clinger* showed that the useful life requirement was not eliminated by ERTA. The dissenters noted that in *Browning*, the taxpayer was not allowed a depreciation deduction because he could not determine the instruments' useful lives.[120] Also, the dissenters quoted language from *Clinger* where the tax court stated:

> [I]t is our opinion that the concept of useful life was not eliminated by the enactment of ACRS under ERTA; hence, where [the Service] has determined that a taxpayer's assets have no determinable useful life and consequently are not depreciable, [the taxpayer] must establish that an asset used in a trade or business has a determinable useful life and prove the class of recovery property to which it is assigned.[121]

The dissenters argued that both of these cases supported the proposition that even under ACRS, an asset must have a determinable useful life to be depreciable.

Although *Browning* and *Clinger* do appear to support the dissenters, these cases are not controlling. In addition to Judge Laro's observations, *Clinger*'s precedential weight is limited since it was merely a tax court memorandum decision.[122] Although *Browning* was affirmed by the Ninth Circuit on the ground that the taxpayer had not carried his burden of proving that the violins had determinable useful

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116 55 T.C.M. (CCH) 1232 (1988), aff'd, 890 F.2d 1084 (9th Cir. 1989). The taxpayer, a professional musician, purchased three antique violins for his trade or business and claimed depreciation deductions for them. See id. at 1232-33.

117 See id. at 1236-37 (reviewing evidence and denying depreciation deduction on violins).

118 Judge Laro did not address these two cases in his opinion in *Liddle*.

119 See Simon v. Commissioner, 103 T.C. 247, 263-65 (1994) (en banc) (concluding that *Simon* record shows sufficient wear for depreciability), aff'd, 68 F.3d 41 (2d Cir. 1995).

120 See id. at 272 (Hamblen, C.J., dissenting); Liddle v. Commissioner, 103 T.C. 285, 299 (1994) (en banc) (Hamblen, C.J., dissenting).

121 *Simon*, 103 T.C. at 272 (Hamblen, C.J., dissenting) (quoting Clinger v. Commissioner, 60 T.C.M. (CCH) 598, 600 (1990)).

122 In general, memorandum decisions are limited to opinions concerning "only the application of existing law or an interpretation of facts" and have no precedential value. See Raabe et al., supra note 81, at 117; Levine et al., supra note 12, at A-42. Additionally, a memorandum decision is the opinion of only a single judge, unlike reviewed opinions like *Simon* and *Liddle*.

lives,[123] that decision is not binding precedent in the Second or Third Circuit. Additionally, as the Second Circuit noted, *Browning* is not controlling because it is a pre-ERTA case.[124] Hence, *Clinger* and *Browning* are not compelling evidence in support of the dissenters' position.

4. *Definition of "Works of Art"*

Historically, the Service has taken the position that works of art are not depreciable. Revenue Ruling 68-232 states that "[a] valuable and treasured art piece does not have a determinable useful life. While the actual physical condition of the property may influence the value placed on the object, it will not ordinarily limit or determine the useful life. Accordingly, depreciation of works of art generally is not allowable."[125] Given this ruling by the Service, Judge Laro had three alternatives with respect to the antique musical instruments in *Simon* and *Liddle*. First, he could have held that the instruments were works of art and not depreciable regardless of their usage. Second, he could have rejected Revenue Ruling 68-232 and declared that all works of art are depreciable if they suffer exhaustion, wear and tear, or obsolescence. Third, he could have defined a work of art to exclude items actively used in a trade or business. Judge Laro chose this third alternative, declaring that "a 'work of art' [is] a passive object, such as a painting, sculpture, or carving, that is displayed for admiration of its aesthetic qualities."[126] He held that since the bows and the viol were used actively in the taxpayers' businesses, the instruments were not works of art.[127]

The dissenters disagreed with Judge Laro's definition of a work of art: "Even if used in a trade or business, a 'work of art' retains its

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[123] See Browning v. Commissioner, 890 F.2d 1084, 1087 (9th Cir. 1989) ("The Tax Court did not clearly err when it held that the Brownings had failed to carry their burden of proving that violins which had already survived for over two hundred years had only twelve years remaining in their useful lives.").

[124] See Simon v. Commissioner, 68 F.3d 41, 46 (2d Cir. 1995).

[125] Rev. Rul. 68-232, 1968-1 C.B. 79, 79. "A revenue ruling is an official interpretation by the Service on how the law . . . should be applied to a specific set of facts. Revenue rulings are published by the IRS for the information and guidance of taxpayers, IRS officials, and other interested parties." Starczewski, supra note 82, at A-29. Revenue rulings are not binding on the tax court, although courts do give long-standing revenue rulings significant weight. See id. at A-30 (discussing taxpayer reliance on revenue rulings).

[126] *Simon*, 103 T.C. at 260 n.11; see also Liddle v. Commissioner, 103 T.C. 285, 294 (1994) (en banc) (Hamblen, C.J., dissenting).

[127] See *Simon*, 103 T.C. at 260 n.11 ("[T]he Tourte bows could have been collector's items except for the fact that [the taxpayers] used them actively, regularly, and routinely in their full-time business."); *Liddle*, 103 T.C. at 294 ("[T]he viol could have been a nondepreciable work of art except for the fact that [the taxpayer] used it actively, regularly, and routinely in his full-time business.").

character as a work of art because it does not have a determinable useful life and generally does not decline in value over a predictable period."[128] The dissenters thus considered the musical instruments to be works of art and therefore not depreciable. Given the lack of statutory guidance over the definition of a work of art, neither Judge Laro's nor the dissenters' opinions are clearly erroneous.

5. The Matching Concept

Judge Laro also did not accept the dissenters' argument, drawn from a position taken by the Service, that the matching concept would prohibit the instruments from being depreciated because they were appreciating in value.[129] The dissenters argued that "[w]hen an asset increases in value . . . there is no loss or waste to match against income,"[130] and thus, no deduction can be taken. In suggesting that depreciation does not apply to appreciating assets, however, the dissenters misunderstood that depreciation is a cost-recovery system. That is, depreciation matches revenues generated by an asset with the cost to purchase or create that asset. The matching concept and depreciation are divorced from the fluctuations in the market value of an asset. As Judge Laro correctly noted, "accounting for the physical depreciation of an asset and accounting for changes in the asset's value on account of price fluctuations in the market" are "two well-established, independent concepts of tax accounting."[131] No one has ever disputed that real property, which generally appreciates in value, is still depreciable under section 168.[132] Hence, the dissenters' matching arguments were not convincing and did not support their position.

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128 *Simon*, 103 T.C. at 274 (Hamblen, C.J., dissenting); see also *Liddle*, 103 T.C. at 305 (Halpern, J., dissenting) (arguing that majority's definition of "work of art" did not relieve taxpayer of burden of proving determinable useful life of viol).

129 See *Simon*, 103 T.C. at 261-62; *Liddle*, 103 T.C. at 295-96.

130 *Simon*, 103 T.C. at 275 (Hamblen, C.J., dissenting). The dissenters argued in the alternative that the matching concept is "not a guiding principle of construction of tax statutes or tax policy in every situation." Id.

131 *Simon*, 103 T.C. at 261.

132 See I.R.C. § 168(b)(3) (West Supp. 1997) (describing method for depreciating nonresidential real property).

It bears keeping in mind that a taxpayer should eventually "pay" for the depreciation allowed. If a taxpayer is depreciating an asset which is increasing in market value, the taxpayer will recognize a large gain when the asset is sold. The gain will equal the sum of the appreciation since the asset was purchased and the depreciation claimed. In other words, the Service "takes back" the depreciation deduction when the asset is sold. For example, Liddle purchased his Ruggeri viol in 1984 for $28,000. See *Liddle*, 103 T.C. at 287. In 1991, the viol was exchanged for a Busan viol valued at $65,000 on the date of the exchange. See id. Under ACRS, Liddle would have recovered the entire $28,000 cost of the Ruggeri viol through the depreciation deduction before 1991, since the viol would have been considered five year property and more than five years have passed between the year

B. *The* Simon-Liddle *Rule Should be Followed*

The legislative history of ERTA reveals that *Simon* and *Liddle* were wrongly decided and states explicitly that the determination as to whether an asset is depreciable did not change with the passage of ERTA.[133] Hence, Congress intended to retain the useful life requirement after the passage of ERTA. The other issues discussed by Judge Laro and the dissenters do not change this result.

Given that *Simon* and *Liddle* were wrongly decided, the issue arises as to whether the *Simon-Liddle* Rule should be followed. There are two major problems with following the Rule. First, following the *Simon-Liddle* Rule would have an undetermined revenue impact for the government because it would expand the pool of potentially depreciable property.[134] Second, as noted above, following the *Simon-Liddle* Rule would be contrary to the legislative intent of ERTA.

While these concerns are important, they do not change the fact that the *Simon-Liddle* Rule is more desirable for both policy and practical reasons than a depreciation rule with a useful life requirement. This section will discuss four reasons for following the *Simon-Liddle* Rule, some of which address the above-noted concerns. This section concludes with the argument that since the *Simon-Liddle* Rule is fundamentally sound, Congress should codify the Rule to address the legislative history of ERTA and to prevent the Service from pursuing future litigation. Additionally, since a tangible asset with no determinable useful life will be depreciated over seven years,[135] Congress should revisit this default recovery period and consider extending it to fifteen years to be consistent with intangible asset amortization under section 197.

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the viol was placed in service (1984) and the year of the exchange (1991). See I.R.C. § 168(c)(2)(B) (1982) (amended 1986, 1995, 1996, 1997) (defining five year property). Thus, Liddle would have no basis in the viol at the time of the exchange. See id. § 1016(a)(2) (West Supp. 1997) (requiring reduction in basis of asset equal to amount of depreciation deduction allowable). If Liddle had sold the Ruggeri viol for $65,000 in cash in 1991, rather than exchanging it for the Busan viol, Liddle would have been taxed on the full $65,000 in cash received. His gain would have equaled the amount of the appreciation while he owned the viol ($65,000 value in 1991 less $28,000 value when purchased, or $37,000), plus the amount of the depreciation deductions claimed (the entire cost of the viol or $28,000).

133 See supra text accompanying note 92.

134 See infra Part III.C. (discussing examples of previously nondepreciable assets which may become depreciable if *Simon-Liddle* Rule is followed).

135 See I.R.C. §§ 168(c)(1), 168(e)(3)(C) (West Supp. 1997) (stating that assets not otherwise classified are depreciable over seven years).

1. *Section 197 Shows Congress's Willingness to Allow Depreciation of Assets with No Useful Lives*

In enacting section 197, Congress has provided for the amortization of "section 197 intangible"[136] assets over a fifteen year period. In fact, section 197 grants an amortization deduction for many intangible assets that were previously unamortizable because they had no useful lives.[137]

A comparison of section 168 and section 197 reveals great similarities between the two sections. First, both allow the recovery of the cost of an asset over an arbitrary time period.[138] Second, a goal of both statutes was tax simplification and the elimination of litigation and controversies.[139] Third, Congress specifically listed properties that were amortizable under section 197[140] and, similarly, under sec-

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[136] A "section 197 intangible" includes assets such as goodwill, going concern value, workforce-in-place, customer lists, and the like. See I.R.C. § 197(d)(1) (1994). The two stated purposes of section 197 are the elimination of controversies between the Service and taxpayers regarding intangible assets, and the simplification of the law with respect to the amortization of intangible assets. See H.R. Conf. Rep. No. 103-213, at 696 (1993), reprinted in 1993 U.S.C.C.A.N. 1088, 1385; H.R. Rep. No. 103-111, at 760 (1993), reprinted in 1993 U.S.C.C.A.N. 378, 991.

[137] Section 167 does not distinguish between tangible and intangible assets. Hence, prior to section 197, an intangible asset was depreciable under section 167 only if it had a determinable useful life. See supra text accompanying notes 48-49 .

Under prior law, when businesses were purchased, part of the purchase price was allocated among intangible assets, including goodwill, leaseholds, and covenants not to compete. While some of these intangible assets had no useful lives and were nondepreciable under section 167, others were depreciable. The allocation of costs between depreciable and nondepreciable assets created controversies between the taxpayer-purchaser and the Service. See Bittker & McMahon, supra note 53, at 14-11 to 14-14.

Congress enacted section 197 in response to Newark Morning Ledger Co. v. United States, 507 U.S. 546 (1993). See H.R. Rep. No. 103-111, at 760 (1993), reprinted in 1993 U.S.C.C.A.N. 378, 991 (stating that tax controversies may still arise even after *Newark Morning Ledger* decision). *Newark Morning Ledger* held that customer lists and similar intangible assets could be depreciated if the taxpayer could determine the asset's useful life and its value. See *Newark Morning Ledger*, 507 U.S. at 566 ("[W]e now hold that a taxpayer able to prove that a particular asset can be valued and that it has a limited useful life may depreciate its value over its useful life . . . ."). Section 197 would "eliminate controversies [like this one] by dealing comprehensively with amortization of the cost of intangible assets." Bittker & McMahon, supra note 53, at 14-29. However, section 197 goes beyond *Newark Morning Ledger* and allows the amortization of purchased intangibles (including goodwill) over 15 years even where the intangible asset does not have a useful life.

[138] Section 197 intangibles can be amortized over 15 years. See I.R.C. § 197(a) (1994). As enacted in 1981, section 168 allowed tangible assets to be depreciated over one of four recovery periods. See id. § 168 (c)(2) (1982) (amended 1986, 1995, 1996, 1997) (listing 3, 5, 10, and 15 year recovery property). After 1986, there are six general recovery periods for personal property. See id. § 168(e)(1) (West Supp. 1997) (classifying assets into 3, 5, 7, 10, 15, and 20 year property).

[139] See supra notes 42, 59, and 136.

[140] See I.R.C. § 197(d) (1994).

tion 168, the Service created a classification system and determined the recovery periods of certain tangible assets.[141]

However, under section 197, unlike section 167, the concept of a useful life is generally irrelevant since many section 197 intangibles have no determinable useful lives.[142] Nevertheless, Congress has allowed the cost recovery of these assets. This suggests that Congress is not opposed to allowing the depreciation of an asset with no useful life for purposes of tax simplification. It can therefore be argued that the tax court followed Congress's lead in *Simon* and *Liddle* (which were decided in the year following the enactment of section 197) and allowed the depreciation of tangible assets with no determinable useful lives for purposes of tax simplification.[143]

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[141] See Rev. Proc. 87-56, 1987-2 C.B. 674, 675-87 (listing recovery periods for certain tangible assets). "A 'revenue procedure' is an official statement of a procedure . . . that either affects the rights or duties of taxpayers or other members of the public under the Internal Revenue Code and related statutes, treaties, and regulations, or . . . [that] should be a matter of public knowledge." Rev. Proc. 89-14, 1989-1 C.B. 814, 814.

[142] As stated above, intangible assets that are not amortizable under section 197 may still be amortizable under section 167. See supra text accompanying notes 48-49. To be amortizable under section 167, the intangible asset must satisfy the requirements of that section, including the useful life requirement. See supra Part II.B. An example of an intangible asset with a determinable useful life is a covenant not to compete where the useful life equals the term of the contract.

[143] As Judge Ruwe stated in his concurring opinion in *Simon*, "[e]veryone seems to favor tax simplification until the simplified law is actually applied to a real set of facts and produces a less-than-perfect result." Simon v. Commissioner, 103 T.C. 247, 267 (1994) (en banc) (Ruwe, J., concurring). He characterized allowing a depreciation deduction to the Simons as "the price of the tax simplification implicit in section 168." Id.; cf. Kevin M. Cunningham, Which Concept of Depreciation Should Guide Us? Trying to Develop a Consistent Framework for the Federal Income Tax System, 14 Va. Tax Rev. 753, 770-74 (1995) (providing hypothetical arguments with respect to section 197 that would have been made by majority and dissenters in *Simon* and *Liddle*).

An alternative reading of the history behind section 197 suggests an intent not to eliminate the useful life requirement, but to bifurcate the basis of an asset into depreciable and nondepreciable components. In the case of an antique musical instrument, the depreciable component would represent that portion of the basis attributable to the asset's use in a trade or business, while the nondepreciable component would represent the basis of the asset attributable to its value as a collectible, as well as any personal "psychological value" that a musician may have in owning an instrument crafted by a master instrument maker. Judge Gerber supported bifurcating the basis of antique musical instruments in his dissenting opinion in *Simon*. See *Simon*, 103 T.C. at 281-84 (Gerber, J., dissenting). Judge Gerber analogized the bifurcation to the allocation of the purchase price of a business to goodwill. See id. at 282.

There are four flaws with Judge Gerber's argument. First, while it is true that the Code allows the bifurcation of an asset's basis for so-called "mixed-use" properties (i.e., property used in both business and personal activities), the Code provides no examples of a bifurcation of basis between the business component and the investment component of an asset, but instead requires that the entire basis be either depreciable or nondepreciable.

Second, the allocation of basis to goodwill and other assets when a business is purchased involves identifying separate and distinct assets to which basis is assigned. See I.R.C. § 1060 (1994) (requiring allocation of consideration paid for acquisition of assets for

Section 197 represented a break with decades of tradition under which useful life was a requirement for depreciability. Congress drafted ERTA twelve years before section 197 was added to the Code, at a time before Congress had considered discarding the useful life requirement for certain intangible assets.[144] Given the break with tradition signaled by section 197 for intangible assets, it is not unreasonable from a policy standpoint for the tax court to break with tradition with respect to tangible assets and create the *Simon-Liddle* Rule despite the clear legislative history of ERTA.

2. *The* Simon-Liddle *Rule Is Consistent with the General Policy Considerations Allowing Depreciation*

The primary justifications for depreciation are the matching of revenues and expenses and the recovery of costs.[145] The *Simon-Liddle* Rule is consistent with these two justifications.

Under the matching concept, if depreciation is a method to match revenues and expenses, and the statute (section 168) determines an arbitrary period over which the expenses must be recognized, then there is no good reason not to follow the *Simon-Liddle* Rule of depreciating assets that suffer exhaustion, wear and tear, or obsolescence but do not have useful lives.[146] It would create more distortion of income to postpone the cost recovery of an asset until it is disposed of

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purposes of determining basis). In the case of an antique musical instrument, however, there is only a single asset.

Third, a bifurcation of basis would effectively re-create the pre-ACRS notion of salvage value. Salvage value is the estimated amount for which an asset can be sold upon its retirement from service and reflects a portion of the initial basis of an asset that is not depreciable. See supra note 55. Similarly, the investment component of the basis of an antique musical instrument would be the nondepreciable portion of the initial basis that reflects the value of the asset as a collectible. Since ERTA explicitly eliminated all salvage value considerations from the depreciation calculation, the courts should not judicially resurrect this concept. See supra note 67.

Finally, it would be difficult to determine the method of bifurcating basis. With mixed-use properties, measuring the amount of personal use is straightforward (e.g., measuring the square footage of a home office or mileage of a car). In this case, however, it would be difficult to separate the value of an instrument used in performances with the value of the instrument as a collectible. Such an arbitrary allocation of basis would be contrary to the simplification goal of ERTA.

144 See Liddle v. Commissioner, 103 T.C. 285, 305 (1994) (en banc) (Halpern, J., dissenting) ("Congress did not write on a clean slate when it added section 168 to the Code.").

145 See supra notes 21-22.

146 Judge Laro and the dissenters in *Simon* and *Liddle* had different views as to the importance of matching to tax depreciation. In *Simon*, Judge Laro stated that a "primary purpose of allocating depreciation to more than 1 year is to provide a meaningful matching of the cost of an income-producing asset with the income resulting therefrom; this meaningful match, in turn, bolsters the accounting integrity for tax purposes of the taxpayer's periodic income statements." *Simon*, 103 T.C. at 253. However, Chief Judge Hamblen, dissenting in *Simon*, stated that "the concept of matching is certainly not a guiding princi-

(the result of not allowing depreciation on such asset) since this would result in the mismatching of revenues and expenses.[147]

Under the cost recovery justification for depreciation, a business or investment asset must suffer wear and tear to be depreciable;[148] even the explicit language of section 167 contains this requirement. Despite this explicit language, an asset must also have a determinable useful life to be depreciable under section 167. However, as discussed previously, the useful life requirement under section 167 and the wear and tear requirement of the *Simon-Liddle* Rule both serve the same purposes.[149] Since both the useful life requirement and the wear and tear requirement measure similar characteristics of an asset, both requirements are not necessary for an asset to be depreciable.

3. *The* Simon-Liddle *Rule Is Consistent with the Policy Justifications of ERTA*

The depreciation system for tangible assets was changed by ERTA for two policy reasons: to stimulate economic growth and capital formation and to simplify the depreciation rules.[150] Both of these policy goals are satisfied by the *Simon-Liddle* Rule.

Mechanically, section 168 grants a taxpayer an accelerated depreciation deduction; that is, it allows the taxpayer to take a larger tax deduction in the near term.[151] Accelerating the depreciation deduction encourages investment in depreciable assets by reducing the after-tax cost (and increasing the after-tax returns) of these assets. The *Simon-Liddle* Rule does not change the mechanics of the depreciation

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ple of construction of tax statutes or tax policy in every situation." Id. at 275 (Hamblen, C.J., dissenting).

[147] See supra text accompanying notes 25-28 (illustrating matching concept); supra note 132 (explaining that depreciation deduction results in larger gain on sale when asset is finally sold).

Since ACRS creates arbitrary recovery periods which are generally shorter than the useful lives of the assets, it is not a "true" system of matching revenues and expenses. Hence, ACRS still results in some income distortion. However, the ACRS recovery periods do reflect the relative useful lives of the assets with the cost of longer-life assets (e.g., real estate) being depreciated over a longer term than assets with shorter lives (e.g., a computer). In enacting MACRS in 1986, see supra text accompanying notes 43-45, Congress attempted to address the matching problem by increasing the number of recovery periods and extending the recovery periods for certain assets. See 1986 Blue Book, supra note 38, at 98-99. Although they are not "true" matching systems, both ACRS and MACRS attempt to balance the matching principle with the simplification goal of ERTA. See infra Part III.B.5. for a proposal to classify assets with no useful lives as fifteen year property.

[148] See supra note 22.

[149] See supra text accompanying note 75 .

[150] See 1981 Blue Book, supra note 39, at 75.

[151] See Malman et al., supra note 4, at 459 ("[T]he effect of an accelerated method is to increase deductions and reduce income in the early years of a wasting asset's life . . . .").

calculation but only increases the types of assets that may be depreciable. Consequently, the *Simon-Liddle* Rule may provide more of an economic stimulus by expanding the pool of depreciable assets.

Additionally, the *Simon-Liddle* Rule provides a very simple depreciation rule. This Rule, coupled with the recovery periods determined under section 168, could eliminate most litigation over useful lives.[152] For a tangible business or investment asset to be depreciable, the taxpayer need only prove that the asset suffered exhaustion, wear and tear, or obsolescence.[153] Accordingly, both policy goals of ERTA would be satisfied under the *Simon-Liddle* Rule.

4. Useful Life Is No Longer Necessary to Calculate the Depreciation Deduction

Under section 167, the cost of an asset is recovered over the useful life of the asset. A determinable useful life is necessary for the mechanical calculation of the depreciation deduction. However, section 168 now prescribes the recovery period over which an asset may be depreciated. Because the useful life of an asset is no longer necessary for the depreciation calculation, it should no longer be a requirement to determine the depreciability of an asset.

It can be argued, as the *Simon* and *Liddle* dissenters did,[154] that a useful life requirement is still applicable as a threshold requirement to determine whether an asset may be depreciable and to classify assets into their respective recovery periods. However, as noted previously, the useful life requirement and the wear and tear requirement measure approximately the same characteristics of an asset.[155] The wear and tear requirement can therefore replace useful life as the threshold for depreciation. As for the determination of the recovery period of an asset, the Service can explicitly promulgate recovery periods for various assets instead of requiring the determination of a useful life to classify the asset. The Service has already done this in Revenue Procedure 87-56.[156] In effect, the Service attempted to do in Revenue

152 See supra note 59 and accompanying text (stating that litigation arose due to useful life requirement).

153 This will still cause some litigation, see supra text accompanying notes 76-77 (discussing evidentiary rule for wear and tear), but it will be less than the present amount of litigation over useful life.

154 See Simon v. Commissioner, 103 T.C. 247, 269 (1994) (en banc) (Hamblen, C.J., dissenting) ("[U]seful life remains a hallmark of the basic concept of depreciation in both sections 167 and 168"); Liddle v. Commissioner, 103 T.C. 285, 304 (1994) (en banc) (Halpern, J., dissenting) ("Nothing indicates . . . that Congress intended to allow a deduction for property . . . that . . . had been nondepreciable [under section 167] on account of the taxpayer's inability to establish a useful life.").

155 See supra text accompanying note 75 .

156 1987-2 C.B. 674, 676-87 (listing recovery periods for various assets).

Procedure 87-56 for recovery periods what it did for useful lives under the ADR system.[157]

5. *A Plea for Congressional Action*

These four reasons support the proposition that the *Simon-Liddle* Rule should be followed: business or investment assets with no determinable useful lives should be depreciable if they suffer exhaustion, wear and tear, or obsolescence. Unfortunately, the legislative history of ERTA seems clear that it was the intent of Congress to preserve the useful life requirement. Given the Service's willingness to challenge the *Simon-Liddle* Rule in other circuits,[158] congressional action codifying the *Simon-Liddle* Rule is necessary to preempt future litigation and to clarify this issue.

Congress should also revisit the default recovery period assigned to assets with no useful lives. This recovery period under ACRS was initially five years,[159] allowing the taxpayers in *Simon* and *Liddle* to depreciate their antique musical instruments over this period. The default recovery period was increased to seven years under MACRS.[160] Under the *Simon-Liddle* Rule, assets that were previously nondepreciable could be depreciated over this seven year period, including state-of-the-art cars, land improvements, golf course improvements, works of art, and other antiques.[161] A seven year recovery period may be too rapid in these cases, especially when considering the potential revenue impact for the government of the *Simon-Liddle* Rule. Some of these concerns may be alleviated by increasing the default recovery period to fifteen years for consistency with section 197. This would allow the costs of both tangible and intangible assets with no useful lives to be recovered over the same fifteen year period.

C. *Examples of Previously Nondepreciable Assets Which May Now Be Depreciable Under the* Simon-Liddle *Rule*

The *Simon-Liddle* holding that business or investment assets subject to exhaustion, wear and tear, or obsolescence are depreciable can be applied to other assets which were previously considered nondepreciable due to the lack of determinable useful lives.

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157 See supra text accompanying note 62 (noting that Treasury determined useful lives for ADR property).

158 See supra text accompanying notes 82-84.

159 See I.R.C. § 168(c)(2)(B) (1982) (amended 1986, 1995, 1996, 1997) (stating that property that does not belong in the 3, 10, or 15 year class shall be deemed five year property).

160 See supra note 135.

161 See infra Part III.C.

1. *State-of-the-Art Cars*

The tax court has already applied the *Simon-Liddle* Rule to allow depreciation of state-of-the-art cars with no determinable useful lives. In *Selig v. Commissioner*,[162] the taxpayer purchased "exotic" automobiles which were never driven and which were used exclusively for display at car shows or photographed for promotional materials. The taxpayer depreciated the costs of these cars under MACRS.[163] Although the taxpayer could not prove the useful lives of the cars, the tax court allowed the deduction.[164]

The tax court reasoned that given the prior decisions of *Simon* and *Liddle*, "[t]he fact that [the taxpayer] . . . failed to show the useful lives of the exotic automobiles is irrelevant."[165] Under the section 167 depreciation system, these cars would not be depreciable because the taxpayer could not prove their useful lives.[166] However, under the *Simon-Liddle* Rule, an asset is depreciable if it is subject to exhaustion, wear and tear, or obsolescence and if it is a business or investment asset.[167] Since the cars in this case were "state-of-the-art," they were subject to obsolescence and therefore depreciable.[168]

2. *Land Improvements and Golf Course Improvements*

Land improvements and golf course improvements now also should be depreciable under the *Simon-Liddle* Rule. Under section 167, the tax treatment of land improvements depends on whether the improvement is an addition to the land or a change in the land itself. Land improvements that are additions to the land and have determinable useful lives are depreciable.[169] However, improvements that are changes to the land itself, "such as grading or excavation that will be useful after the life of any building or structure with which it is associated,"[170] are treated as land and are not depreciable.

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[162] 70 T.C.M. (CCH) 1125 (1995).

[163] See supra text accompanying notes 43-45 (discussing MACRS).

[164] See *Selig*, 70 T.C.M. (CCH) at 1128-29 (stating that because taxpayer showed exotic cars suffered obsolescence, cars were depreciable).

[165] Id. at 1128.

[166] See supra note 56 and accompanying text (stating that useful life is requirement for depreciability under section 167).

[167] See supra text accompanying notes 71-73.

[168] See *Selig*, 70 T.C.M. (CCH) at 1129 (finding that cars suffered obsolescence).

[169] See, e.g., Rudolph Inv. Corp. v. Commissioner, 31 T.C.M. (CCH) 573, 578 (1972) (holding that earthen water tanks and dams on ranch are depreciable because they have determinable useful lives); see also Rev. Proc. 87-56, 1987-2 C.B. 674, 677 (assigning 15 year recovery period to land improvements).

[170] Bittker & McMahon, supra note 53, at 14-10 to 14-11.

The Fifth Circuit explained this disparate treatment with respect to landscaping costs in *A. Duda & Sons, Inc. v. United States*.[171] The court noted that landscaping costs that are "inextricably associated" with land are not depreciable while landscaping costs that are associated with physical improvements to the land are depreciable.[172] The court explained that "[t]his distinction appears founded on considerations of administrative convenience .... The difficulty is in computing a useful life for land."[173]

Under the *Simon-Liddle* Rule, the fact that land has no useful life is no longer relevant. The key is the wear and tear requirement—if landscaping or other land improvements suffer exhaustion, wear and tear, or obsolescence, the land improvements should be depreciable. The distinction between land improvements as an addition to land or a change to the land itself should no longer be relevant. As long as the addition or change to the land suffers exhaustion, wear and tear, or obsolescence, it should be depreciable.

With respect to golf course improvements, under section 167, the cost to the golf course developer to landscape tees, fairways, greens, and sandtraps are not depreciable since golf course improvements, like land, have no useful lives and golf courses usually improve rather than deteriorate over time.[174] However, the costs to replace the seed, sod, and soil are deductible as ordinary and necessary business expenses.[175]

Under the *Simon-Liddle* Rule, the golf course owner need only show that the golf course improvements are business or investment assets that suffer exhaustion, wear and tear, or obsolescence for these improvements to be depreciable. It is not relevant that these improvements have no useful lives or that a course improves over time since these factors do not determine the depreciability of an asset. The repair and maintenance expense of the golf course owners for maintaining the golf course is strong evidence that the golf course im-

[171] 560 F.2d 669 (5th Cir. 1977).

[172] See id. at 679.

[173] Id. at 679 n.15.

[174] See Edinboro Co. v. United States, 224 F. Supp. 301, 303 (W.D. Pa. 1963) (holding that "tees, greens, fairways, traps and other hazards are not distinguishable from ... land [and] ... have an unlimited useful life"). In *Edinboro*, an expert opined that "if a golf course is regularly reseeded, resodded and irrigated, it does not wear out" and that "the depth of the sod usually increases as a result of constant maintenance and thus the quality of the course improves with the passage of time." Id. at 302; see also Rev. Rul. 55-290, 1955-1 C.B. 320, 320 (holding that costs incurred by taxpayer for construction of greens are nondepreciable capital expenses).

[175] See Rev. Rul. 55-290, 1955-1 C.B. 320, 320 (stating that "operating expenses for sod, seed, soil and other sundry maintenance constitute ordinary and necessary business expenses which are deductible").

provements suffer wear and tear,[176] and indicates that golf course improvements should be depreciable.[177]

3. *Works of Art and Other Antiques*

Although not explicitly stated in the opinions, *Simon* and *Liddle* have undercut the foundation of Revenue Ruling 68-232, which held that works of art are not depreciable because they have no useful lives.[178] Since, under the *Simon-Liddle* Rule, useful life is no longer a requirement for depreciability, works of art may now be depreciable if they are business or investment assets that suffer exhaustion, wear and tear, or obsolescence. If the situation in *Clinger*[179] came before the court today and if the taxpayer could prove that the painting in question satisfied the wear and tear requirement, the cost of the painting may now be depreciable.

Regardless of how courts rule on the depreciability of works of art, under the *Simon-Liddle* Rule, antiques should be depreciable if they are business or investment assets that suffer exhaustion, wear and tear, or obsolescence. Indeed, the Second Circuit agreed with this result when the court stated that "the result of our holding may give favorable treatment to past investment decisions that some regard as wasteful, such as a law firm's purchase of expensive antique desks, the cost of which could have been quickly depreciated under our current ruling."[180]

Conclusion

The tax court in *Simon* and *Liddle* interpreted ERTA as creating a new rule to determine the types of assets that are depreciable under ACRS. This Rule allows a tangible business or investment asset to be depreciated if it suffers exhaustion, wear and tear, or obsolescence, effectively eliminating the useful life requirement for depreciating tangible assets.

Based on the legislative history of ERTA, these cases were wrongly decided. Nevertheless, the *Simon-Liddle* Rule is fundamen-

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176 See supra text accompanying note 76 (discussing evidentiary rule for wear and tear).

177 Cf. Claudia L. Kelley, Stradivarius at the Links: An Extension of the Depreciation of Classical Instrument Decisions to Golf Courses, 23 J. Real Est. Tax'n 313, 319-21 (1996) (arguing that costs to construct greens, tees, and hazards may be depreciable if deemed land improvements, thereby obviating need for *Simon-Liddle* Rule for depreciability).

178 See supra text accompanying note 125. Recall that in *Simon* and *Liddle*, Judge Laro ruled that assets used actively in a trade or business are not works of art. See supra text accompanying notes 126-27.

179 See supra notes 114-15 and accompanying text for a discussion of Clinger v. Commissioner, 60 T.C.M. (CCH) 598 (1990).

180 Simon v. Commissioner, 68 F.3d 41, 46 (2d Cir. 1995).

tally sound and the useful life requirement should be eliminated. This conclusion is supported by section 197, under which Congress allowed the amortization of certain intangible assets with no useful lives. The tax court in *Simon* and *Liddle* has simply followed Congress by allowing the depreciation of tangible assets with no useful lives. Additionally, the Rule is consistent with the policy considerations underlying ERTA and the general policy considerations underlying depreciation. Moreover, given the recovery periods established by ACRS, there is no practical reason that a determinable useful life must be required. Because the Service has indicated its intent to litigate this issue further, Congress should act to codify the *Simon-Liddle* Rule and to revisit the default recovery period. Since it has become irrelevant for tax depreciation purposes, the useful life requirement has outlived its useful life.