PUBLISH

UNITED STATES COURT OF APPEALS

TENTH CIRCUIT

FILED
United States Court of Appeals
Tenth Circuit

SEP 27 1996

PATRICK FISHER
Clerk

ABC RENTALS OF SAN ANTONIO, INC.; DAVID R. PETERS; DIANA L. PETERS; JOHN P. PARSONS; MELBA R. PARSONS,

Petitioners - Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent - Appellee.

GRAUEL ENTERPRISES, INC.,

Amicus Curiae.

Nos. 95-9008
95-9009
95-9010
(Consolidated)

APPEAL FROM THE UNITED STATES TAX COURT
(T.C. Nos. 20689-91, 20690-91 and 20691-91)

Timothy P. O'Sullivan (Lyndon W. Vix and John R. Gerdes with him on the brief), of Fleeson, Gooing, Coulson & Kitch, Wichita, Kansas, for appellants.

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Before PORFILIO, KELLY and BRISCOE, Circuit Judges.

BRISCOE, Circuit Judge.

In these consolidated appeals, we decide whether the rent-to-own industry may properly depreciate its inventory for tax purposes using the income forecast method rather than the Modified Accelerated Cost Recovery System (MACRS) under I.R.C. § 168(f)(1). The Tax Court held that appellants' rent-to-own inventory was not properly depreciable under the income forecast method, and thus upheld the Commissioner's notice of deficiency. We reverse and remand for further proceedings.

Based on our analysis of the statutory language and legislative history, we conclude that § 168(f)(1) does not *preclude* use of the income forecast method for property like taxpayers' rent-to-own inventory, provided other conditions are met. If the taxpayers can establish that the income forecast method is a reasonable and consistent method under § 167(b)(4) and that it complies with the limitations of § 167(b)(4) and (c), as modified by § 168(f)(1), this method of depreciation is available to them. To satisfy the requirements of § 167(b)(4) and (c), an alternative method must (1) be a reasonable and consistent method of determining a reasonable allowance for depreciation; (2) be no faster than the declining balance method of § 167(b)(2) over the first two-thirds of the useful life of the property; and (3) apply to property with a useful life of at least three years. Section 168(f)(1) relaxes the second requirement by requiring only that the property be properly depreciated under a method not expressed in a term of years for the first taxable year for which the taxpayer can take a depreciation deduction for the property. Accordingly, for property to be properly depreciated by a method not expressed in a term of years under § 168(f)(1), the method must (1) be reasonable and consistent; (2) produce no greater depreciation in the first taxable year than the declining balance method; and (3) be applied to property with a useful life of at least three years.

The income forecast method as limited by § 167(b)(4) and (c) is a reasonable and consistent method for depreciating the taxpayers' inventory. However, to be properly depreciated by a method not expressed in a term of years under § 168(f)(1), the method must also produce greater depreciation in the first taxable year than the declining balance method of § 167(b)(2), and the useful life of the property must be at least three years. We remand to the tax court for determination of those issues.

Background

At issue are depreciation deductions claimed by two rent-to-own companies on their inventory of rental units for the tax years ending December 31, 1987, and December 31, 1988. ABC Rentals of San Antonio, Inc., (ABC) was a subchapter C corporation for its fiscal year ended May 31, 1987, and was a subchapter S corporation thereafter. John P. Parsons was ABC's sole shareholder. Guaranteed Rental, Inc., (Guaranteed) was a subchapter S corporation and Parsons and Diana L. Peters were shareholders in Guaranteed. Parsons and Peters each filed joint tax returns for the years at issue with their respective spouses, Melba R. Parsons and David R. Peters.

During the years at issue, ABC and Guaranteed operated rent-to-own businesses that leased appliances, furniture, televisions, stereos, and videocassette recorders to customers in Texas. Under the rental agreements, customers leased the rental property for a specified time period, which varied based on the type of property and the number of times the property had been leased. Generally, the initial lease term on a rental unit was between twelve and twenty-one months. If a customer paid the weekly or monthly rental amount for the full term of the rental contract, the customer would obtain full title to the rental property at no additional cost. The customer also had the right under the rental contract to return the property before expiration of the full term with no further obligation. Each particular rental unit would be leased to subsequent customers until a customer retained the unit for the entire lease term and obtained title to the property. On average, ABC and Guaranteed dispose of rental units within two years of purchase, and they dispose of about 90% of all rental units within three and one-half years of purchase.

Prior to 1981, rent-to-own companies generally used an eighteen, twenty-one, or twenty-four month straight line method to depreciate their inventory of rental units. With enactment of the Accelerated Cost Recovery System (ACRS) by Congress in 1981 and MACRS in 1986, industry practice has been to calculate the depreciation deduction on rental units using the income forecast method. Under the income forecast method, the yearly depreciation deduction for a particular rental unit is equal to the cost of the rental unit multiplied by a percentage obtained by dividing the income produced by that rental during the year (numerator) by 300% of the cost of the unit (denominator), which represents the total anticipated gross rental revenue for the life of the unit. Under this method, a rental unit is depreciated in full during its income-producing life. When a rental unit leaves the company's inventory and stops producing income, the company ceases claiming a depreciation deduction on that particular unit. Both ABC and Guaranteed used the income forecast method to determine their depreciation deductions for the years in question.

The Commissioner served a notice of deficiency on appellants and disallowed a portion of the depreciation deductions claimed by ABC and Guaranteed, contending the taxpayers were prohibited from using the income forecast method; rather, they were required to calculate their depreciation deductions under MACRS. The Commissioner determined that, under MACRS, the rental inventory had a class life of nine years and the applicable recovery period was therefore five years. Obviously, this longer recovery period under MACRS results in smaller yearly depreciation deductions. Appellants petitioned the Tax Court to challenge the notices of deficiency. The Tax Court adopted the Commissioner's reasoning and upheld the notices of deficiency, holding the rental units were not properly depreciated under the income forecast method.

Discussion

I.

We review tax court decisions "in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury." I.R.C. § 7482(a)(1). Therefore, we review the tax court's findings of fact under a clearly erroneous standard while questions of law are reviewed de novo. Worden v. C.I.R., 2 F.3d 359, 361 (10th Cir. 1993).

The parties disagree as to whether this appeal presents a factual or a legal question. The Commissioner argues a determination of whether the rent-to-own inventory at issue fits into the exception to MACRS created by I.R.C. § 168(f)(1) is a factual issue regarding the nature of rent-to-own property. Appellants correctly point out, however, that given the stipulated facts, the question of whether the inventory fits into the exception to MACRS presents a legal issue regarding application and interpretation of § 168(f)(1). Even if the facts were not stipulated, this case still would present a mixed question of law and fact in which the legal issues predominate. Because this is a legal question, the Commissioner incorrectly contends appellants had a burden of proof at trial to establish the nature of the inventory.

II.

Section 167(a) of the Code establishes the right to claim "as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)" of property used in trade or business or property held for the production of income. The amount of the depreciation deduction for tangible property is governed by MACRS, which is set out in I.R.C. § 168. Nevertheless, MACRS does not apply to all tangible property; § 168(f)(1) creates an exception whereby other methods of depreciation than that prescribed by MACRS are permitted. Section 168(f)(1) states in part:

> (f) Property to which section does not apply.--This section shall not apply to--
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> (1) Certain methods of depreciation.--Any property if--
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> (A) the taxpayer elects to exclude such property from the application of this section, and
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> (B) for the 1st taxable year for which a depreciation deduction would be allowable with respect to such property in the hands of the taxpayer, the property is *properly depreciated* under the unit of production method or any method of depreciation not expressed in a term of years.

(Emphasis added.)

The Tax Court correctly concluded, and the parties do not dispute, that the income forecast is a "method of depreciation not expressed in a term of years," as required by § 168(f)(1)(B). The remaining inquiry is whether the rent-to-own inventory is "properly depreciated" under the income forecast method. The government contended, and the Tax Court agreed, that only property whose economic usefulness cannot adequately be measured by its physical condition or the passage of time and that may produce an uneven stream of income based on its popularity is properly depreciated under the income forecast method. This argument is based on the reasoning of Rev. Rul. 60-358, 1960-2

C.B. 68. In that ruling, which predated § 168, the IRS held that television films cannot be adequately depreciated by the usual methods of § 167(b) because their economic usefulness cannot adequately be measured by physical condition or passage of time, and they may produce an uneven stream of income based on their popularity. The IRS limited the income forecast method in its application to television films "and other property of a similar character."

In a series of later revenue rulings, the IRS permitted use of the income forecast method to depreciate motion picture films, Rev. Rul. 64-273, 1964-2 C.B. 62, book manuscripts, patents, and master recordings, Rev. Rul. 79-285, 1979-2 C.B. 91. These rulings also predated the 1981 enactment of § 168 and were based entirely on § 167, which was then the only provision governing depreciation methods. After enactment of § 168, the IRS continued to follow its initial revenue ruling and extended the income forecast method to videocassettes, Rev. Rul. 89-62, 1989-1 C.B. 78, and video games, Priv. Ltr. Rul. 9323007 (June 11, 1993), on the ground that they are similar to television films. Taxpayers could elect under § 168(f)(1) to use the income forecast method rather than the ACRS. However, it was not until 1995 that the IRS issued a revenue ruling that denied use of the income forecast method to depreciate property subject to normal wear and tear. Rev. Rul. 95-52, 1995-34 I.R.B. 16 (consumer goods leased under rent-to-own contracts).[1]

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[1] In Carland v. C.I.R., 90 T.C. 505 (1988), the Tax Court held that the income forecast method could not be used to depreciate physical assets whose economic usefulness could adequately be measured by physical condition and passage of time, but the tax years at issue preceded the ACRS and, in any case, the Eighth Circuit affirmed on other grounds and expressly declined to decide whether the income forecast method can ever be appropriate for assets whose (continued...)

IRS revenue rulings are not binding precedent on this court. "Unlike treasury regulations, which are promulgated in accordance with the notice and comment requirements of the Administrative Procedure Act, revenue rulings 'do not have the force and effect of law' and therefore are 'accorded less weight then regulations.'" American Stores Co. v. American Stores Co. Retirement Plan, 928 F.2d 986, 994 (10th Cir. 1991) (quoting Flanagan v. United States, 810 F.2d 930, 934 (10th Cir. 1987)). Revenue rulings do not have the force and effect of regulations and may not be used to alter the plain language of a statute. C.I.R. v. Schleier, 115 S. Ct. 2159, 2167 n. 8 (1995).

Revenue rulings are given considerable weight when they are issued contemporaneously with the enactment of the statute and have been in long use, and the statutory language has been reenacted without change, indicating apparent congressional satisfaction with the prevailing interpretation. See Davis v. United States, 495 U.S. 472, 481-85 (1990) (legislative reenactment doctrine as applied to revenue rulings). See generally Linda Galler, Emerging Standards for Judicial Review of IRS Revenue Rulings, 72 B.U.L. Rev. 841 (1992). Here, the rulings were not contemporaneous with the enactment of either § 167 or § 168. Although the IRS for thirty years has permitted the income forecast method for movies and similar property, and has indicated the method would be permitted only for such property, it recently ruled the method cannot be used for property unlike movies. Section 168 was enacted after the initial revenue rulings, but § 167, the basis for those rulings, has not been reenacted. Congress has simply left it

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[1](...continued)
usefulness declines over time through normal wear and tear. Carland v. C.I.R., 909 F. 2d 1101, 1105 (8th Cir. 1990).

unchanged. The "legislative reenactment" doctrine is inapplicable here.

In any case, reenactment without change in relevant statutory language and mere Congressional inaction are at best unreliable indications of Congressional intent to adopt an administrative construction of a statute. See Central Bank of Denver v. First Interstate Bank of Denver, 114 S. Ct. 1439, 1452-53 (1994); C.I.R. v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955). See also S.E.C. v. Sloan, 436 U.S. 103, 120-21 (1978); United States v. Board of Com'rs of Sheffield, 435 U.S. 110, 134 (1978). The inference of Congressional approval is stronger when legislative history contains some indication that Congress was aware of and approved the administrative construction. See Central Bank, 114 S. Ct. at 1452-53; United States v. Riverside Bayview Homes, 474 U.S. 121, 137 (1985); Fletcher v. Warden, United States Penitentiary, 641 F.2d 850, 854 (10th Cir.), cert. denied 453 U.S. 912 (1981).

We find no indication in the legislative history of § 168 that Congress approved limitation of the income forecast method or § 168(f)(1) to movies and similar assets, or that it was even aware of the revenue rulings. To the contrary, the legislative history suggests that Congress intended to permit taxpayers to exclude "most property" from the ACRS and MACRS under § 168(f)(1). S. Rep. No. 144, 97th Cong., 1st Sess. at 82-83 (1981), reprinted in 1981 U.S.C.C.A.N. 105. See H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. at 106 (1986), reprinted in 1986 U.S.C.C.A.N. 4075; S. Prt. 98-169, 98th Cong., 2d Sess., at 467 (1984), (quoted in ABC Rentals of San Antonio v. C.I.R., 1994 WL 682914, *20 (Tax Court 1994).

Nor does the legislative history of amendments to § 167 show Congressional approval of the revenue rulings. Congress was aware of the revenue rulings permitting the use of the income forecast method to depreciate television films and movies when it made a minor technical amendment to § 167(b) in the Tax Reform Act of 1976, Pub. L. No. 94-455, § 1906(b)(13)(A), 90 Stat. 1520.[2] However, although Congress was concerned about movie industry tax shelters to which the income forecast method contributed, it did not consider whether the method was or should be limited to property similar in character to movies. See H.R. Rep. No. 658, 94th Cong., 2d Sess. 116-18 (1976), reprinted in 1976 U.S.C.C.A.N. 2897.

As part of the Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1604, Congress has added rules to § 167 to govern use of the income forecast method. The House Ways and Means Committee Report on this legislation noted the revenue rulings permitting use of the income forecast method for films and similar property, as well as the two judicial decisions[3] holding the method inapplicable to property subject to ordinary wear and tear. However, the report expressed neither approval nor disapproval of those decisions and, although some special provisions apply only to movies and similar types of property, the new provisions do not limit the method to those types of property. Moreover, the report indicated the scope of § 168(f)(1) was broad: "MACRS does not apply to certain property, including any motion picture film, video tape, or sound recording *or to [any other] property if the taxpayer elects to exclude such property from MACRS and the taxpayer applies a* unit-of-production method or other *method of*

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[2] The earlier version had provided that the Secretary of the Treasury "or his delegate" could promulgate regulations for computing depreciation; the amendment struck the phrase "or his delegate."

[3] The cases noted in the report are Carland, 90 T.C. 505, and the Tax Court opinion in this case.

depreciation not expressed in a term of years." (Emphasis added.) H.R. Rep. No. 586, 104th Cong., 2d Sess., 1996 WL 272189, *378-79 (1996). This broad construction of § 168(f)(1) is not determinative because the views of Congress on the meaning of a statute passed by an earlier Congress are ordinarily not entitled to great weight. See United States v. X-Citement Video, 115 S. Ct. 464, 471 (1994). However, the report does not indicate Congressional approval of the IRS's narrow construction of § 168(f)(1) and the limitation of the income forecast method to movies and similar property.

The taxpayers contend that any kind of property can be properly depreciated under the income forecast method.[4] Based on our analysis of the statutory language and the legislative history, we conclude § 168(f)(1) does not *preclude* use of the income forecast method for other types of property, such as taxpayers' rent-to-own inventory.

Although we agree with taxpayers that § 168(f)(1) does not preclude them from using the income forecast method, we find their reliance on Massey Motors v. United States, 364 U.S. 92 (1960), to be misplaced. As Massey was a pre-ACRS case, it has limited relevance to the issue before us--construction of § 168(f)(1). To resolve that issue, we must start with the language of the statute. See Good Samaritan Hosp. v. Shalala, 508 U.S. 402 (1993); Phillips Petroleum Co. v. Lujan, 4 F.3d 858 (10th Cir. 1993). If the language is clear, the inquiry is over. The plain meaning of statutory

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[4] Taxpayers argue the nine-year class life to which their rent-to-own inventory is assigned does not reasonably reflect anticipated useful life and anticipated decline in value over time, as required by § 168(I). The record supports this argument; on average taxpayers dispose of rental units within two years of purchase, and dispose of 90% of all units within three and a half years of purchase. However, they do not argue the rental units should be treated as three-year property with a three-year recovery period under § 168(e)(1), the shortest period recognized under the MACRS. They argue only that under § 168(f)(1), they can elect out of the MACRS and depreciate the units by the income forecast method.

language is conclusive, except in the rare case in which literal construction will produce a result demonstrably at odds with the intention of its drafters. See United States v. Ron Pair Enterprises, 489 U.S. 235 (1989); Ute Distribution Corp. v. United States, 938 F.2d 1157 (10th Cir. 1991), cert. denied 504 U.S. 940 (1992). As we find no ambiguity in the statutory scheme at issue here, we are not required to defer to the Commissioner's interpretation. See Chevron, U.S.A. v. Natural Resources Defense Council, 467 U.S. 837, 842-43 (1984).

Section 168(f)(1) applies to "any property" if it is "properly depreciated under . . . any method of depreciation not expressed in a term of years." The broad phrase "any property" supports the taxpayers' position. However, the property must be "properly depreciated" by a method not expressed in a term of years. Section 168(f)(1) does not define "properly depreciated." There is nothing in the statutory language that suggests Congress intended to limit property properly depreciable by methods not expressed in a term of years to property similar in character to movies or otherwise intended to adopt the reasoning of Rev. Rul. 60-358. For the phrase "properly depreciated" to have some meaning, there must be some limitation on use of alternative methods such as the income forecast method. We find that limitation in § 167(b) and (c). In determining the meaning of a statute, the courts look not only at the specific statute at issue, but at its context of related statutes. See Rowland v. California Men's Colony, 506 U.S. 194 (1993); State of Utah v. Babbitt, 53 F.3d 1145 (10th Cir. 1995).

Sections 168 and 167 are closely related. Section 167 was enacted as part of the Internal Revenue Code of 1954. 68A Stat. 51 (1954). It governed depreciation until enactment of § 168 as part of the Economic Recovery Tax Act of 1981, Pub. L. No. 97-

34, § 201(a), 95 Stat. 172, 203. Section 167(a) provides that depreciation under § 168 shall be deemed to constitute the reasonable allowance under § 167. Section 168(a) provides that, except as otherwise provided in § 168, the depreciation deduction provided by § 167(a) shall be determined by the ACRS methods of § 168. Since 1981, depreciation of property excluded from § 168 is governed by § 167. See Rev. Rul. 89-62. In the absence of a definition in § 168(f)(1), we conclude that whether property is "properly depreciated" by a method not expressed in a term of years under § 168(f)(1) depends on whether the property could be properly depreciated by such a method under § 167.

Until 1990, § 167 provided that methods of depreciation that satisfied certain requirements were presumptively reasonable. The version of § 167(b) and (c) in effect during the tax years at issue (I.R.C. § 167(b) (West 1988) (amended 1990)) provided:

> (b) Use of certain methods and rates--For taxable years ending after December 31, 1953, the term "reasonable allowance" as used in subsection (a) shall include (but shall not be limited to) an allowance computed in accordance with regulations prescribed by the Secretary, under any of the following methods:
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> (1) the straight line method,
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> (2) the declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in paragraph (1),
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> (3) the sum of the years-digits method, and
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> (4) any other consistent method productive of an annual allowance which, when added to all allowances for the period commencing with the taxpayer's use of the property and including the taxable year, does not, during the first two-thirds of the useful life of the property, exceed the total of such allowances which would have been used had such allowances been computed under the method described in paragraph (2).
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> Nothing in this subsection shall be construed to limit or reduce an allowance otherwise allowable under subsection (a).
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> (c) Limitations on use of certain methods and rates.--Paragraphs (2), (3), and (4) of subsection (b) shall apply only in the case of property (other than intangible property) described in subsection (a) with a useful life of 3 years or more . . . .
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> Paragraphs (2), (3), and (4) of subsection (b) shall not apply to any motion

picture film, video tape, or sound recording.[5]

Subparagraph (b)(4) includes *any* other consistent method, including methods not expressed in a term of years. The legislative history shows Congress intended § 167 (b)(4) to include methods not expressed in a term of years. The unit of production method is not expressed in a term of years, and Congress intended (b)(4) to include that method. See H.R. Rep. No. 1337, 83d Cong., 2d Sess. (1954), reprinted in 1954 U.S.C.C.A.N. 4047; S. Rep. No. 1622, 83d Cong., 2d Sess. (1954), reprinted in 1954 U.S.C.C.A.N. 4655. Thus, any method, including the income forecast method, that satisfies the requirements of (b)(4) and (c) is presumptively reasonable.

The IRS takes the position that § 168(f)(1) applies only to property such as movies that can be depreciated *only* under a method not expressed in a term of years. Here, the income forecast method is not the only reasonable and consistent method for depreciating taxpayers' inventory. Because the inventory's useful life can be adequately measured by

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[5] In 1990, Congress eliminated former sections (b) and (c) as obsolete. Revenue Reconciliation Act of 1990, Pub. L. No. 101-508, § 11812, 104 Stat. 400. The dissent agrees that § 167 governs the propriety of the income forecast method under § 168(f)(1), but considers it unlikely that the provisions of § 167(b) and (c) can be integral to the application of § 168(f)(1) because those provisions were stricken from the Code as obsolete in 1990 while § 168(f)(1) was left unchanged. However, Congress' understanding of § 168(f)(1) in 1990 has little weight in determining the intent of Congress when it enacted that provision as part of the ACRS in 1981. See X-Citement Video, 115 S.Ct. at 471. The provisions of § 167(b) and (c) that were stricken in 1990 were in existence when Congress enacted the ACRS in 1981 and are applicable to the 1987 and 1988 tax years at issue in this case.

The dissent expresses concern that the majority opinion incorporates the now-stricken provisions of former §167(b) and (c) into § 168(f)(1) for post-amendment tax years. That does not necessarily follow from the majority opinion. It may be that "properly depreciated" in § 168(f)(1) means properly depreciated under § 167 as amended rather than as it existed before the 1990 amendment. Nothing in the majority opinion is contrary to that interpretation. However, that issue is not before us; we do not decide the effect of the 1990 amendment on § 168(f)(1) in later tax years.

passage of time, the usual time-based methods also meaningfully allocate the cost to the periods to which the assets contribute. However, § 168(f)(1) does not provide that a taxpayer may elect to use a method not expressed in a term of years only for property such as movies that cannot be depreciated by a method expressed in a term of years. Section 167(b) expressly provides that *any* of the methods listed in that subsection are acceptable. It does not provide that a taxpayer may use an alternative method under (b)(4) only when the methods under (b)(1) through (3) cannot be used. Nor do the treasury regulations impose any such limitation. See Treas. Reg. § 1.167(b)-0 (1960), (b)-4 and (c)-1.[6] The IRS position has no basis in the statutory language of § 167(b) or § 168(f)(1).

The statutory language of § 167(b)(4) does not limit use of the income forecast method or other methods not expressed in a term of years to movies or similar property. The legislative history of § 167 shows that the methods set out in § 167(b) were intended "to apply to all types of tangible depreciable assets." S. Rep. No. 1622. Nor do the prescribed regulations limit methods to any specific types of property. They require only that the taxpayer establish that an alternative method under (b)(4) is "both a reasonable and consistent method" and that it complies with the limitations of § 167(b)(4) and (c). See Treas. Reg. §§ 1.167(b)-4 (1960) and (c)-1 (1972) (amended 1994 and 1995). Any method that satisfies these requirements is presumptively reasonable under § 167. See St. Louis County Water Co. v. United States, 452 F.2d 1022, 1027-28 (Ct. Cl. 1971)

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[6] Proposed Treas. Reg. § 1.168-4(b), 49 F.R. 5940, 5958 (1984), would permit exclusion of property from § 168 under (f)(1) only if a method not expressed in a term of years "was a recognized method within the particular industry for the type of property in question" and the "taxpayer properly elects such . . . for the first taxable year."

(modified straight line method based on costs not fully incurred held reasonable because depreciation allowances claimed did not exceed those from declining balance method).

Methods that do not satisfy the requirements of § 167(b)(4) and (c) may nonetheless be permitted by § 167. Section 167(b) provides that a reasonable allowance for depreciation "shall include (but shall not be limited to)" the methods set out in (b), and that "[n]othing in this subsection shall be construed to limit or reduce an allowance otherwise allowable under subsection (a)." Congress included this language in 1954 to make it clear that § 167(b) does not preclude use of other methods that, under existing law, had been or might be proved reasonable. See H.R. Rep. No. 1337; S. Rep. No. 1622; H.R. Conf. Rep. No. 2543, 83d Cong., 2d Sess. (1954), reprinted in U.S.C.C.A.N. 5288. Thus, taxpayers may use methods that do not comply with (b)(4) based on facts and circumstances which necessitate a more rapid write off than permitted under the declining balance method. See H.R. Rep. No. 1337.

Because it is difficult to estimate the useful life of property like movies, it is difficult to determine whether depreciation of such property by the income forecast method produces a more rapid write off than the declining balance method, which is based on an estimate of useful life. The facts and circumstances peculiar to movies and similar property necessitate use of a method not subject to the limitations of (b)(4).[7]

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[7] Language excluding motion picture films, videotapes, and sound recordings from paragraphs (b)(2) through (4) was added to § 167(c) in the Tax Reform Act of 1986. The legislative history indicates the change was intended to limit depreciation of movies to the straight line method and the income forecast method, and to provide that alternative methods under (b)(4) were not available for movies. See H.R. Rep. No. 426, 99th Cong., 2d Sess., 914-15, 1986-3 (Vol. 2), C.B. 914-15 (1986). This might appear to suggest the income forecast method is not within (b)(4). However, (b)(4) permits the income forecast method only when it (continued...)

Those facts and circumstances do not exist in the case of rent-to-own inventory, which has a determinable useful life.

Although the inventory cannot properly be depreciated by the income forecast method outside of (b)(4), it can be properly depreciated by the method if it satisfies the requirements of (b)(4) and (c). To satisfy the requirements of § 167(b) and (c), an alternative method must (1) be a reasonable and consistent method of determining a reasonable allowance for depreciation; (2) be no faster than the declining balance method of subsection (b)(2) over the first two-thirds of the useful life of the property; and (3) apply to property with a useful life of at least three years. Section 168(f)(1) relaxes the second requirement. Section 167(b)(4), as interpreted by Treas. Reg. § 1.167(b)-4, requires that an alternative method produce no greater depreciation than the declining balance method for each year of the first two-thirds of the useful life of the property. Section 168(f)(1) requires only that the property be properly depreciated under a method not expressed in a term of years for the first taxable year for which the taxpayer can take a depreciation deduction for the property.

The requirement of § 168(f)(1) that the property be properly depreciated for the first taxable year makes sense only as a modification of the requirement of § 167(b)(4) that alternative depreciation methods not be faster than the declining balance method for the first two-thirds of the property's useful life. The provision makes no sense under the IRS interpretation that § 168(f)(1) is limited to certain types of property with specific

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[7](...continued)
does not result in a faster write off than the declining balance method of (b)(2). That method cannot be applied to movies. When not subject to the limitations of (b)(4) and (c), however, the income forecast method can be applied to movies.

characteristics, like movies. A type of property that by its nature is properly depreciated under the income forecast method one year must necessarily be properly depreciated under that method in following years; the property cannot change its nature from one year to the next.[8] Accordingly, for property to be properly depreciated by a method not expressed in a term of years under § 168(f)(1), the method must (1) be reasonable and consistent; (2) produce no greater depreciation in the first year than the declining balance method; and (3) be applied to property with a useful life of at least three years.

We conclude the first requirement, that the method be a reasonable and consistent method of computing a reasonable allowance for depreciation, is satisfied. In Massey, 364 U.S. at 104, the court explained it is "the primary purpose of depreciation accounting to further the integrity of periodic income statements by making a meaningful allocation of the cost entailed in the use . . . of the asset to the periods to which it contributes." The income forecast method meaningfully allocates costs to the periods to which the asset contributes. Here, counsel for the Commissioner conceded at oral argument that the income forecast method is the most economically accurate depreciation method for rent-to-own inventory. Given this concession, we can only conclude the income forecast method is a reasonable and consistent method that meaningfully allocates the costs of the inventory to the periods to which it contributes. However, to be properly depreciated by a

[8] Proposed Treas. Reg. § 1.168-4(1)(ii) attempts to avoid this problem by interpreting the provision as requiring that the taxpayer *properly elect* for the first taxable year to depreciate property under a method not expressed in term of years. However, § 168(f)(1) does not require a proper election for the first taxable year; it requires that for the first year the property be *properly depreciated* under a method not expressed in a term of years. Section 168(f)(1)(A) governs election. Section 168(f)(1)(B) governs depreciation method, and requires that the property be properly depreciated under a method not expressed in a term of years.

method not expressed in a term of years under § 168(f)(1), the method also must not produce greater depreciation in the first taxable year than the declining balance method of § 167(b)(2), and the useful life of the property must be at least three years. We are unable to resolve these issues from the record before us.[9] This case must be remanded to the tax court for a determination of those issues.

The decision of the Tax Court is REVERSED, and the case is REMANDED for further proceedings.

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[9] Because two years is the average time a unit remains in inventory, it appears unlikely that the useful life of the property is at least three years, but we cannot make that determination from the record on appeal.

No. 95-9008, 95-9009, 95-9010, ABC Rentals of San Antonio, Inc. et al. v. Commissioner of Internal Revenue.

KELLY, Circuit Judge, concurring in part and dissenting in part.

I agree with the Court that use of the income forecast method is not limited to films and similar property, but rather may include "any property," I.R.C. § 168(f)(1), including rent-to-own inventory.

I disagree with the Court that the phrase "properly depreciated under . . . any method of depreciation not expressed in a term of years," I.R.C. § 168(f)(1)(B), incorporates the requirements of I.R.C. §§ 167(b) and (c) (1988). Although the depreciation deduction under the income forecast method would be subject to the general rule of I.R.C. § 167(a), see Newark Morning Ledger Co. v. United States, 507 U.S. 546, 553 (discussing § 167(a)), I doubt that the limitations of I.R.C. §§ 167(b) and (c) (1988) apply. These limitations, as interpreted by the Court, would preclude use of the income forecast method if the depreciation allowance exceeded that under the double-declining balance method during the first two-thirds of the property's useful life or the property had a useful life of less than three years. Section 168(f) does not cross-reference these provisions and nothing in any legislative history even remotely suggests that they apply. To the contrary, § 168(f)(1) is broadly worded to apply to "any property" that is "properly depreciated" under an alternative method. Moreover, the legislative history suggests that Congress did not intend it to be difficult for tangible property to fall under § 168(f)(1). See H.R. Conf. Rep. No. 841, 99th Cong. , 2d Sess. II-40 (1986), reprinted in 1986 U.S.C.C.A.N. 4075, 4128 ("As under present law, property which the taxpayer properly elects to depreciate under the unit-of-production method or any other method not expressed in terms of years . . . will be so depreciated.").

Problems abound with the court's restrictive approach. First, if the limitations contained in I.R.C. §§ 167(b) and (c) (1988) were integral to the application of § 168(f), it seems very unlikely that these limitations would have been stricken from the Code in 1990 as "obsolete provisions" while § 168(f)(1) survived. See Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11,812, 104 Stat. 1388-534. While the Treasury Regulations still contain provisions tracking these subsections, Treas. Reg. §§ 1.167(b)-4 and 1.167(c)-1, these dated regulations are firmly tied to the now obsolete subsections and were enacted long before § 168(f)(1) and its predecessor § 168(e)(2). Although it is true that we must look at the Code as it existed for the tax years at issue, we cannot ignore that Congress retained § 168(f)(1) while deleting §§ 167(b) and (c), ostensibly critical provisions which define "properly depreciated" under § 168(f)(1). The court's answer to this obvious problem is that "[i]t may be that 'properly depreciated' in § 168(f)(1) means properly depreciated under § 167 as amended rather than as it existed before the 1990 amendment." Ct. Op. at 14 n.14. It is far more likely that §§ 167(b) and (c) do not apply, and that Congress would not tinker with the meaning of "properly depreciated" in such an odd and inadvertent manner. Second, while we may look at related statutes for interpretive help, here a statute no longer in existence and its accompanying regulations are being consulted to provide quantitative benchmarks for the phrase "properly depreciated." Nothing in any legislative or administrative history suggests that the phrase "properly depreciated," as used in the provision allowing exit from § 168 and MACRS, should be restricted in accordance with the narrowest meaning of "reasonable allowance" under §§ 167(b)(4) and (c) (1988). Third, incorporating these obsolete subsections as a further condition on use of the income forecast method seems beyond judicial interpretation and within the legislative and administrative spheres. While we are obligated to reject the Commissioner's positions that are without support in the law,

> Congress has delegated to the Commissioner, not to the courts, the task of prescribing, "all needful rules and regulations for the enforcement" of the Internal Revenue Code. 26 U.S.C. § 7805(a). In this area of limitless factual variations, "it is the province of Congress and the Commissioner, not the courts, to make the appropriate adjustments."

United States v. Correll, 389 U.S. 299, 307 (1967) (quoting Commissioner v. Stidger, 386 U.S. 287, 296 (1967)). See also Treas. Reg. §§ 301.7805-1(a); 601.601(a). Finally, neither party cited these obsolete subsections, let alone suggested that they applied--we are without the Commissioner's views, which we must consider, and those of the taxpayers. For these reasons, I respectfully dissent from that portion of the judgment remanding for an inquiry under I.R.C. §§ 167(b)(4) and (c) (1988). I would simply reverse.