congressional intent, for *Skifter* had asked whether the property would be taxed under other sections of the code if it were not life insurance, not whether the power held by the decedent would have been sufficient under those sections to result in inclusion. This distinction is critical, for the former statement of the issues requires the court to examine, in addition to the nature of the power, the source of the power, the way in which it is held, and whether the arrangement is a substitute for testamentary disposition of the property.

Implicit in the *Lumpkin* court's decision is the view that even though life insurance is not always inherently testamentary, it has testamentary characteristics which may justify taxation in situations where other forms of property would not be taxed. Whether this premise is valid is open to question in view of the refusal of Congress to treat life insurance as inherently testamentary, but even if the premise is accepted the court did little to provide guidelines for applying it to other situations. The factors which other courts have viewed as important in defining "incidents of ownership" are neither integrated into the *Lumpkin* result nor rejected outright; this should allow wide latitude for other courts to distinguish the decision.

*Lumpkin* is an apparent success for the contention of the Service that powers sufficient to result in inclusion under other sections of the Code are sufficient to constitute incidents of ownership, but it does little to provide a workable definition of "incidents of ownership" and may only inject more confusion into this unsettled area of the law.

STEVEN KROPELNICKI, JR.

Federal Income Tax—Internal Revenue Code Sections 167 and 263—Depreciation on Depreciation?

Section 167 of the Internal Revenue Code allows the taxpayer a deduction from gross income for depreciation of certain property used in his business.\(^1\) Section 263 forbids the deduction of any amounts

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1. *INT. REV. CODE OF 1954*, § 167, provides in part:
   (a) 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.

Prior versions of section 167, applicable to cases discussed in the text, are comparable.
paid out as capital expenditures and improvements,\textsuperscript{2} although those capital expenditures might themselves be depreciable. Amounts paid out for such expenditures include acquisition and construction costs.\textsuperscript{3} Recently, in \textit{Idaho Power Co. v. Commissioner},\textsuperscript{4} the question arose whether construction costs to be capitalized might include depreciation incurred on a taxpayer's equipment during the construction of its own capital properties. The Ninth Circuit Court of Appeals held against capitalization of construction equipment depreciation.

The taxpayer in \textit{Idaho Power} was a public utility that normally built additions to its own primary electrical transmission and distribution lines and stations. During the taxable years 1962 and 1963, Idaho Power had charged to plant accounts all depreciation and operating expenses incurred on its equipment to the extent it was used in construction of new lines.\textsuperscript{5} The depreciation thus capitalized on the books totalled 280,571.41 dollars on equipment with a composite life of ten years. On its federal tax returns the taxpayer deducted all depreciation incurred during these periods, including that allocated on its books to construction. The I.R.S. disallowed a substantial portion of the deduction, but did allow the depreciation to be added to the depreciable portion of the facilities constructed and thus to be deducted over the useful lives of the facilities, all of which were expected to last at least thirty years.\textsuperscript{6}

On appeal to the Tax Court from the deficiency,\textsuperscript{7} Idaho Power contended that the depreciation should be entirely deductible in the years it was incurred since the equipment was used in its "trade or business" within the meaning of section 167.\textsuperscript{8} The government countered that construction of power facilities was not within the scope of

\textsuperscript{2} \textit{Int. Rev. Code of 1954, \S 263, provides in part:}
\begin{itemize}
  \item[(a)] \textit{General Rule.—No deductions shall be allowed for—}
  \begin{itemize}
    \item[(1)] Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate.
  \end{itemize}
\end{itemize}
\textsuperscript{3} \textit{Treas. Reg. \S 1.263(a)-2(a) (1958).}
\textsuperscript{4} 477 F.2d 688 (9th Cir.), \textit{cert. granted}, 94 S. Ct. 351 (1973) (No. 263).
\textsuperscript{5} Although on its books the taxpayer capitalized depreciation as well as maintenance and other equipment operating expenses, it deducted as expenses pension contributions, Social Security tax, and motor vehicle tax. 477 F.2d at 690.
\textsuperscript{6} It should be noted that the mere allowance of capitalization does not necessarily permit subsequent deduction (through amortization) of the particular cost. \textit{E.g.}, Treas. Reg. \S 1.167(a)-3 (1960) (goodwill).
\textsuperscript{8} \textit{Id. at 429; see Int. Rev. Code of 1954, \S 167(a)(1).}
the taxpayer's trade or business and that even if it were, the current deduction of any capital expenditure in connection with trade or business is prohibited by section 263. The Tax Court held for the Commissioner and focused on section 263 in requiring capitalization.

The court of appeals directed its attention to section 167 and found the "trade or business" determination to be crucial. It reversed the Tax Court and held that immediate deduction of this type of depreciation is allowable.

When the depreciation-capitalization problem had previously been addressed, the courts had split. In 1927, the Board of Tax Appeals decided *Great Northern Railway* which involved depreciation of trains and equipment already owned but used occasionally for transporting employees to railway construction sites. The workers were carried on regularly scheduled runs. The Board held that any operating expenses, incremental or not, which could possibly be allocated to construction must not be deducted immediately. Specifically, the court disallowed the portion of the depreciation deduction allocable to construction work. In so doing, the court held that "a part of the wear and tear of the train equipment, of the rails, ties, etc., may be properly capitalized."

A few years later, the same railway brought the same question

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9. 477 F.2d at 696. As to the weight accorded court of appeals decisions by the Tax Court, compare Jack E. Golsen, 54 T.C. 742, 756-57 (1970), aff'd, 445 F.2d 985 (10th Cir. 1971) (will follow the court of appeals for its circuit if squarely in point), with Estate of George I. Speer, 57 T.C. 804, 812 (1972) (will not follow if a different state is involved), and Donald W. Fausner, 55 T.C. 620, 626 (1971). Also, the judges of the Tax Court do not bind each other by their decisions unless they are reviewed by the court as a whole. Comment, *Toward New Modes of Tax Decision Making*, 83 HARV. L. REV. 1695, 1700 n.30 (1970).

10. 8 B.T.A. 225 (1927), aff'd, 40 F.2d 372 (8th Cir.), cert. denied, 282 U.S. 855 (1930). A strong analogy can be drawn between railroads and electric companies, and between railway tracks and power lines. Both industries are regulated, and expansion and replacement of facilities have been a major part of their businesses.

11. 8 B.T.A. at 263 (even though the Board also found the depreciation to have been incurred in the railroad's regular business). I.R.S. disallowance of current depreciation deductions was particularly onerous to railroads since they commonly used the "retirement" method for reporting. Under this method, capitalized acquisition costs are not depreciable over time. Only when restoration and replacement charges exceed half the current replacement cost of the asset may the original cost be deducted from revenues. Since the original cost contains the depreciation on equipment from the construction period, recovery of that depreciation cost free of taxes was postponed drastically. 4 J. MERTENS, LAW OF FEDERAL INCOME TAXATION § 23.37 (rev. 1969). But see INT. REV. CODE OF 1954, § 263(e) (added in 1969). Note, however, that replacements (as opposed to originals) of railroad track were customarily treated as current expenses, *e.g.*, Union Pac. R.R. v. United States, 99 U.S. 402, 421 (1878).
back to the Board of Tax Appeals. During 1928, 1929, and 1930, Great Northern Railway incurred depreciation on equipment that it was again using "in the construction of additions to or betterments of" its property. As prescribed by Interstate Commerce Commission directives, the railway had added this depreciation to the cost of the assets on its books, but for tax purposes it deducted all the depreciation immediately. The Board allowed the deduction as a matter of course once it found the equipment to have been used in a trade or business.

In this second Great Northern case, the court did not explore the section 263 capitalization problem because the government brief had failed to cite the first Great Northern case, key precedent in support of capitalization. This omission by the Commissioner was interpreted by the Board as an indication that the I.R.S. was abandoning its traditional position favoring capitalization. The I.R.S. had not, in fact, abandoned that policy and referred in its brief many years later in Southern Natural Gas Co. v. United States to "the Board's mistaken view that the Commissioner's unexplained failure to cite the first Great Northern decision meant that he repudiated its authority."

The taxpayer in Southern Natural Gas was an interstate gas carrier that built new pipelines to expand its system. Some of the equipment that it owned primarily for maintenance and operation was used from time to time to construct additional facilities. The Court of Claims held that depreciation allocable to the use of the equipment in construction was not a proper current deduction but should be capitalized and recovered over the lives of the new pipelines. Although the results in Southern Natural Gas and Idaho Power are divergent, in both cases the courts relied on the section 167 trade or business test. This approach had been adopted by the court in Northern Pacific Railway

12. Great N. Ry., 30 B.T.A. 691 (1934) [hereinafter referred to as the second Great Northern case].
13. Id. at 707.
14. See 477 F.2d at 694. The Board of Tax Appeals which had decided the second Great Northern later expressly limited that holding to precisely this point, that the depreciation was incurred in trade or business since it is part of a railroad's regular business to construct additional capital facilities for doing business as a common carrier. Producers Chem. Co., 50 T.C. 940, 960 (1968).
15. 30 B.T.A. at 708.
17. Id. at 1268 n.78. The I.R.S. has successfully defended this position in Northern Pac. Ry. v. Helvering, 83 F.2d 508 (8th Cir. 1936); Churchill Farms, Inc., 38 P-H Tax Ct. Mem. 1071 (1969); Ben Perlmutter, 44 T.C. 382 (1965), aff'd, 373 F.2d 45 (10th Cir. 1967).
v. Helvering, an earlier case in which transportation expenses borne by the railroad in constructing additions were held to be allocable to capital items. The approved allocation formula included “wear and tear (i.e., depreciation) of the train equipment,” even though the expenses were not incurred in pursuance of the railroad’s duty as a public carrier but as a private owner of property.

No mention of “trade or business” is made in Revenue Ruling 59-380 nor in Revenue Ruling 55-252, both of which require capitalization. Ruling 59-380 was written in response to an inquiry from a taxpayer who used already owned and newly acquired construction equipment for his own capital improvements. This ruling was expressly approved in Southern Natural Gas. Ruling 55-252 required depreciation of trucks and equipment used in reforestation to be capitalized in the cost of the trees and recovered tax-free through depletion allowances. Neither of these rulings has been rescinded by the Commissioner.

There are limits, however, to the government’s favor of capitalization. The 1970 reversal of L.W. Brooks, Jr. by the Fifth Cir-

18. 83 F.2d 508 (8th Cir. 1936).
19. Id. at 513, quoted and clarified in Southern Natural Gas v. United States, 412 F.2d 1222, 1267 (Cl. Ct. 1969).
20. 83 F.2d at 514. The distinction drawn here between actions within and without the role of common carrier for tax purposes was based upon the same distinction as drawn in Santa Fe P. & P. Ry. v. Grant Bros. Constr. Co., 228 U.S. 177 (1913) for tort and contract liability purposes.
21. 1959-2 Cum. Bull. 87: Depreciation sustained on construction equipment owned by a taxpayer and used in the erection of capital improvements for its own use is not an allowable deduction, but shall be added to and made a part of the cost of the improvements. So much thereof as is applicable to the cost of depreciable capital improvements is recoverable through deductions for depreciation over the useful life of such capital improvements.
23. 412 F.2d at 1268. The Idaho Power court rejects the ruling, however, basing its rejection on (1) its perceived invalidity of Southern Natural Gas, and (2) its limited regard for revenue rulings. 477 F.2d at 696 & n.10. As to the second point, see Bartels v. Birmingham, 332 U.S. 126, 132 (1947); Stubbs v. United States, 445 F.2d 1142, 1146-47 (5th Cir. 1971); cf. Overbey v. United States, 44 F.2d 268 (Cl. Ct. 1930); Arthur H. Lamborn, 13 B.T.A. 177 (1928). But see 1 J. MERTENS, supra note 11, at § 3.20: “If, however, a ruling reflects a position not departed from by the Treasury Department over a period of many years, it is entitled to serious consideration by the courts.”
25. Although not a limitation, note that the Commissioner will not allow capitalization of construction depreciation for investment credit purposes when the additions are new section 38 property. “New section 38 property” is depreciable tangible property (other than buildings) with a useful life of three years or more which is completed after Dec. 31, 1961. Int. Rev. Code of 1954, § 48(h).
26. 50 T.C. 927 (1968), rev’d, 424 F.2d 116 (5th Cir. 1970).
cuit indicates that when depreciation and other expenses are incurred in recovering minerals, capitalization or deduction of those expenditures may hinge on the type of "estate" involved.\textsuperscript{27} Customarily, oil leases are divided into the financing interest and the operating interest. The lease owner sells to the operator a "working interest" in the land in return for the operator's promise to pay the owner a set amount out of the oil produced, if any, during the early stages of production. Risk is thus borne by both parties. If expenses of operation, such as depreciation, are added to the basis of the oil in the ground in which the production payment owner has an interest, he would enjoy a tax advantage upon the sale of that oil. If, on the other hand, such expenses are deducted by the operator, he would reap the tax benefits.

Capitalization might be proper only to the extent the expenditures add to the estate of the production payment owner. Normally, however, these expenditures in raising oil add nothing to the interest itself but merely accelerate payment. Although the operator's costs of raising oil that is allocable to production payments can be considered costs of acquiring the capital asset and thus properly capitalized (on the theory that the operator has simply paid the production payment owner's share of costs), the appellate court disallowed capitalization. Operators may currently deduct all operating expenses, even if a net loss results, because "the proper allocation of where the operating expense burden [and the tax benefit lie] depends on the type of legal estate or interest involved\textsuperscript{28} and because a basic characteristic of a production payment interest is its freedom from operating expenses. Such expenses are, rather, an attribute of the working interest in the land.\textsuperscript{29}

If depreciation adds to the estate, it should be capitalized even though it might be considered an "intangible" cost. The court in \textit{Idaho Power} discussed the problem of transmuting an intangible expense into tangible property. In recent years, both grading\textsuperscript{30} and dredging\textsuperscript{31} have been held to be intangible costs subject to capitaliza-

\textsuperscript{27} 424 F.2d at 122. The estates involved are the working interest and the production payment interest. The oil in the ground is a capital asset in which the production payment owner has an incorporeal hereditament.

\textsuperscript{28} \textit{Id.}

\textsuperscript{29} \textit{Id.} See also C. BREEDING & A. BURTON, INCOME TAXATION OF OIL AND GAS PRODUCTION \textsection 2.04 (1961).

\textsuperscript{30} Commonwealth Natural Gas Corp. v. United States, 395 F.2d 493, 494 (4th Cir. 1968).

Capitalization of intangible expenses as additions to the estate has been specifically held to be proper by Revenue Ruling 72-403.\textsuperscript{33} Decided in response to a request by another electric company, this ruling makes costs of acquiring easements for electrical transmission lines depreciable and initial grading a tangible asset.

Requiring capitalization as the result of a trade or business determination (as in \textit{Southern Natural Gas}) is consistent with cases that have dealt with equipment depreciation which occurred prior to the commencement of business. In those cases involving extractive industries, such costs have been capitalized and recovered through deductions for depletion.\textsuperscript{34} In \textit{Idaho Power} the new assets had not been put into revenue-producing business at the time equipment depreciation was incurred. Thus, a portion of its business had not been commenced, and capitalization was appropriate so that costs could be matched against revenue which only arose later.

The taxpayer in \textit{Idaho Power} did not rely wholly on a trade or business determination, however. It pointed to the words "paid out" in section 263\textsuperscript{36} and contended that depreciation is not a payment and thus cannot be capitalized.\textsuperscript{37} The court pursued interpretations of these words in other Code sections. Although depreciation has been held to be a "payment" for charitable contribution purposes,\textsuperscript{38} it is not a "payment within the taxable year"\textsuperscript{39} and is thus not deductible.

The Regulations themselves address the point obliquely. When otherwise ordinary and necessary business expenses are "paid or incurred"\textsuperscript{39} to construct capital items, they themselves are capital items. To add to the confusion, the taxpayer in \textit{Idaho Power} was sufficiently enamored of the paid-out notion to concede, contrary to its own in-

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\textsuperscript{32} If the costs are "inextricably associated" with the land they may not be depreciated. Algernon Blair, Inc., 29 T.C. 1205, 1221 (1958).

\textsuperscript{33} 1972 INT. REV. BULL. No. 34, at 9-10.

\textsuperscript{34} Producers Chem. Co., 50 T.C. 940 (1968), following New Quincy Mining Co., 36 B.T.A. 376 (1937). The depreciation sustained prior to beginning active production, since not attributable to regular on-going business, was held capitalizable as a development cost to be recovered in deductions for depletion and was not a statutory net loss.

\textsuperscript{35} See note 2 supra.

\textsuperscript{36} 477 F.2d at 694.

\textsuperscript{37} Orr v. United States, 343 F.2d 553, 556 (5th Cir. 1965); cf. Rogers v. Commissioner, 281 F.2d 233 (4th Cir. 1960).

\textsuperscript{38} Maurice S. Gordon, 37 T.C. 986-87 (1962) (involving section 213, Medical Deductions). Note that section 213 requires capitalization of certain medical expenses to the extent they add value to the taxpayer's property.

\textsuperscript{39} Treas. Reg. § 1.263(a)-1(b) (1965) (emphasis added).
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terests (and contrary to common accounting practice), that even small tools paid for immediately, but which had lives of less than one year, should be capitalized in the year of purchase when used for capital construction.

Although depreciation is not specifically included in the capitalization rule, it is not specifically exempted from the "no deduction" rule as are certain other provisions of the Code. Nor is section 167 found among those sections singled out by the Regulations for taxpayers' election to deduct or capitalize. By contrast, research and development expenses are allowable as an immediate deduction even if incurred in construction of capital assets. The inescapable conclusion from the plain statutory words is that depreciation expense which meets the criteria of section 263 is required to be capitalized.

One of Idaho Power's major contentions was not argued until its appeal from the Tax Court. It asserted that deductions expressly set out in the Code are somehow different from ordinary business expenses (and thus not encompassed by section 263) simply by virtue of their specific treatment. These special deductions include repairs (section 162), interest (section 163), taxes (section 164), research and experiment (section 174), and depreciation. The Tax Court in All-Steel Equipment, Inc. supported this interpretation of the Code's overall scheme and cited several cases holding that "deductions expressly granted by statute are not to be deferred even though they relate to inventory or capital items." However, this particular argument was rejected by the circuit court. The court said that under section 162 ordinary and necessary business repairs are not deductible immediately but only when the manufactured goods, related to the repairs, were sold. The court of appeals held that the Tax Court erred

41. 39 P-H Tax Ct. Mem. at 430.
42. See INT. REV. CODE OF 1954, § 263(a)(1).
43. Treas. Reg. § 1.263(a)-3 (1965).
44. This is perhaps true because of the difficulties inherent in allocating the expenses to various projects. There is also a policy of encouraging research which stems from international technological competition.
45. The specific treatment is most likely due to the materiality and complexity of those various deductions.
46. 54 T.C. 1749 (1970), rev'd, 467 F.2d 1184 (7th Cir. 1972).
47. 54 T.C. at 1759.
48. All-Steel Equip., Inc. v. Commissioner, 467 F.2d 1184, 1186 (7th Cir. 1972). Seeming almost to foresee Idaho Power, the Tax Court had pointed out that the problem of cost allocation for capital assets is indistinguishable from allocation to inventory. 54 T.C. at 1759.
in concluding that special treatment of certain expenses in the Code dictates special timing too, and it required repairs to be allocated to inventory. 49

Income tax Regulations also directly address this problem of which costs are properly a part of inventory. The Regulations require that in valuing inventory the taxpayer "shall conform as nearly as may be to the best accounting practice in the trade or business." 50 The American Institute of Certified Public Accountants, the recognized authority on accounting, advises that depreciation related to manufacturing is to be considered in the inventory computation. 51 It is appropriate under the Regulations for the taxpayer to allocate indirect costs (such as depreciation) to inventory for tax purposes in the same manner as he does on his books 52 when the inventory costs include the indirect costs necessarily incident to production. 53

Finally, the court in Northern Pacific Railway v. Helvering, 54 a case factually similar to Idaho Power, stated that each unit of service as well as each unit of production must carry its proper proportion of all expenses. 55 This line of reasoning seems not only to justify but to require capitalization of construction depreciation even for service companies, so that expenses can properly be matched against revenue accruing from use of the asset constructed.

Section 446 of the Code requires that taxable income be computed by the same method of accounting as "book" income. Although the term "method of accounting" is broad in meaning, it does include the accounting treatment prescribed for depreciation. 56 Best tax and accounting treatment calls for clear presentation of income. This requires expenses to be matched against revenues by cause-and-effect or, failing that, by systematic rational allocation. Only if neither of these methods can be applied should expenses such as depreciation be simply charged off in periods in which incurred. 57

49. 467 F.2d at 1186. See also 1954 U.S. CODE CONG. & AD. NEWS 4851; cf. INT. REV. CODE OF 1954, § 174(b).
51. AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, ACCOUNTING PRINCIPLES BOARD STATEMENT No. 4, ¶ 159 (1970); AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, ACCOUNTING TERMINOLOGY BULLETIN No. 4, ¶ 2 (1957).
54. 83 F.2d 508 (8th Cir. 1936).
57. AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, ACCOUNTING PRINCIPLES BOARD STATEMENT No. 4, ¶ 161 (1970).
Immediate write-off of indirect production costs has an effect similar to accelerated depreciation methods: both postpone taxes. For growing utilities and other enterprises, this amounts to a permanent exemption. Nevertheless, accelerated depreciation allowances, additional first year depreciation, and investment tax credits are all evidence of the same congressional policy to allow current reduction of tax burdens by immediate deduction of construction depreciation. The purpose of that policy is to free working capital in the economy for investment and thereby sufficiently raise aggregate taxable income in the long run so that no net tax revenue loss results for the government.

Were *Idaho Power* to be followed generally in states which allow a "fair return" to utilities on the "fair value" of their assets, rates would undoubtedly be affected. Depreciation incurred in constructing electrical facilities is of considerable magnitude. If depreciation were to be capitalized the rate base would be inflated; if it is deducted immediately asset costs remain lower. When depreciation is capitalized for rate purposes and deducted on tax returns, as in *Idaho Power*, rates become higher for present customers but more working capital is available for utility service expansion.

In its apparent adherence to congressional expansionary policy, the court in *Idaho Power* exercised liberality in construing the applicable statutes and regulations. Perhaps it realized that the usual narrow judicial scrutiny given deductions should not be invoked when private businesses perform what would otherwise entail public expense.

*Idaho Power*, then, seems most readily justifiable as policy in action. It is contrary to expressed opinions of the I.R.S. and would surely have been resolved differently if the court had adhered to the plain meaning of the Code and Regulations. Indeed, reasoning by analogy from the Code would mandate a different result. For example, a contractor who constructs assets for others instead of himself and who uses the completed contract method of recognizing income is required to defer depreciation incurred during construction and to deduct it all in

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58. 1954 U.S. CODE CONG. & AD. NEWS 4048: "For all segments of the American economy, liberalized depreciation policies should assist modernization and expansion of industrial capacity, with resulting economic growth, increased production, and a higher standard of living."
59. *Id.* at 4050.
60. In North Carolina, rates are computed by the Utilities Commission which considers, among other things, the original cost of property less accumulated depreciation. N.C. GEN. STAT. § 62-133(b)(1) (1965).
61. 1 J. MERTENS, *supra* note 11, § 3.07, at 17.
the year of completion. This matches expense against revenue as required by sound accounting and tax principles. Proper matching in the Idaho Power situation would require all non-revenue producing costs incurred during construction to be deferred for later matching against revenue arising from use of the revenue producing capital asset itself.

CONCLUSION

The Court of Appeals for the Ninth Circuit seems to have attempted to justify a policy decision on non-policy grounds, with limited success. Even the implicit policy of economic expansion and investment, although applicable during the taxable years in question, is painfully passé in these days of inflation and congressional tightening of investment incentives. For its expressed rationale the court relied heavily upon the second Great Northern case, a discredited case which had been decided on a misunderstanding. The “trade or business” test applied is a section 167 rule that has been artificially grafted onto section 263 by several courts. It is a factual test, but its ill-defined application to the facts in Idaho Power affords little guidance to other taxpayers, even those residing in the Ninth Circuit. If Idaho Power’s construction of its own power lines were not related to a business, no recovery of equipment cost should have been allowed at all. If it were a regular business activity, then depreciation allowed should have been allocated against the revenue to be produced by the new assets, which were themselves most certainly used in the regular business.

The case was decided with a singular disregard for explicit rulings, sound cases, and statutory law. The record indicates that the Commissioner has consistently favored capitalization. The Internal Revenue Code states explicitly that provisions of Title 26 Part VI allowing deductions such as those in section 167 for depreciation are subject to Part IX exceptions, one of which is section 263. It seems that “trade or business” can properly serve only as a threshold test for determining whether an item is of a depreciable nature. All consideration of capitalization must center in section 263 alone.

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62. Treas. Reg. § 1.451-3 (1957); 2 J. MERTENS, supra note 11, at § 12.130.
63. Contra, International Trading Co., 57 T.C. 455 (1971), rev’d and remanded, 484 F.2d 707 (1973). It was held that a corporation may deduct a loss realized on the sale of property which was neither used in the corporation’s business nor held for the production of income.
64. INT. REV. CODE OF 1954, § 161.