Grauman's Greater Hollywood Theatre, 47 B.T.A. 1130 (1942)

The 'allowable' depreciation for a tax year should be based on the correct useful life of an asset, even if no depreciation was claimed in prior years, unless depreciation was explicitly 'allowed' in those prior years based on a different useful life.

Summary

Grauman's Greater Hollywood Theatre sought a determination of 'allowable' depreciation for its plant and equipment for a 10-year period where no depreciation was claimed on its tax returns. The central issue was whether the depreciation should be calculated based on a 20-year useful life initially applied by the Commissioner, or a later-determined 33-year useful life. The Board of Tax Appeals held that depreciation should be computed based on the corrected 33-year useful life, as no depreciation had been explicitly 'allowed' during the period in question, distinguishing the case from situations where excessive depreciation deductions were previously claimed and allowed.

Facts

The petitioner, Grauman's Greater Hollywood Theatre, owned plant and equipment used in its business.
For a 10-year period (1921-1923 and 1927-1933), Grauman's did not claim any depreciation deductions on its tax returns.
In 1934, the Commissioner determined that the remaining useful life of the assets was 20 years from June 1, 1920.
Subsequently, the petitioner claimed and was allowed depreciation deductions based on this 20-year life span, ending in 1940.
In 1939, the Commissioner revised the estimated useful life to 33 years, ending in 1953, which the petitioner conceded.

Procedural History

The case originated before the Board of Tax Appeals concerning the determination of 'allowable' depreciation for the years in question.
The Commissioner had initially determined depreciation based on a 20-year useful life. The Commissioner later revised this to a 33-year useful life for the tax year 1939.

Issue(s)

Whether the depreciation 'allowable' for the years in question (where no depreciation was claimed) should be computed based on the originally determined 20-year useful life or the subsequently corrected 33-year useful life.

Holding

Yes, because in the absence of explicit depreciation being claimed and ‘allowed’ during the years in question, the depreciation ‘allowable’ should be computed based on the corrected 33-year useful life.

Court’s Reasoning

The Board of Tax Appeals reasoned that the case differed from situations where a taxpayer had claimed and been allowed excessive depreciation deductions. In those cases, the taxpayer could not later reduce the depreciation to the ‘allowable’ amount, even if they did not benefit from the excessive deductions.
In this case, because no depreciation was claimed or ‘allowed’ during the years in question, the petitioner was entitled to use the corrected 33-year useful life for calculating the ‘allowable’ depreciation.
The Board emphasized that there was no suggestion that the nature or character of the business had changed or that the assets were used differently. It was simply a case where a 20-year useful life had been mistakenly applied. The Board stated, “In the circumstances, we think it must be held that the depreciation ‘allowable’ for the years in question should be computed upon the longer useful life period.”

Practical Implications

This case clarifies that taxpayers who have not previously claimed depreciation are not necessarily bound by an incorrect prior determination of useful life when calculating ‘allowable’ depreciation. It emphasizes the importance of determining the correct useful life of an asset. The case distinguishes between situations where excessive depreciation was ‘allowed’ and situations where no depreciation was claimed, highlighting that the ‘allowable’ depreciation can be recomputed based on new information in the latter scenario. This ruling affects tax planning and asset management, encouraging taxpayers to accurately assess and update the useful lives of their assets for depreciation purposes.