14 T.C. 695 (1950)

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A reasonable rate for depreciation is determined based on facts known at the close of the respective taxable year, considering both existing conditions and those reasonably anticipated.

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Summary

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Morganton Full Fashioned Hosiery Co. disputed the Commissioner's disallowance of depreciation deductions on its machinery for 1941-1943, arguing that the agreed-upon depreciation rate from 1935 remained reasonable given the conditions at the end of each tax year. The Tax Court held that the original depreciation rates were reasonable because unforeseen obsolescence (nylon's introduction and wartime restrictions) significantly impacted the machinery's useful life, supporting the company's deductions. The court also determined the company was part of a controlled group for excess profits tax calculation. The depreciation holding highlights the importance of contemporaneous assessment of asset value.

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Facts

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Morganton Full Fashioned Hosiery Co. manufactured women's hosiery. In 1935, the company and the IRS agreed on a depreciation formula: 15-year useful life for new machinery and 12 years for used machinery. From 1936-1940, the IRS allowed these depreciation deductions without change. However, by 1941, the introduction of nylon, which was more suited to newer, finer-gauge machines, rendered much of Morganton's older machinery obsolete. Silk, a primary material, became unavailable due to World War II. The company continued using the 1935 depreciation rates, but the Commissioner later adjusted the depreciation rates, increasing the anticipated useful life of the equipment acquired before 1933.

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Procedural History

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The Commissioner determined deficiencies in Morganton's income, declared value excess profits, and excess profits taxes for 1941-1943. Morganton petitioned the Tax Court, contesting the disallowance of depreciation. The Tax Court reviewed the Commissioner's determination and the evidence presented, ultimately ruling in favor of Morganton on the depreciation issue.

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Issue(s)

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1. Were the depreciation deductions claimed by Morganton for 1941-1943 reasonable, considering the conditions existing at the close of each of those years?

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2. Was Morganton a member of a controlled group of corporations as defined in Section 713(g)(5) of the Internal Revenue Code for excess profits tax credit purposes?

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Holding

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1. Yes, because the depreciation rates previously applied were accurate and did not require revision at the end of each of the taxable years given the obsolescence and material changes that occurred in the hosiery industry.

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2. Yes, because the statutory definition of a

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