Lola Johnson Motel, Inc. v. Commissioner, 55 T. C. 1119 (1971)

A taxpayer who initially selects an incorrect method of depreciation may adopt a different acceptable method without the Commissioner's consent if the original method was never 'regularly' used.

Summary

Lola Johnson Motel, Inc. initially used the double declining-balance method for depreciation, which was disallowed because the motel properties did not meet the statutory requirements under Section 167(c). The court ruled that the company could switch to the 150-percent declining-balance method without the Commissioner's consent since it had not 'regularly' used the double declining-balance method. This decision underscores the flexibility in choosing depreciation methods, emphasizing that an erroneous initial choice does not lock a taxpayer into using the straight-line method if another method is reasonable and acceptable.

Facts

Lola Johnson constructed or acquired motel properties between December 31, 1963, and December 27, 1965. Upon incorporation on December 27, 1965, these properties were transferred to Lola Johnson Motel, Inc. The company used the double declining-balance method for depreciation on its 1966 and 1967 tax returns, a method later found to be inapplicable under Section 167(c) due to the properties' original use not commencing with the taxpayer. The company sought to switch to the 150-percent declining-balance method, which the Commissioner opposed, arguing for the use of the straight-line method.

Procedural History

The Commissioner determined deficiencies in the company's income tax for the years 1966 and 1967. The company conceded the inapplicability of the double declining-balance method but sought to use the 150-percent declining-balance method. The case came before the Tax Court to decide whether this change was permissible without the Commissioner's consent.

Issue(s)

1. Whether a taxpayer, having initially selected an incorrect method of depreciation, may adopt a different acceptable method without the Commissioner's consent if the original method was never 'regularly' used.

Holding

1. Yes, because the taxpayer had not 'regularly' used the double declining-balance method, it could adopt the 150-percent declining-balance method without the Commissioner's consent.

Court’s Reasoning

The court reasoned that the regulation under Section 1. 167(b)-1(a) does not mandate that a taxpayer use the straight-line method after an erroneous election of an accelerated method. The court highlighted that since the taxpayer had never ‘regularly’ used the double declining-balance method due to its inapplicability from the outset, it was not changing its method of accounting under Section 446(e), which requires the Commissioner’s consent for such changes. The court emphasized the policy behind the liberalized depreciation methods, noting that an ‘all or nothing’ approach would undermine the intent of Section 167(b) and (c). The decision also distinguished this case from others where taxpayers had regularly used an acceptable method before seeking a change. The court concluded that the 150-percent declining-balance method, conceded to be reasonable by the Commissioner, could be adopted without further consent.

Practical Implications

This decision provides taxpayers with greater flexibility in correcting initial errors in depreciation method selection. It clarifies that if an initially chosen method was never ‘regularly’ used due to its inapplicability, taxpayers can switch to another acceptable method without needing the Commissioner’s consent. This ruling impacts how tax practitioners advise clients on depreciation strategies, particularly in the initial years of property acquisition. It also influences how the IRS administers depreciation-related regulations, potentially reducing the strictness of its approach to method changes. Businesses can plan their tax strategies more confidently, knowing they have options if an initial depreciation method proves incorrect. Subsequent cases and IRS guidance have referenced this decision in discussing the flexibility of depreciation method changes.

