Action on Decision 1996-009

SUBJECT: Richard L. and Fiona Simon v. Commissioner,
68 F.3d 41 (2d Cir. 1995), aff'g 103 T.C. 247 (1994)

ISSUE: Whether professional musicians are entitled under I.R.C. § 168 to depreciate their antique musical instruments used in their trade or business, notwithstanding that the instruments have no determinable useful lives.

DISCUSSION : The taxpayers claimed depreciation deductions for two nineteenth-century violin bows used in their careers as professional musicians. The instruments were purchased and placed in service during the taxable years governed by the accelerated cost recovery system (ACRS). The taxpayers claimed depreciation deductions as determined under I.R.C. § 168(b) with respect to 5-year recovery property. The Service disallowed taxpayers' depreciation deductions in full. See also Liddle v. Commissioner, 65 F.3d 329 (3d Cir. 1995), aff'g 103 T.C. 285 (1994) (depreciation deduction allowed for a seventeenth-century bass viol).

Section 167(a), which provided a "reasonable allowance" for depreciation, was amended to provide that the deduction allowable under section 168 shall be deemed to constitute such reasonable allowance. Section 203(a) of the Economic Recovery Tax Act of 1981 (ERTA), Pub. L. No. 97-34, 1981-2 C.B. 283. Section 168 (added to the Code by section 201(a) of ERTA, 1981-2 C.B. 275) established the ACRS method of depreciation. Under section 168, the cost or other basis of eligible property was recovered using an accelerated method of depreciation over a predetermined recovery period. Eligible property, i.e., "recovery property", was assigned to one of five classes of property each with its own designated recovery period. I.R.C. § 168(c). The term "recovery property" was defined as "tangible property of a character subject to the allowance for depreciation." I.R.C. § 168(c)(1).

Prior to the enactment of ACRS, the concepts of useful life and salvage value were factors to be considered in determining the eligibility of an asset for a depreciation deduction. The amount of depreciation was limited to the cost or other basis of the property less a reasonable estimate for salvage value. The useful life was determined based on the facts and circumstances or under an asset depreciation range. See former I.R.C. § 167(m), section 109(a) of the Revenue Act of 1971, Pub. L. No. 92-178, 1972-1 C.B. 443, 450. Although ACRS statutorily eliminated the concept of salvage value by permitting the entire cost of an assetto be recovered, I.R.C. § 168(b), it did not diverge from the concept that to be entitled to depreciation, property had to have a determinable useful life.

The dispute is whether taxpayers' antique musical instruments constitute "recovery property" as defined in section 168(c)(1). Resolution of that question depends upon the meaning of the phrase "property of a character subject to the allowance for depreciation." The government argued that antique musical instruments that do not have a determinable useful life are not "of a character subject to the allowance for depreciation."

The Tax Court construed the phrase "property of a character subject to the allowance for depreciation" as including any property used in a trade or business that is subject to exhaustion, wear and tear or obsolescence, even if such property has an indeterminable useful life and concluded that the musical instruments were subject to wear and tear and thus depreciable. The Second Circuit (Simon) and the Third Circuit (Liddle) affirmed the Tax Court.

It is the Service's position that the enactment of ACRS merely shortened the recovery period over which an asset is depreciated to stimulate economic growth but did not convert assets that formerly were not depreciable into assets that are depreciable. The Senate Report, in discussing property that is depreciable under section 168, notes that "assets that do not have a determinable useful life and that do not decline in value predictably are not depreciable." S. Rep. No. 144, 97th Cong., 1st Sess. 39 (1981), 1981-2 C.B. at 421. See also H. Conf. Rep. No. 215, 97th Cong., 1st Sess. 196 (1981), 1981-2 C.B. 481.

Despite substantial statutory revisions that modify the accelerated cost recovery system (MACRS) and delete the term "recovery property," section 201(a) of the 1986 Act, Pub. L. No. 99-514, 1986-3 C.B. (Vol. 1) 38, the adverse decision in Simon impacts on property placed in service after 1986. See Selig v. Commissioner, T.C. Memo. 1995-519 (MACRS would not reinstate the determinable useful life requirement that the court previously had determined was eliminated with the enactment of ACRS).

Since there is no conflict among the circuits, no petition for certiorari was recommended. We believe that the Simon and Liddle cases are wrongly decided and the issue should be pursued in other circuits.

RECOMMENDATION: Nonacquiescence.

Andrea Tucker, Attorney, P&SI Branch

Approved: STUART L. BROWN, Chief Counsel

By: HARVE M. LEWIS, Senior Technician Reviewer

Passthroughs & Special Industries Branch

Field Service Division

By: JUDITH C. DUNN, Associate Chief Counsel

(Domestic)