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Depreciation and Depletion in Relation to Invested Capital

BY WILLIAM B. GOWER

Some interesting questions arise from treasury requirement (reg. 45 rev. art. 838) that the earned surplus and undivided profits of a corporation, forming part of its invested capital for purposes of profits tax calculations, must be "true" and must accord "full recognition" of all expenses and losses from the time of organization down to the taxable year, including depreciation of property and depletion of natural resources.

We are concerned particularly with the question as to what constitutes "true earned surplus and undivided profits" and what constitutes "full recognition" of depreciation and depletion of property during the period, be it long or short, covered by the entire life of the corporation down to the taxable year; whether present day rules adopted by the treasury for computing depreciation and depletion under the revenue act of 1918 are applicable necessarily to the anterior economic period during which a corporation accumulated its earnings and surplus; whether the prevailing tendency towards enhanced values of depreciable property (using the term "value" in either of its two different meanings of "value in use" and "value in exchange") has any bearing on the subject; and whether the present condition and value of depreciable property is a factor in the reckoning.

In order to understand clearly the treasury rule as to the bearing of depreciation of tangible property and depletion of property upon the invested capital of a corporation, it is necessary to state first the four elements which constitute invested capital, as defined by the statute. Broadly speaking, they consist of assets acquired with or represented by:

- (a) The cash paid in for stock;
- (b) The tangible property paid in for stock;
(at a value not exceeding actual cash value at the time of payment);
- (c) The paid-in and earned surplus and undivided profits;
- (d) The intangible property paid in for stock
(within limitations).

Neither the statutory definition of the elements (a), (b) and (d) of invested capital nor the treasury regulations appear to contemplate, either by direct expression or by implication, any diminution of these elements, per se, as expressions of original investments in depreciable property. So far as these three elements of invested capital are concerned, the present condition of depreciable property appears to be of no consequence—it may be abandoned or in ruins without affecting these elements. Apparently neither expiration of a portion of its useful life nor deterioration nor the complex of agencies working for impairment and destruction need be taken into consideration. Nor, on the other hand, is any expansion of these elements of invested capital permitted by reason of the action of natural and economic forces which may have resulted in appreciation over original cost-value. In a word, the present condition of property and its present value seem to have no bearing whatever upon these three elements of invested capital.

The view of the treasury regulations is that the remaining element of invested capital—(c) “earned surplus and undivided profits, not including surplus and undivided profits earned during the year”—is the one to which we must look for recognition of depreciation and depletion of property.

REGULATION: Only true earned surplus and undivided profits can be included in the computation of invested capital, and if for any reason the books do not properly reflect the true surplus such adjustments must be made as are necessary in order to arrive at the correct amount.

In the computation of earned surplus and undivided profits full recognition must first be given to all expenses incurred and losses sustained from the original organization of the corporation down to the taxable year, including among such expenses and losses reasonable allowances for depreciation, obsolescence or depletion of property (irrespective of the manner in which such property was originally acquired) and for the amortization of any discount on its bonds.

There can of course be no earned surplus or undivided profits until any deficit or impairment of paid-in capital due to depletion, depreciation, expense, losses or any other cause has been made good.

Before examining this regulation in detail we might point out that it would apply, undoubtedly, not only to corporations which claimed an earned surplus and undivided profits as part of their invested capital, but also to corporations which had distributed all their earnings to the shareholders and did not claim an existing surplus as part of their invested capital. In the latter event, if inadequate recognition of depreciation and depletion had occurred

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in the profit and loss account, it would be held that a liquidation of capital had taken place, to which full effect must be given in reckoning invested capital under article 860 of the regulations.

(1) The opening phrase of the regulation insists that the earned surplus and undivided profits which a corporation claims as part of its invested capital shall be "true." There is no distinction of fundamental character between "earned surplus" and "undivided profits," for surplus is merely profits reserved from distribution. Broadly speaking, they represent in combination the accretions of wealth during the economic period derived from business conduct and dealings in property, as distinct from accretions derived from mere accessions of capital or from borrowed funds. The accretions of wealth must have been earned and must be in possession. It is in the sense of these necessary attributes of earned surplus and undivided profits that the treasury regulation applies the adjective "true" in the opening phrase.

The accretions of corporate wealth from the date of organization down to the taxable year are expressed by the difference between the total of the assets (less liabilities) at the beginning of the taxable year and the corresponding total at the commencement of corporate operations. To the accountant it is a comparison of balance-sheets and carries with it all the debatable questions which surround assets and the principles of their valuation. The main problems are well known namely:

- (a) What items may be taken in as assets?
- (b) What expenditures may be included in their cost price?
- (c) In subsequent revaluations of assets, shall they be put down at the original acquisition price or the current market price or the present value in use to the corporation or the liquidating value or some other value?

For our immediate purpose we need consider only the one question as to the value to be placed in the balance-sheets on depreciable property, the so-called "fixed assets," by which are meant those which are acquired for permanent or long-continued use as instruments of production and service. The accounting rule is that in preparing the comparative balance-sheets for the purpose of verifying accumulated earnings over a given period, the fixed assets must appear consistently in each balance-sheet at their cost-value, that is to say not in excess of the cash paid

for them or in excess of the fair value at the time of acquisition if stock was issued in payment. Further, that changes in market value of fixed assets, the maintenance of which is provided for, may be ignored; but that depreciation (in the sense of amortization of cost-value, less estimated salvage) must always be taken into account. This accounting rule was adopted and has received general acceptance, in spite of the admitted objection that cost-value is no criterion of "value to a going concern" at a subsequent date.

Even though the established accounting rule were set aside, and depreciable property were valued in a later balance-sheet at a figure substantially greater than its cost-value or fair value at the time of acquisition—say at its estimated present worth—the difference would be considered an unrealized value-appreciation or increment which, as an accretion of corporate wealth, would not be accepted by the treasury as "earned surplus" or "undivided profits."

Let us assume the problems of valuation of assets in the balance-sheet solved by applying in each instance the principles which find the greatest support from the courts and recognized accounting practice and assume the extent of accretions of corporate wealth determined. We reach then the difficult questions involved in classifying the derivation of the accretions and determining what portion was derived from "earnings" and "profits," as distinct from other sources.

To the accountant, it is no longer a comparison of balance-sheets, assets and liabilities, but an examination of the complementary record contained in the summary of the economic accounts (profit and loss, surplus, distribution) from the date of corporate organization down to the beginning of the taxable year. Here again many debatable questions arise, for there are no exact and invariable standards of measurement accepted by the courts, financiers, accountants and economists. The difficulty increases with the length of the economic period during which the accumulations of earnings arose, which may be years or decades.

In the study of the economic summary the problems may be divided broadly between those relating to the credit side (we may instance the question whether or not realized and unrealized ap-

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preciation of property values is earned surplus) and those relating to the debtor side, losses, expenses, charges and outlays.

The emphasis in the treasury regulation which we are now considering is on the debtor side of the accounts in the economic summary, the only reference to the credit side being contained in the opening caution that earned surplus and undivided profits must be "true."

(2) In dealing with the debtor side of the accounts in the economic summary (losses, expenses, charges and outlays) the treasury regulation confines itself to a requirement and an opinion. It requires "full recognition" of all expenses incurred and losses sustained from the organization of a corporation down to the taxable year, including depreciation, depletion, obsolescence and discount. It states an opinion that there can be no earned surplus or undivided profits until any deficit or impairment of paid-in capital due to any cause whatever has been made good.

Concerning the requirement for full recognition of expenses and losses as charges against the profit and loss account, accountants will assent, provided the expenses and losses are restricted to those which accounting practice recognizes as proper charges to profit and loss. For instance, there are certain losses, such as those arising from fire, shipwreck, default of capital investments, exploitation of natural resources, etc., which may be regarded as a loss of capital, rather than a loss of profits. Neither the decisions of our courts nor the practice of accountants confirms the opinion of the treasury regulation that there can be no profits until any deficit or impairment of paid-in capital, due to any cause whatever, has been made good. The accounting position has been stated by Professor Hatfield with concise and admirable lucidity in his standard work *Modern Accounting*, and his conclusion may be quoted:

It may be logical to claim that *all* losses or gains, however caused, should go to profit and loss, and not direct to some other proprietorship account. But such a claim, while logical enough, does not at all conform to accounting practice of any land or time.

The form of expense which we term depreciation, however, is recognized by accounting practice as a necessary charge against profits; but the recognition is not so general in the case of depletion. We have now to consider what constitutes full recognition of these expenses from the organization of a corporation down to the taxable year.

DEPRECIATION OF TANGIBLE PROPERTY

It has been said that the debtor side of the accounts in the economic summary contains the expressions of the decreases in corporate wealth which take place contemporaneously and necessarily in the efforts to increase the corporate wealth. This is a sufficiently correct generalization when applied to the entire economic life of a corporation, from organization to final liquidation, considered as an entity. It requires modification, however, when applied to each accounting period or year, the sum of which constitutes the operating history of the corporation. Particularly is this so in regard to periodic charges to profit and loss for the amortization of prepaid expenses and anticipation accounts and for the destruction of cost-value of fixed assets, for these periodic charges do not necessarily connote contemporaneous and commensurate decreases of wealth.

The cost-value of an instrumentality of production and service, a fixed asset acquired for long-continued use, less the net proceeds of final disposal, in an expense appertaining to the period of its useful life considered as a unit of time, because a decrease of wealth takes place. Custom demands, however, that this unit of time be divided into yearly portions and accounts be stated for each year. The decrease of wealth inevitable in the instrumentality does not take place, strictly speaking, until its usefulness is ended; for its value to the going concern is rarely less than its cost-value so long as it functions and provision is made for its maintenance. But the fact that the corporation suffers no decrease of wealth while the instrumentality functions and its maintenance is provided for does not constitute a sound reason for allotting the expense to the final year—one reason being that the instrumentality assists in producing revenue throughout its years of useful life, and it is only right that when this revenue is apportioned to yearly periods there should be charged against it some portion of the inevitable future decrease of wealth involved in the purchase and demise of the instrument. These apportioned charges year by year constitute what we term the expense for depreciation, and they are anticipations of future decreases of wealth.

These annual expenses for depreciation of tangible property, therefore, do not necessarily connote contemporaneous and equiva-

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lent decreases of corporate wealth, but represent instalments in anticipation of future inevitable decreases of wealth, which will occur when the useful life of the property terminates. To justify these annual expense charges there must be a reasonable degree of certainty as to the occurrence in the future of a decrease of wealth by reason of the termination of the useful life of the property—in other words, that the proceeds of ultimate disposal will be less than cost-value.

Economists have a theory which is built up from the premise that fixed assets yield a series of fairly uniform services for a fairly fixed term of years. From this premise they argue that an analogy exists to a terminable annuity, the annual instalments of which represent the value of the services rendered during the year by the fixed assets. They conclude, therefore, that the fixed assets have a capital-value, that is to say the discounted value of the annual instalments of valued future services. They regard this capital-value as diminishing progressively as the date for the termination of the service approaches, and this progressive decline in capital-value is the depreciation of the fixed assets. All this is ingenious, no doubt, but the ground is too slippery for accounting practice. We have troubles enough in our work without concerning ourselves with "series of fairly uniform services" or abstract "values" of such services or analogies which lead us to the quagmire of "capital-values."

There is no connection, necessarily, between these annual expenses which we term depreciation and any fluctuations in value of the property during its term of life. To represent annual depreciation charges as the registration of contemporaneous decline in value is fallacious. No matter what concept of "value" is used, whether fair market value, liquidating value, value in use, or any other, mere fluctuations and changes during the term of useful life of property are disregarded in accounting, because the going concern is not affected thereby. The present value in use of a manufacturing plant erected in 1914 may be several times its cost-value; but this is not a phenomenon to be reflected in the economic accounts, nor does it warrant the discontinuance of annual provision through depreciation charges for the decrease in corporate wealth which is inevitable in the future, when its useful life is ended. Nor, if the present liquidating value of the

plant be only one-half of its cost-value, does it warrant the assumption that one-half of the cost-value should have been provided to date by depreciation charges against the income, unless, by chance, one-half of the useful term of life has expired.

The accumulated depreciation allowances at a given date do not pretend to measure a supposed diminution in value of the property since its acquirement; for if the useful life of the property is in full swing there is no decrease of corporate wealth which the accountant is called upon to recognize. Subtracting the accumulated depreciation from the cost-value of the property does not give a remainder which pretends to reflect present value, whether fair market value, liquidating value or utility value.

Accountants are responsible in a large measure for the prevailing erroneous ideas on this subject, for accounting literature is saturated with them, such as that present value of depreciable property is necessarily reflected in a balance-sheet; that the use of depreciable property compels a continuous and progressive shrinkage in its value; that depreciation allowances year by year reflect and measure this supposititious shrinkage in value, and that each annual instalment is a contemporaneous loss of some kind. The progress toward correct thinking on this subject cannot be better illustrated than by contrasting the language of the treasury regulations of 1914, 1918 and 1919, and observing the fundamental change:

Reg. 33 Jan. 5, 1914.

The deduction for depreciation should be the estimated amount of the *loss*, accrued during the year to which the return relates, *in the value of the property* in respect of which such deduction is claimed, that arises from . . .

Reg. 33 rev. Jan. 2, 1918.

The deduction for depreciation should be the amount of the *loss* occurring during the year to which the return relates, estimated on the cost of the physical property with respect to which such deduction is claimed, which loss results from . . .

Reg. 45 rev. 1919.

The necessity for a depreciation allowance arises from the fact that certain property used in the business gradually approaches a point where its usefulness is exhausted. . . . The capital sum to be replaced should be charged off over the useful life of the property either in equal annual instalments or in accordance with any other recognized trade practice.

In order to determine whether or not full recognition has been given in the profit and loss account to the expense known as depreciation of tangible property at a given date, we require only the following data: (a) the cost-value, (b) the probable amount

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to be realized upon termination of useful life, (c) the term of useful life and (d) the expired term of useful life. Expressed algebraically the formula is

$$\frac{d(a - b)}{c}$$

The present-day value of the property does not enter into the question at all, except indirectly as bearing upon the factor (b), the probable amount to be realized upon liquidation when the useful life of the property ends, and perhaps to some slight extent in affecting the time when the property will be disposed of.

This basis of reckoning the expense known as depreciation of tangible property, in order to determine whether or not it has been fully recognized in the earned surplus at a given date, applies, even though in years subsequent to 1908 a corporation may have used a valuation higher than cost-value of the property in computing depreciation and reporting net income under the excise tax law of 1909 and subsequent income and profits tax laws. In recent years depreciation has been computed in many cases upon the fair market value of property as of March 1, 1913. This value was frequently higher than cost-value.

In such cases there has been recognition of two separate and distinct concepts—the first, an expense representing anticipated decrease of wealth based on extinguishment of cost-value; the second, recognition of another element which is not an accounting expense, but an allowance out of gross income to replace an arbitrary capital-value existing at March 1, 1913, being the appreciation in value of property at that date over its cost-value. The term depreciation is used to cover both elements, but there is a sharp differentiation between the two, for one is an element of true corporate expense, which must be recognized invariably in the economic accounts, while the other element is a mere allowance, an artificial product of income-tax legislation, born with the income tax, and assured of oblivion at its demise.

The existence of these two elements in present-day depreciation, the one a natural corporate expense, the other an artificial allowance out of receipts designed to recover appreciation in value at March 1, 1913, over original cost, is recognized expressly in article 844 of the regulations. The language of this article confirms, unreservedly, our opinion that in computing earned surplus

and undivided profits which may be included as invested capital, the reckoning of depreciation of tangible property is full and complete when based on cost-value. If a basis higher than cost has been used, and the surplus account has been reduced accordingly, the excess "may be treated as surplus and included in the computation of invested capital, if undistributed and used and employed in the business."

To sum up: the present condition and value of depreciable property has no bearing whatever upon corporate invested capital, nor is there any necessary relation between so-called depreciation allowances and changes in value of property to which such allowances relate. Tangible property may be included in invested capital at its full cost-value, no matter what its present condition and value is; but in certain cases, a portion of this cost-value must be deducted from invested capital. The cases referred to are those wherein the net assets which constitute the entire admissible invested capital, considered as an entity, were derived not only from paid-in capital but from earned surplus and undivided profits. In that event the amount representing the earned surplus and profits must be tested to see that a deduction has been made therefrom for the cost-value of property which has been used up and for a ratable share of cost-value (less estimated proceeds of final disposal) of property which remains in use, whose end is certain.

Stated in another way, no greater deduction from the earnings and profits accumulated by a corporation down to the taxable year is required, in the case of depreciable property, than would be required by a court of law in proceedings which involved the ascertainment of earnings and profits during the period—that is to say, the depreciation need not be based upon a value higher than cost-value.

DEPLETION OF NATURAL RESOURCES

The revenue act of 1918 provides that in computing taxable income there may be deducted a reasonable allowance for the depletion of natural resources, according to the peculiar conditions of each case, based upon cost, or in certain eventualities upon a higher value.

The interpretation which the treasury regulations give to depletion is that it involves the recovery or extinction or amortiza-

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tion of a given capital sum out of income; and to this extent, and in this particular only, depletion is regarded as analogous to depreciation.

The treasury rule governing the allotment by years of the capital sum recoverable through depletion allowances is entirely different from the rule for the corresponding yearly allotment of depreciation of property. We have seen that the rule in the yearly allotment of depreciation requires a more or less equal share apportioned to each and every year of useful life. Specifically, the controlling factor is the time the wealth will last, in terms of consecutive years.

Nor is the allotment rule adopted by the treasury for depletion one which is accepted by accountants in apportioning to years any form of prepaid expenses, deferred charges to operation, bond discount or similar amortization, in all of which the number of consecutive years is controlling.

Neither did the treasury adopt an allotment rule for the depletion of natural deposits similar to that applied where a tract of land is purchased, divided into parcels and sold. The rule in that case requires an equitable apportionment of the capital sum among the several parcels and an extinguishment of the capital according to the respective lots sold. There are some analogies between the two classes of transactions which may not have received due consideration.

The treasury adopts as the governing rule in the yearly allotment of the capital sum representing the investment in natural resources the accounting method which would be applied to the ordinary purchase and consumption of a definitely known stock of materials (such as a quantity of pig iron or bricks or other commodity of uniform character and quality) which may be measured in its own special unit, the accessibility of each unit known within limits, the measurement of the three magnitudes of wealth (quantity, unit price and value) capable of being stated with reasonable accuracy, and where a diminution in quantity connotes a directly proportionate diminution in the fund capital. The allotment of the fund capital is made only to those years in which a diminution in quantity takes place, and the value extinguished in a given year is in direct proportion to the quantity removed during the year.

Certain investments in natural resources resemble closely the ordinary purchase and consumption of a stock of materials, and all the characteristics of such a transaction, as described above, are reproduced with reasonable approximation. The valuable content is known and determinable at the time of acquirement; it is the basis of the purchase; and there are no subsequent new discoveries.

But the great majority of investments in natural resources, particularly mineral deposits, do not fulfil originally the conditions or exhibit the characteristics of an ordinary purchase of a stock of materials for consumption in productive processes; the measurement of the three magnitudes of wealth (quantity, unit price and value) at the time of acquirement cannot be stated even approximately; nor is there a direct proportion between diminution in the number of valuable units and diminution in the nominal fund capital. In particular, these investments in mineral deposits frequently exhibit the phenomenon through long periods of time of a removal of large quantities of valuable contents unaccompanied by any shrinkage in the fund capital. The majority of these investments in natural resources contains two separate and distinct elements, the relative size of the elements varying with the character of the property and other extraneous conditions. One of these elements (the product in sight or reasonably certain) may resemble in some respects the ordinary purchase of a stock of materials; but the second element, frequently the larger of the two, is essentially different, for it is a speculation in future discoveries.

In order to put this latter class (the great majority) of investments in natural resources on a parity with the smaller class previously mentioned, and in order to maintain the analogy to the ordinary purchase and consumption of a stock of materials, the speculative element in the majority class has been specifically recognized in the revenue act of 1918, which provides that new discoveries of natural resources shall be taken into the reckoning of depletion at their fair market value at the date of discovery or within 30 days thereafter.

LAW: section 234 (a 9). In the case of mines, oil and gas wells, discovered by the taxpayer on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value

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of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery or within thirty days thereafter.

The word mine has two different meanings, one being applied to a body of ore whether it is being worked or not and the other applying to the underground openings which furnish entry to the mine, facilitate searching for ore and open avenues for extraction. From the context of the law it is evident that the word mine is used in the sense of a commercially valuable deposit of ore or mineral, and this meaning is adopted in the regulations.

It is not so easy to decide the sense in which the term discovery is used in the statute, but evidently it must be read with the context calling for ascertainment of the fair market value of the property discovered, which demonstrates that the term imports the process of uncovering a commercially valuable deposit of ore or mineral through development, and not merely locating an ore body by prospecting.

Such discovery of mineral deposit is not limited to new prospects and mining claims, previously unproductive, but applies equally to development of unproved ore and minerals in a producing mine; for the statutory limitation excluding "purchase of a proven tract" (so far as the mining industry is concerned, where the term proven tract is unknown) can only apply to proved ore in a producing mining claim—that is to say, ore where there is practically no risk of failure of continuity.

Hence it follows that the term discovery as used in the statute, and applicable to mines, must apply to the development of all ore and mineral deposit beyond the range of vision and in the case of producing mines would cover the entire prospective value to be developed by extension of the deposit beyond a short distance from the last opening.

The development of this prospective value of a mineral deposit is a more or less continuous process, dependent upon a variety of conditions, such as the character of the deposit, the smelting or treatment capacity, the market for the product, the management, finance, business policy, etc. It follows that the discovery of commercial ore and minerals, whether in the prospecting or producing stage, is continuous in character, and the date of discovery (which the statute requires to be established) is an equally continuous affair.

All this is practical acceptance of the theory of depletion of mines set out at length by the writer in *THE JOURNAL OF ACCOUNTANCY*, August, 1918, in which it was contended that the fund capital to be returned is the intrinsic value of the content (in place, en bloc) which existed from the beginning, although much of it may have been latent, and determined only by "extension in depth"; and that the amount of depletion to be taken in each year during which valuable content is removed must be the number of units removed in the year multiplied by a more or less constant unit rate.

But while the original intrinsic value of the mineral deposit which existed from the beginning (in place, en bloc) is thus effectively recognized as the total fund capital to be returned through depletion allowances, on a basis of yearly allotment analogous to the accounting treatment for consumption of an ordinary stock of materials, this original intrinsic value has not yet been recognized by the regulations as invested capital for profits tax purposes. Under the regulations a corporation may not include the mineral property as invested capital at a greater sum than actual cost, if purchased for cash, or to a greater extent than the developed and ascertained value at the time of acquirement, if purchased for stock. It seems to us, however, that in these limitations upon invested capital the regulations do not interpret the statute reasonably; and that original intrinsic value of natural resources at the time of acquirement, whether actually known at the time or developed subsequently, is true paid-in surplus to the extent that original intrinsic value exceeds the nominal cost-value, and is admissible as invested capital under that sub-division.

Until this principle is accepted, however, there will remain constant discrepancies between cost-value of natural deposits (as invested capital) and intrinsic value of the same property (for depletion purposes), with the result of creating a question as to what constitutes "full recognition" of depletion from the time a corporation is organized down to the taxable year, as a charge against earned surplus and undivided profits claimed as a part of invested capital. Specifically the question is this: suppose the case of an investment in natural deposits acquired many years ago at a cost-value of \$2,000,000 (invested capital) and suppose further an original intrinsic value of \$50,000,000 which was not

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fully established until later by new discoveries. Suppose further that one-half of the original intrinsic value has been removed by operations. In that event, is any diminution of the cost-value of \$2,000,000 required by charge against profit and loss?

Obviously not, because depletion is calculated on the same principles as those applying to the consumption of a stock of materials; and until the last \$2,000,000 of valuable content is removed there is no impairment of that purely nominal fund capital.

The \$2,000,000 fund capital is an artificial creation, far removed from the reality of the intrinsic fund capital. Nevertheless, this artificial or nominal fund capital was the basis upon which the accounts were kept and was the basis upon which the profits were calculated which are now claimed as invested capital. It is the basis upon which the balance-sheet must be constructed, in order to verify the accumulated profits; for the natural deposit may not be taken in at a greater value than \$2,000,000. The accumulated profits need not be diminished by depletion until the artificial and nominal fund capital is actually impaired by removal; and it is the last to be removed. Actual impairment of quantity and value is the basis of depletion. Therein it differs from depreciation, wherein the element of time is controlling.

In testing the earned surplus and undivided profits of a corporation from its organization down to the taxable year, in order to see that full recognition has been accorded throughout those years to the loss from depletion of natural resources, we do not see that any greater amount is called for than would be required by a court of law in any proceedings which involved stating the earnings of that period. The amount would be the ascertained impairment of the nominal fund capital, if impairment had taken place, and no more.

In conclusion, the true earned surplus and undivided profits of a corporation at a given date are the difference between the assets and unadjusted debits at that date, valued according to accepted accounting rules and excluding unearned increment, and the amount of the liabilities, unadjusted credits and nominal capital, similarly reckoned. So long as the statement conforms to accepted accounting practice, it need not be modified by rules

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adopted specially for the administration of an income or profits tax measure. The revenue act of 1918, in allowing earned surplus and undivided profits as part of the invested capital of a corporation, does not qualify, limit or restrict the sense in which the terms earnings and profits are employed, and we must assume that they have their usual significance.