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of depreciation, i.e., the group, classified, or composite rate used for the entire account. In the case of group accounts, i.e., accounts containing assets which are similar in kind and which have approximately the same estimated useful lives, the group rate is determined from the average of the useful lives of the assets. In the case of classified or composite accounts, the classified or composite rate is generally computed by determining the amount of one year's depreciation for each item or each group of similar items, and by dividing the total depreciation thus obtained by the total cost or other basis of the assets. The average rate so obtained is to be used as long as subsequent additions, retirements, or replacements do not substantially alter the relative proportions of different types of assets in the account. An example of the computation of a classified or composite rate follows:

Cost or other basis	Estimated useful life (years)	Annual depreciation
\$10,000	5	\$2,000
10,000	15	667
20,000		2,667

Average rate is 13.33 percent (\$2,667÷\$20,000) unadjusted for salvage. Assuming the estimated salvage value is 10 percent of the cost

or other basis, the rate adjusted for salvage will be 13.33 percent minus 10 percent of 13.33 percent (13.33% - 1.33%), or 12 percent.

*Example (3).* The use of the straight line method for group, classified, or composite accounts is illustrated by the following example: A taxpayer filing his returns on a calendar year basis maintains an asset account for which a group rate of 20 percent has been determined, before adjustment for salvage. Estimated salvage is determined to be 6 2/3 percent, resulting in an adjusted rate of 18.67 percent. During the years illustrated, the initial investment, additions, retirements, and salvage recoveries, which were determined not to change the composition of the group sufficiently to require a change in rate, were assumed to have been made as follows:

- 1954—Initial investment of \$12,000.
- 1957—Retirement \$2,000, salvage realized \$200.
- 1958—Retirement \$2,000, salvage realized \$200.
- 1959—Retirement \$4,000, salvage realized \$400.
- 1959—Additions \$10,000.
- 1960—Retirement \$2,000, no salvage realized.
- 1961—Retirement \$2,000, no salvage realized.

DEPRECIABLE ASSET ACCOUNT AND DEPRECIATION COMPUTATION ON AVERAGE BALANCES

Year	Asset balance Jan. 1	Current additions	Current retirements	Asset balance Dec. 31	Average balance	Rate (per cent)	Allowable depreciation
1954		\$12,000		\$12,000	\$6,000	18.67	\$1,120
1955	\$12,000			12,000	12,000	18.67	2,240
1956	12,000			12,000	12,000	18.67	2,240
1957	12,000		\$2,000	10,000	11,000	18.67	2,054
1958	10,000	2,000	8,000	9,000	11,000	18.67	1,680
1959	8,000	10,000	4,000	14,000	11,000	18.67	2,054
1960	14,000		2,000	12,000	13,000	18.67	2,427
1961	12,000		2,000	10,000	11,000	18.67	2,054

CORRESPONDING DEPRECIATION RESERVE ACCOUNT

Year	Depreciation reserve Jan. 1	Depreciation allowable	Current retirements	Salvage realized	Depreciation reserve Dec. 31
1954		\$1,120			\$1,120
1955	\$1,120	2,240			3,360
1956	3,360	2,240			5,600
1957	5,600	2,054	\$2,000	\$200	5,854
1958	5,854	1,680	2,000	200	5,734
1959	5,734	2,054	4,000	400	4,188
1960	4,188	2,427	2,000		4,615
1961	4,615	2,054	2,000		4,669

§ 1.167(b)-2 Declining balance method.

(a) *Application of method.* Under the declining balance method a uniform

rate is applied each year to the unrecovered cost or other basis of the property. The unrecovered cost or other basis is the basis provided by section

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167(g), adjusted for depreciation previously allowed or allowable, and for all other adjustments provided by section 1016 and other applicable provisions of law. The declining balance rate may be determined without resort to formula. Such rate determined under section 167(b)(2) shall not exceed twice the appropriate straight line rate computed without adjustment for salvage. While salvage is not taken into account in determining the annual allowances under this method, in no event shall an asset (or an account) be depreciated below a reasonable salvage value. However, see section 167(f) and § 1.167(f)-1 for rules which permit a reduction in the amount of salvage value to be taken into account for certain personal property acquired after October 16, 1962. Also, see section 167(c) and § 1.167(c)-1 for restrictions on the use of the declining balance method.

(b) *Illustrations.* The declining balance method is illustrated by the following examples:

*Example (1).* A new asset having an estimated useful life of 20 years was purchased on January 1, 1954, for \$1,000. The normal straight line rate (without adjustment for salvage) is 5 percent, and the declining balance rate at twice the normal straight line rate is 10 percent. The annual depreciation allowances for 1954, 1955, and 1956 are as follows:

Year	Basis	Declining balance rate (percent)	Depreciation allowance
1954 .....	\$1,000	10	\$100
1955 .....	900	10	90
1956 .....	810	10	81

*Example (2).* A taxpayer filing his returns on a calendar year basis maintains a group account to which a 5 year life and a 40 percent declining balance rate are applicable. Original investment, additions, retirements, and salvage recoveries are the same as those set forth in example (3) of paragraph (b) of § 1.167(b)-1. Although salvage value is not taken into consideration in computing a declining balance rate, it must be recognized and accounted for when assets are retired.

**DEPRECIABLE ASSET ACCOUNT AND DEPRECIATION COMPUTATION USING AVERAGE ASSET AND RESERVE BALANCES**

Year	Asset balance Jan. 1	Current additions	Current retirements	Asset balance Dec. 31	Average	Average reserve before depreciation	Net depreciable balance	Rate (pct.)	Allowable depreciation
1954 .....		\$12,000		\$12,000	\$6,000		\$6,000	40	\$2,400
1955 .....	\$12,000			12,000	12,000	\$2,400	9,600	40	3,840
1956 .....	12,000			12,000	12,000	6,240	5,760	40	2,304
1957 .....	12,000		\$2,000	10,000	11,000	7,644	3,356	40	1,342
1958 .....	10,000		2,000	8,000	9,000	7,186	1,814	40	726
1959 .....	8,000	10,000	4,000	14,000	11,000	5,212	5,788	40	2,315
1960 .....	14,000		2,000	12,000	13,000	4,727	8,273	40	3,309
1961 .....	12,000		2,000	10,000	11,000	6,036	4,964	40	1,986

**DEPRECIATION RESERVE**

Year	Reserve Jan. 1	Current retirements	Salvage realized	Reserve Dec. 31, before depreciation	Average reserve before depreciation	Allowable depreciation	Reserve Dec. 31, after depreciation
1954 .....						\$2,400	\$2,400
1955 .....	\$2,400			\$2,400	\$2,400	3,840	6,240
1956 .....	6,240			6,240	6,240	2,304	8,544
1957 .....	8,544	\$2,000	\$200	6,744	7,644	1,342	8,086
1958 .....	8,086	2,000	200	6,286	7,186	726	7,012
1959 .....	7,012	4,000	400	3,412	5,212	2,315	5,727
1960 .....	5,727	2,000		3,727	4,727	3,309	7,036
1961 .....	7,036	2,000		5,036	6,036	1,986	7,022

Where separate depreciation accounts are maintained by year of acquisition and there is an unrecovered balance at the time of the last retirement, such unrecovered balance

may be deducted as part of the depreciation allowance for the year of such retirement. Thus, if the taxpayer had kept separate depreciation accounts by year of acquisition

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and all the retirements shown in the example above were from 1954 acquisitions, depreciation would be computed on the 1954 and 1959 acquisitions as follows:

1954 ACQUISITIONS

Year	Asset balance Jan. 1	Acquisitions	Current retirements	Asset balance Dec. 31	Average balance	Avg. reserve before depreciation	Net depreciable balance	Rate (percent)	Allowable depreciation
1954		\$12,000		\$12,000	\$6,000		\$6,000	40	\$2,400
1955	\$12,000			12,000	12,000	\$2,400	9,600	40	3,840
1956	12,000			12,000	12,000	6,240	5,760	40	2,304
1957	12,000		\$2,000	10,000	11,000	7,644	3,356	40	1,342
1958	10,000		2,000	8,000	9,000	7,186	1,814	40	726
1959	8,000		4,000	4,000	6,000	5,212	788	40	315
1960	4,000		2,000	2,000	3,000	2,727	273	40	109
1961	2,000		2,000		1,000	836	164		164

<sup>1</sup> Balance allowable as depreciation in the year of retirement of the last survivor of the 1954 acquisitions.

DEPRECIATION RESERVE FOR 1954 ACQUISITIONS

Year	Reserve Jan. 1	Current retirements	Salvage realized	Reserve Dec. 31, before depreciation	Average reserve before depreciation	Allowable depreciation	Reserve Dec. 31, after depreciation
1954						\$2,400	\$2,400
1955	\$2,400			\$2,400	\$2,400	3,840	6,240
1956	6,240			6,240	6,240	2,304	8,544
1957	8,544	\$2,000	\$200	6,744	7,644	1,342	8,086
1958	8,086	2,000	200	6,286	7,186	726	7,012
1959	7,012	4,000	400	3,412	5,212	315	3,727
1960	3,727	2,000		1,727	2,727	109	1,836
1961	1,836	2,000		(164)	836	164	

1959 ACQUISITIONS

Year	Asset balance Jan. 1	Acquisition	Asset balance Dec. 31	Avg. balance	Reserve Dec. 31, before depreciation	Net depreciable balance	Rate percent	Allowable depreciation	Reserve Dec. 31, after depreciation
1959		\$10,000	\$10,000	\$5,000	None	\$5,000	40	\$2,000	\$2,000
1960	\$10,000		10,000	10,000	\$2,000	8,000	40	3,200	5,200
1961	10,000		10,000	10,000	5,200	4,800	40	1,920	7,120

In the above example, the allowable depreciation on the 1954 acquisitions totals \$11,200. This amount when increased by salvage realized in the amount of \$800, equals the entire cost or other basis of the 1954 acquisitions (\$12,000).

(c) *Change in estimated useful life.* In the declining balance method when a change is justified in the useful life estimated for an account, subsequent computations shall be made as though the revised useful life had been originally estimated. For example, assume that an account has an estimated useful life of ten years and that a declining balance rate of 20 percent is applicable. If, at the end of the sixth year, it is determined that the remaining

useful life of the account is six years, computations shall be made as though the estimated useful life was originally determined as twelve years. Accordingly, the applicable depreciation rate will be 16⅔ percent. This rate is thereafter applied to the unrecovered cost or other basis.

[T.D. 6500, 25 FR 11402, Nov. 26, 1960, as amended by T.D. 6712, 29 FR 3653, Mar. 24, 1964]

§ 1.167(b)-3 Sum of the years-digits method.

(a) *Applied to a single asset—(1) General rule.* Under the sum of the years-digits method annual allowances for depreciation are computed by applying