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**Section 179Allowed on Capitalized Orchard and Vineyard Costs**

*After 26 years, the IRS finally acknowledges that Section 179 is allowed on capitalized orchard and vineyard costs*

**Background: The Law Prior to Passage of the Tax Reform Act of 1986**

The allowance of a Section 179 deduction for trees and vineyards was governed by the old Section 179 rules and interpreted by the IRS in Rev. Rul. 67-51. This ruling disallowed the Section 179 deduction because the IRS ruled that trees were part and parcel of the land and, thus, realty. It did, however, allow trees and vineyards to qualify for the old investment tax credit allowed under Section 38.

When Rev. Rul 67-51 was issued, the regulations under Section 179 provided that for purposes of Section 179, the term “tangible personal property” included any tangible property except land, and improvements thereto, such as buildings or other inherently permanent structures thereon. In Rev. Rul 67-51, the IRS concluded that trees and vines are inherently permanent structures attached to the land and did not qualify for Section 179.

**The Law after Passage of the Tax Reform Act of 1986**

Since the issuance of Rev. Rul. 67-51, the definition of Section 179 property has significantly changed. Under Section 179(d)(1), the term “Section 179 property” is property that is:

1. Tangible property to which Section 168 applies or certain computer software;
2. Section 1245 property (as defined in Section 1245(a)(3)); and
3. Acquired by purchase for use in the active conduct of a trade or business.

Section 50(b) specifically disallows certain property such as (1) property used outside the United States, (2) property used in lodging, (3) property used by certain tax-exempt organizations and other property from the rules of Section 179. However, trees and vineyards required to be capitalized under Section 263A are not enumerated in Section 50(b).

For those interested in the technical details, here is how the IRS reasoned that orchards and vineyards meet the three Section 179(d) definitions (but if details bore you, jump to The New IRS Guidance):

**Section 168 applies.** Section 168(e)(3)(D)(ii) states that any tree or vine bearing fruit or nuts is classified as 10-year property. Accordingly, a vineyard or orchard meets the requirement of being tangible property under Section 168.

**Property defined in Section 1245(a)(3).** Section 1245(a)(3) property is property that can be depreciated under Section 167 and is (A) personal property or (B) other property, but only if such other property is tangible and depreciation is allowed during the time the property is used as an integral part of ... production... . Reg. 1.1245-3(c)(2) provides that the language “was used as an integral part of ... production...” has the same meaning as when used in Reg. 1.48-1(a), relating to the definition of property for purposes of the investment tax credit.
Reg. 1.48-1(d)(2) provides that the terms “manufacturing,” “production” and “extraction” include the cultivation of the soil. In addition, Reg. 1.48-1(d)(2) provides that Section 38 property would include, for example, property used as an integral part of the cultivation of orchards, gardens, or nurseries.

If the property (an integral part of the production process) is an inherently permanent structure, the property meets the definition of other tangible property under Reg. 1.48-1(d) and, therefore by cross-reference, the property is other tangible property described in Section 1245(a)(3)(B)(i). Accordingly, a vineyard or orchard meets the definition of being Section 1245 property.

Acquired by purchase. Section 179(d)(2) defines the term “purchase” as meaning any acquisition of property, but only if the property is not acquired from a decedent, related party or the trade-in value under Section 179(d)(2)(A), (B), or (C) (Reg. 1.179-4(c)). CCA 201234024 released on August 24, 2012 now clearly defines that the planting of a vineyard or orchard with costs properly capitalized under Section 263A meets the definition of “purchase.”

The New IRS Guidance: CCA 201234024

In CCA 201234024, taxpayers were individuals who filed Schedule F for a vineyard business activity. In 2005, the taxpayers began planting their vineyard. The costs of land preparation, labor, rootstock, and the planting were capitalized over three years under Section 263A. The land preparation costs claimed did not include any nondepreciable land costs.

In 2009, when the plants became viable, taxpayers placed the vineyard in service and took a deduction under Section 179 for the costs incurred in planting the vineyard.

The CCA cited the analysis above and concluded that any orchard or vineyard costs (either purchased or planted) that do not include any nondepreciable land costs will qualify for the Section 179 deduction. The CCA states that the observations apply to the year 2009 and any subsequent years. It is our opinion that these rules also apply to years before 2009, to the extent those years remain open under the statute of limitations.

Observations

Prior to 2008, the availability of the Section 179 deduction for orchards and vineyards placed in service was extremely limited due to the overall asset addition phase-out limit ($500K to $625K) property cost restrictions. However, for 2008-2009 there was an $800K threshold and for 2010 and 2011 it was a $2.0M to $2.5M phase-out. Thus, many taxpayers may qualify to elect Section 179 on their orchards and vineyards placed in service in recent years, but may not have elected Section 179 because of guidance provided under the old Rev. Rul. 67-51 rules.

Taxpayers who did not take a Section 179 deduction on their planted orchards and vineyards may consider amending their 2009-2011 tax returns (and years previous if not closed under the statute of limitations). If the taxpayer had elected out of Section 168(k) on these vineyards or orchards, by amending their tax returns, they may be able to adjust their taxable income by the elected amount and retain the balance to be depreciated over 10 years.

Additionally, if the taxpayer had elected out of Section 263A, this now allows them to make a late Section 179 deduction election to deduct any “hard” costs capitalized during those years (e.g., trellis, irrigation system and the plants).

Although the IRS is 26 years late in issuing its CCA, at least it updated its interpretation to reflect current rules and has removed Rev. Rul. 67-51 as being applicable. The CCA is a reminder that revenue rulings are not always accurate interpretations of statutes in an environment of ever-changing tax laws.

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