Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Number: **INFO 2001-0289**
Release Date: 12/31/2001
Index Number: 179.00-00

[redacted]

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CC:PSI:6-CONEX-154036-01
Date:

November 1, 2001

Re: Application of the IRC section 179(b)(3) Limitation Rule to a Partnership and its Partners

Dear [redacted]

This letter is in response to your letter, dated August 20, 2001, to the President of the United States, relating to the application of the taxable income limitation rule of section 179(b)(3) of the Internal Revenue Code to a partnership and its partners or a S corporation and its shareholders. We hope that you find the following general information to be helpful.

Section 179(a) of the Code allows a taxpayer to elect to deduct all or part of the cost of qualifying section 179 property in the year the taxpayer places the property in service. A taxpayer can do this instead of recovering the cost by taking depreciation deductions over a specified recovery period.

However, there are limitations under section 179(b) of the Code on the amount a taxpayer can deduct in a year. The total cost of section 179 property (i.e., the maximum dollar limit) a taxpayer can elect to deduct for 2001 is $24,000. See section 179(b)(1). If the cost of a taxpayer's qualifying section 179 property placed in service in a year is over $200,000, the maximum dollar limit is reduced for each dollar over $200,000 (but not below zero). See section 179(b)(2). In applying the taxable income limitation rule under section 179(b)(3), the total cost a taxpayer can deduct each year is limited to the taxable income of the taxpayer derived from the active conduct by the taxpayer of any trade or business during such taxable year.

In the case of a passthrough entity, such as a partnership or a S corporation, that elects to deduct the cost of qualifying section 179 property in the year the entity places the property in service, section 179(d)(8) of the Code provides a special rule for the application of the limitations under section 179(b) to either a partnership and each

of its partners or a S corporation and each of its shareholders. Thus, in light of section 179(d)(8), the term "taxpayer" as it appears in section 179(a) and (b) is viewed as encompassing partnerships and S corporations for purposes of section 179.

With respect to a partnership and each of its partners, section 179(d)(8) allows for the application of the section 179(b) limitations (including the taxable income limitation under section 179(b)(3)) to the partnership and to each of its individual partners. Section 1.179-2(c)(2) of the Income Tax Regulations describes how to apply the taxable income limitation of section 179(b)(3) to a partnership and to each of its partners. Section 1.179-2(c)(2) provides that a partnership may not allocate to its partners as a section 179 expense deduction for any taxable year more than the partnership's taxable income limitation for that taxable year, and a partner may not deduct as section 179 expense deduction for any taxable year more than the partner's taxable income limitation for that taxable year. The Tax Court has held that section 1.179-2(c)(2) is valid. Hayden v. Commissioner, 112 T.C. 115 (1999), aff'd, 204 F.3d 772 (7th Cir. 2000).

The copies of the following materials are enclosed for your reference and the information provided therein may be of interest to you:

(1) Section 179 of the Internal Revenue Code, and

(2) Section 1.179-1 - 1.179-5 of the Income Tax Regulations.

This letter has called your attention to certain general principles of tax law. It is intended for informational purposes only and does not constitute a ruling. See sections 2.01 and 2.04 of Revenue Procedure 2001-1, 2001-1 I.R.B. 4, a copy of which is enclosed. We hope the materials enclosed will be helpful to you; however, if you should have any additional questions or comments, please contact our office at (202) 622-3110.

Sincerely yours,

Kathleen Reed

KATHLEEN REED
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Enclosures (3)