Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Agriculture Technical Specialist
(C:LB&I:PFTG:RFPH)

from: Branch Chief, Branch 7, CC:ITA:7
(Income Tax & Accounting)

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subject: Section 179 for Vineyards

This Chief Counsel Advice responds to a request for assistance dated February 9, 2012. This advice may not be used or cited as precedent.

LEGEND

Taxpayers =

ISSUES

Are Taxpayers, who are individuals, entitled to claim a deduction under § 179 of the Internal Revenue Code with respect to a vineyard they planted in 2005 and placed in service in 2009?

CONCLUSIONS

Because the vineyard constitutes § 179 property and provided Taxpayers have satisfied the limitations and other requirements under § 179, Taxpayers are entitled to elect to expense in 2009 the cost (including capital expenditures made by Taxpayers to develop the vineyard to an income-producing stage) or a portion of the cost of the vineyard under § 179.

FACTS

Taxpayers are individuals who attached Schedule F, Profit or Loss From Farming, to their federal income tax return, claiming to operate a vineyard business activity. In 2005, Taxpayers began planting the vineyard. The costs of the land preparation, labor, rootstock, and the planting were capitalized over three years. The land preparation costs claimed do not include any nondepreciable land costs.

In 2009, when the plants became viable, Taxpayers placed the vineyard in service and took a deduction under § 179 (a § 179 deduction) for the costs incurred in planting the vineyard. [1]

LAW AND ANALYSIS

In the discussion and analysis that follows, unless otherwise indicated, all § 179 references are to the provisions of § 179 of the Internal Revenue Code of 1986 and the regulations under § 179 in effect for 2009, the year in issue.

Section 179(a) allows a taxpayer to elect to expense the cost (or a portion of the cost) of § 179 property, up to a limit, in the taxable year the property is placed in service by the taxpayer, instead of recovering the property by taking depreciation deductions over the applicable recovery period. The aggregate cost of § 179 property that the taxpayer can elect to expense under § 179 for a taxable year beginning in 2009 (2009 taxable year) generally cannot exceed the § 179(b)(1) dollar limitation amount of $250,000. See § 179(b)(1). This $250,000 dollar limitation amount is reduced by the amount by which the cost of all of taxpayer's § 179 property placed in service during the 2009 taxable year exceeds the § 179(b)(2) threshold amount of $800,000. See § 179(b)(2). The total cost the taxpayer can deduct after the taxpayer has applied the § 179(b)(1) and (b)(2) limitations is limited to the taxable income derived from the taxpayer's active conduct of any trade or business during the taxable year. See § 179(b)(3). Any amount that is not allowed as a deduction because of the taxable income limitation under § 179(b)(3) may be carried forward to succeeding taxable years.

Under §179(d)(1), the term "§ 179 property" is property that is: (1) tangible property to which § 168 applies or certain computer software; (2) § 1245 property (as defined in § 1245(a)(3)); and (3) acquired by purchase for use in the active conduct of a trade or business. Further, § 179(d)(1) provides that § 179 property shall not include any property described in § 50(b) and shall not include air conditioning or heating units.

Is Taxpayers' vineyard tangible property to which § 168 applies?

[1] Under § 1.46-3 (d)(2)(iii) of the Income Tax Regulations, fruit bearing trees and vines shall not be considered placed in service until they have reached an income-producing stage.

Section 167(a) provides that there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) of property used in a taxpayer's trade or business, or of property held for the production of income.

The depreciation deduction provided by § 167(a) for tangible property placed in service after 1986 generally is determined under § 168. This section prescribes two methods of accounting for determining depreciation allowances. One method is the general depreciation system in § 168(a) and the other method is the alternative depreciation system in § 168(g). Under either depreciation system, the depreciation deduction is computed by using a prescribed depreciation method, recovery period, and convention.

For purposes of the general depreciation system, the depreciation method, recovery period, and convention are determined by the property's classification under § 168(e). Pursuant to § 168(e)(3)(D)(ii), any tree or vine bearing fruit or nuts is classified as 10-year property.

In this case, Taxpayers placed the vineyard in service during 2009. Accordingly, Taxpayers' vineyard is tangible property to which § 168 applies.

Is Taxpayers' vineyard § 1245 property?

Under § 1245(a)(3), the term "§ 1245 property" means property which is or has been property of a character subject to the allowance for depreciation provided in § 167 and is (among other things) (A) personal property, or (B) other property (not including a building or its structural components) but only if such other property is tangible and has an adjusted basis in which there are reflected adjustments described in § 1245(a)(2) for a period in which such property (or other property) was used as an integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services.

Section 1.1245-3(b)(1) of the Income Tax Regulations provides that the term "personal property" means tangible personal property as defined in § 1.48-1(c), relating to the definition of § 38 property for purposes of the investment credit under former § 48. Section 1.48-1(c) defines the term "tangible personal property" as meaning any tangible property except land and improvements thereto, such as buildings or other inherently permanent structures (including items that are structural components of such buildings or structures).

Section 1.1245-3(c)(2) provides that the language "was used as an integral part of manufacturing, production, or extraction or of furnishing transportation, communications,

electrical energy, gas, water, or sewage disposal services" used in § 1245(a)(3)(B)(i) has the same meaning as when used in § 1.48-1(a), relating to the definition of § 38 property for purposes of the investment credit under former § 48.

Section 1.48-1(a) defines the term "§ 38 property" as meaning property that is, among other requirements, other tangible property (not including a building and its structural components) but only if such other property is used as an integral part of manufacturing, production, or extraction, or as an integral part of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services by a person engaged in a trade or business of furnishing any such services.

Section 1.48-1(d) provides the rules applicable to other tangible property (but not including a building or its structural components) for purposes of § 1.48-1(a). Section 1.48-1(d)(2) provides that the terms "manufacturing", "production", and "extraction" include the cultivation of the soil. In addition, § 1.48-1(d)(2) provides that § 38 property would include, for example, property used as an integral part of the cultivation of orchards, gardens, or nurseries.

If Taxpayers' vineyard is not an inherently permanent structure, the vineyard meets the definition of tangible personal property under § 1.48-1(c). As a result, under § 1.48-1(c) and, therefore by cross-reference, Taxpayers' vineyard is personal property under § 1245(a)(3)(A). If Taxpayers' vineyard is an inherently permanent structure, the vineyard meets the definition of other tangible property under § 1.48-1(d). Thus, under § 1.48-1(d) and, therefore by cross-reference, Taxpayers' vineyard is other tangible property described under § 1245(a)(3)(B)(i). Accordingly, Taxpayers' vineyard is § 1245 property and meets the second requirement of § 179(d)(1).

We understand that there is some confusion about the application of Rev. Rul. 67-51, 1967-1 C.B. 68. This revenue ruling concluded that certain fruit bearing trees are not § 179 property because they do not qualify as tangible personal property within the meaning of § 179 of the Internal Revenue Code of 1954 (1954 Code). When Rev. Rul. 67-51 was issued, §179(d)(1) of the 1954 Code provided that the term "§ 179 property" meant tangible personal property of a character subject to the allowance for depreciation under § 167, acquired by purchase after December 31, 1957, for use in a trade or business or for holding for production of income, and with a useful life (determined at the time of such acquisition) of 6 years or more. The regulations under § 179 of the 1954 Code (former § 1.179-3(b)) provided that for purposes of § 179 of the 1954 Code, the term "tangible personal property" included any tangible property except land, and improvements thereto, such as buildings or other inherently permanent structures thereon (including items which are structural components of such buildings or structures).

Since the issuance of Rev. Rul. 67-51, the definition of § 179 property has significantly changed. For the year in issue and currently, § 179 property includes depreciable property that is tangible personal property or other tangible property under § 1245(a)(3).

Because of the change in the definition of § 179 property, Rev. Rul. 67-51 no longer applies for purposes of § 179 of the 1986 Code.

Is Taxpayers' vineyard acquired by purchase for use in the active conduct of a trade or business

Section 179(d)(2) defines the term "purchase" as meaning any acquisition of property, but only if the property is not acquired in a transaction described in § 179(d)(2)(A), (B), or (C). See also §1.179-4(c). Under the facts of this case, Taxpayers did acquire the vineyard and the acquisition is not described in § 179(d)(2)(A), (B), or (C). Assuming Taxpayers' vineyard is for use in Taxpayers' active conduct of a trade or business, Taxpayers' vineyard meets the third requirement of § 179(d)(1).

Because Taxpayers' vineyard meets all of the requirements of § 179(d)(1), we conclude that Taxpayers' vineyard meets the definition of § 179 property under § 179(d)(1).

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Please call (202) 622-4930 if you have any further questions.