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## DEPRECIATING TREES AND SHRUBS

— by Neil E. Harl\*

The answer to the question of whether trees and shrubs could be depreciated has never been clear.<sup>1</sup> A recent United States District Court case focused on the issue but contributed little to resolution of the issue.<sup>2</sup>

### Everson case

The federal case, *Everson v. United States*,<sup>3</sup> involved the purchase of a 3700 acre ranch for \$1,200,000 in 1983. As the opinion stated —

"Some twenty years prior to this sale, a portion of the land had been planted with parallel rows of bushes and trees. These rows are approximately 200 feet apart....Those trees and bushes do not produce saleable timber and have never, in and of themselves, produced any fruit, nuts, or other products that could be sold. The trees and bushes were planted as windbreak under a soil conservation program and are intended to reduce moisture evaporation and soil erosion."<sup>4</sup>

The taxpayers allocated \$1 of the purchase price to each tree and shrub or \$250,000 of the total purchase price. Both depreciation and investment tax credit were claimed on the trees and shrubs.<sup>5</sup> IRS objected on the grounds that the trees and shrubs were not depreciable.

The court noted that a depreciation deduction is allowed on property used in a trade or business.<sup>6</sup> The court then proceeded to agree with the IRS argument that trees are generally considered part of the land<sup>7</sup> and thus are not depreciable. The court recognized that an exception has been created for "trees purchased and held for the production of revenue."<sup>8</sup> Thus, the trees and shrubs in *Everson*<sup>9</sup> were not depreciable inasmuch as they did not produce revenue.

### Determinate life

The court's distinction between trees and shrubs that produce revenue and those that do not has some support in the cases involving orchards.<sup>10</sup> The principal question, however, is whether the taxpayer can establish that the trees or vines have a limited useful life.<sup>11</sup> A depreciation deduction on fruit trees has been disallowed where the evidence indicated that the trees continued to increase in production capacity during the period in question.<sup>12</sup> In

several cases, the courts have had little difficulty in finding that trees involved in the production of fruit or nuts have a limited useful life.<sup>13</sup> However, depreciation deductions have been denied for an avocado grove,<sup>14</sup> a walnut grove,<sup>15</sup> and an orange grove<sup>16</sup> on the grounds that the trees involved had an indeterminant life.

In Rev. Rul. 80-25,<sup>17</sup> IRS allowed a taxpayer with trees and an irrigation system with a 20-year life to depreciate both the irrigation system and the trees with depreciation on the irrigation system allowed beginning in the year the irrigation system was placed in service. That position was modified in Rev. Rul. 83-67<sup>18</sup> to require that depreciation could commence on the irrigation system only when the orchard or grove reaches the income producing stage.

It is reasonably clear that trees are depreciable if a determinable life is proved.

### Trees and shrubs in landscaping

The remaining question is whether trees and shrubs have to be revenue producing to be depreciable even if a determinable life is established.

IRS has ruled that landscaping consisting of perennial shrubbery and ornamental trees adjacent to the buildings in a newly-constructed apartment complex is depreciable over the life of the buildings if the replacement of the buildings would destroy the landscaping.<sup>19</sup> Other landscaping was not considered to be depreciable property.<sup>20</sup>

The Tax Court has allowed depreciation on landscaping of a mobile home park<sup>21</sup> and shrubbery in conjunction with employee recreation facilities.<sup>22</sup> The Tax Court, however, has denied depreciation deductions for landscaping of a shopping center because the costs were "inextricably associated with the land."<sup>23</sup> Similarly, landscaping costs in conjunction with housing projects were treated as nondepreciable.<sup>24</sup>

The latest IRS publication classifying property for depreciation purposes, Rev. Proc. 87-56,<sup>25</sup> lists as depreciable land improvements—"...fences, landscaping, shrubbery...." Land improvements are depreciable over 15-years.<sup>26</sup>

### In conclusion

If "landscaping and shrubbery" are depreciable over 15-years, then why are trees and shrubs planted as a windbreak and to reduce moisture evaporation and soil erosion not

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deductible also? There seems to be no defensible reason for treating the two situations differently so long as a determinable life can be proved.

#### FOOTNOTES

- <sup>1</sup> See generally 4 Harl, *Agricultural Law* § 29.03[6] (1995); Harl, *Agricultural Law Manual* § 4.03 [4] (1995).
- <sup>2</sup> *Everson v. United States*, 95-1 U.S. Tax Cas. ¶50,150 (D. Mont. 1995).
- <sup>3</sup> Note 2 *supra*.
- <sup>4</sup> *Id.*
- <sup>5</sup> *Id.*
- <sup>6</sup> I.R.C. § 167(a)(1).
- <sup>7</sup> Rev. Rul. 67-51, 1967-1 C.B. 68.
- <sup>8</sup> See n. 2 *supra*.
- <sup>9</sup> *Id.*
- <sup>10</sup> See 4 Harl, *supra* n. 1, § 29.03[6].
- <sup>11</sup> *Ribbon Cliff Fruit Co.*, 12 B.T.A. 13 (1928), *acq.*, VII-2 C.B. 34; F.H. Wilson, 12 B.T.A. 403 (1928).
- <sup>12</sup> *Palmer v. Comm'r*, 23 B.T.A. 296 (1931) (orange grove).
- <sup>13</sup> *Davis v. Comm'r*, T.C. Memo. 1965-30 (lemon trees had limited useful life; depreciation allowed). See Rev. Rul. 71-488, 1971-2 C.B. 60 (macadamia nut trees eligible for investment tax credit when "income producing stage"

- reached); Rev. Rul. 69-249, 1969-1 C.B. 31 (same for citrus trees); Rev. Rul. 65-104, 1965-1 C.B. 28 (same).
- <sup>14</sup> *Krome v. Comm'r*, 9 T.C.M. 178 (1950). But see Ltr. Rul. 8108007, Oct. 29, 1980:  
"Avocado trees are depreciable assets under section 167 of the Code, provided that the taxpayers can establish a determinable useful life of three years or more, and if so, qualify for the investment tax credit under section 38 of the Code."
  - <sup>15</sup> *Knox v. Comm'r*, 2 B.T.A. 1107 (1925), *acq.*, V-1 C.B.3.
  - <sup>16</sup> *Palmer v. Comm'r*, n. 12 *supra*.
  - <sup>17</sup> 1980-1 C.B. 65.
  - <sup>18</sup> 1983-1 C.B. 74.
  - <sup>19</sup> Rev. Rul. 74-265, 1974-1 C.B. 56.
  - <sup>20</sup> *Id.*
  - <sup>21</sup> *Trailmont Park, Inc. v. Comm'r*, T.C. Memo. 1971-212.
  - <sup>22</sup> *Alabama-Georgia Syrup Co. v. Comm'r*, 36 T.C. 747 (1961), *rev'd on other issues*, 311 F.2d 640 (5th Cir. 1962).
  - <sup>23</sup> *Shainberg v. Comm'r*, 33 T.C. 241 (1959).
  - <sup>24</sup> *Algernon Blair, Inc. v. Comm'r*, 29 T.C. 1205 (1958).
  - <sup>25</sup> 1987-2 C.B. 674.
  - <sup>26</sup> Rev. Proc. 87-56, 1987-2 C.B. 674 (Class 00.3).

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## CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

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### BANKRUPTCY

#### GENERAL-ALM § 13.03.\*

##### EXEMPTIONS

**ANNUITIES.** Prior to filing for bankruptcy, the debtor had been receiving payments from a pension fund owned by the debtor's former business. Fearful that the business might terminate the pension payments, the debtor requested a lump sum payment and purchased three annuities to provide for retirement payments. The debtor claimed the annuities as exempt under Iowa Code § 627.6(8)(e) as payments made on account of age. The court held that the pension plan payments would have been eligible for the exemption; therefore, the annuities purchased with the plan payments were also eligible for the exemption. *In re Caslavka*, 179 B.R. 141 (Bankr. N.D. Iowa 1995).

**HOMESTEAD.** The debtors originally filed under Chapter 11 and claimed their 59 acre ranch as an exempt homestead. No objection to the exemption was filed. The debtors then sold the ranch for cash and a note and purchased another ranch for cash and a note, using the first note as security for the second note. The case was then converted to Chapter 7 and the trustee objected to the exemption as to the second ranch and the proceeds of the first ranch. The court held that the exemption was allowed for the second ranch but held that, under Tex. Prop. Code § 41.001(c), the proceeds of the sale of the first ranch lost their exempt status after six months unless reinvested in exempt property. Because the first note was not "invested" in the second ranch but was only used to secure the purchase

of the second ranch, the note was not eligible for the exemption six months after the sale of the first ranch and became estate property in the Chapter 7 case. *In re Reed*, 178 B.R. 707 (Bankr. W.D. Tex. 1994).

#### CHAPTER 12-ALM § 13.03[8].\*

**PLAN.** The debtor's Chapter 12 plan provided for payment of several secured claims at an interest rate below the contract rate of interest. The debtor did not provide any evidence that the new interest rate matched a market rate for similar loans, but the creditors provided evidence that the market rate exceeded or at least matched the contract rate. The court held that the plan could not be approved because the creditors would not receive the present value of their claims. *In re DeSanto*, 178 B.R. 634 (Bankr. M.D. Pa. 1994).

The debtor's Chapter 12 plan provided for payment of an oversecured claim by payment of the claim over 10 years at 6 percent interest. The debtor calculated the interest rate by determining the creditor's cost of lending and adding 1.54 percent "to insure confirmation." The creditor objected to the plan and sought a market rate of interest for similar loans. The court held that the interest rate would be the rate for U.S. Treasury instruments with a maturity date closest to the plan termination date. *In re Smith*, 178 B.R. 946 (Bankr. D. Vt. 1995).

**SETOFF.** The debtor filed for Chapter 12 on January 19, 1994. The FmHA had filed a claim in the case for prepetition debts of the debtor to the FmHA. The debtor had participated in the 1993 disaster payment program, applying for benefits in April 1993. The payments were not payable,