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New Guidance on Depreciating Water Wells, Drip Irrigation Systems and Grape Trellises

-by Neil E. Harl*

In a decision released on April 3, 2007, the Tax Court provided new insights into the recovery period[1] for depreciating water wells, drip irrigation systems and grape trellises.[2] While the classification of property for depreciation purposes is, in part, a facts and circumstances matter within the context of the class lives assigned by the Internal Revenue Service,[3] the case of *Trentadue v. Commissioner*[4] provides helpful insights into how the three types of property should be classified for depreciation purposes.

The facts of the case

The decision in *Trentadue v. Commissioner*[5] involved a California grape producer who also owned a winery and processed the grapes into wine. The taxpayer had claimed depreciation on grape trellises as seven year property (a 10-year class life)[6] on drip irrigation as seven year property[7] and on a water well as seven year property.[8] The Tax Court agreed that the grape trellises were seven year property (as "machinery and equipment" used in the production of ". . . crops or plants, vines . . .") because the trellises were movable and reusable and were not designed to remain permanently in place.[9] The drip irrigation system and the water well, however, were held by the Tax Court to be "15-year property" as "land improvements."[10]

The determination of the proper classification of the grape trellises as seven year property was hardly surprising, as was the classification of the drip irrigation system as 15-year property but the holding on water wells as 15-year property runs counter to some older IRS authority.[11]

What is a "land improvement"?

The Tax Court relied heavily on *Whiteco Industries, Inc. v. Commissioner*[12] in reaching the conclusion that the drip irrigation system and the water well were both 15-year property as "land improvements."[13] The *Whiteco* decision had derived six factors in deciding whether a particular asset was a land improvement – (1) whether the property is capable of being moved and, in fact, has been moved; (2) whether the property is designed or constructed to remain permanently in place; (3) whether circumstances tend to show the expected or intended length of affixation to the land; (4) how substantial a job is it to remove the property and how time consuming it is; (5) how much damage would be sustained upon the removal of the property; and (6) the manner of affixation to the land (whether the property could be easily removed).[14]

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In applying the factors to the situation in *Trentadue*,[15] the court found the factors tended to suggest that both assets were land improvements rather than machinery or equipment. In dictum, the court noted that ". . . an above-ground irrigation system would more likely be classified as machinery or equipment, whereas one buried in the ground would more likely be classified as a permanent land improvement.[16] That leaves open the possibility that above-ground center pivot irrigation facilities might be seven year property.

Other authority for water wells

For over half a century, IRS has maintained that the drilling costs for water wells were not depreciable but parts of wells such as piping and casings were depreciable.[17] Yet, a passage in the regulations[18] under the soil and water conservation deduction provision[19] stated that expenditures for making structures such as wells involved depreciable property.[20] Also, IRS ruled in 1972 that water wells providing water for raising poultry or livestock "whether they are unlined or contain replaceable or nonreplaceable casings or linings " were "other tangible property" and, thus, eligible for investment tax credit,[21] which was then available.[22] To be eligible for investment tax credit, the property had to be depreciable property.[23]

The Tax Court decision in *Trentadue*[24] did not cite any of those authorities. Indeed, the court in *Trentadue*[25] stated that "there is no question in this case about whether the subject assets were depreciable."[26] That statement, and the holding in the case, would seem to resolve the question of whether water wells with a determinable life (as established in *Trentadue*) used for business purposes are, in fact, depreciable. Moreover, it is the position of the Tax Court that water wells are 15-year property, eligible for 150 percent declining balance depreciation.[27] If upheld by the Ninth Circuit Court of Appeals, which is expected, the guidance should have even greater standing.

Footnotes

[1] I.R.C. § 168(c).

[2] Trentadue v. Comm'r, 128 T.C. No. 8 (2007). See generally 4 Harl, *Agricultural Law* § 29.06[a] (2006); Harl, *Agricultural Law Manual* § 4.03[4][c] (2006); Harl, *Farm Income Tax Manual* § 508 (Matthew-Bender 2006).

[3] See Rev. Proc. 1987-56, 1987-2 C.B. 674, as modified by Rev. Proc. 1988-22, 1988-1 C.B. 785 (business horses).

[4] 128 T.C. No. 8 (2007).

[5] *Id.*

[6] See I.R.C. § 168(c); Rev. Proc. 1987-56, 1987-2 C.B. 674, § 5.02, asset class 01.1.

[7] *Id.*

[8] *Id.*

[9] Trentadue v. Comm'r, 128 T.C. No. 8 (2007).

[10] Rev. Proc. 1987-56, 1987-2 C.B. 674, § 5.02, asset class 00.3.

[11] E.g., Rev. Rul. 1956-599, 1956-2 C.B. 122.

[12] 65 T.C. 664 (1975).

[13] Rev. Proc. 1987-56, 1987-2 C.B. 674, § 5.02, asset class 00.3.

[14] Whiteco Industries, Inc. v. Comm'r, 65 T.C. 664 (2007).

[15] Trentadue v. Comm'r, 128 T.C. No. 8 (2007).

[16] *Id.*

[17] Rev. Rul. 1956-599, 1956-2 C.B. 122.

[18] Treas. Reg. § 1.175-2(b)(1).

[19] I.R.C. § 175.

[20] Treas. Reg. § 1.175-2(b)(1).

[21] I.R.C. § 48(a)(1), repealed in 1986. See Harl, *Agricultural Law* § 32.03[1] (2006).

[22] Rev. Rul. 1972-222, 1972-1 C.B. 17.

[23] I.R.C. § 48(a)(1). See Rev. Rul. 1981-120, 1981-1 C.B. 20 (deep wells for disposal of liquid waste eligible for investment tax credit).

[24] Trentadue v. Comm'r, 128 T.C. No. 8 (2007).

[25] *Id.*

[26] *Id.*

[27] I.R.C. 168(b)(2)(A).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

ADVERSE POSSESSION

SURVEY. The defendants purchased their land with a fence and trees on the southern border which they considered to be the boundary between their land the the plaintiff's land. The defendants eventually cleared some of the trees and removed most of the fence, using the disputed strip as clear land which they mowed on a regular basis, built a grape arbor, cultivated a garden and added landscaping. The plaintiff planned to develop its land and had a survey conducted for the purpose of locating the actual boundary line, which turned out to be several feet onto the area mowed by the defendants. The plaintiff sought to quiet title and the defendants claimed title by adverse possession. The trial court granted summary judgment to the defendants, holding that a survey was insufficient to toll the time limitation for adverse possession and that the defendants' actions were sufficient for adverse possession use. The appellate court reversed, holding that a survey was sufficient