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**Survey of the Law and Selected Issues
Relating to the Deductibility of Soil and Water
Conservation Expenditures Under Section 175
of the Internal Revenue Code**

by

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Survey of the Law and Selected Issues Relating to the Deductibility of Soil and Water Conservation Expenditures Under Section 175 of the Internal Revenue Code

BY LONNIE R. BEARD*

INTRODUCTION

Section 175 of the Internal Revenue Code (hereinafter I.R.C. or Code) provides farmers with a deduction for certain soil and water conservation expenditures which would otherwise be capital in nature.¹ This section has exclusive application to agriculture. For the expenditures to be deductible under section 175, the taxpayer claiming a deduction must be “engaged in the business of farming” and the soil and water conservation expenditures must have been made with respect to “land used in farming.”² This Article focuses on the rather technical requirements which farmers must satisfy before they can claim a section 175 deduction.

I. SECTION 175: BACKGROUND AND STRUCTURE

Section 175 was enacted as part of the Internal Revenue Code of 1954.³ Prior to its enactment, most conservation ex-

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¹ I.R.C. § 175(a) (1984) provides:

(a) In general—A taxpayer engaged in the business of farming may treat expenditures which are paid or incurred by him during the taxable year for the purpose of soil or water conservation in respect of land used in farming, or for the prevention of erosion of land used in farming, as expenses which are not chargeable to capital account. The expenditures so treated shall be allowed as a deduction.

² See *id.*

³ See S. REP. No. 1622, 83d Cong., 2d Sess. 216 (1954).

penditures incurred for improvements were required to be capitalized.⁴ However, in 1953 the Tax Court allowed a taxpayer to deduct substantial costs incurred in building earthen terraces to control water erosion because the terraces did not constitute permanent improvements which added value to the land.⁵ The Internal Revenue Service (IRS or Service) quickly took the position that the case would be limited to its unusual facts.⁶

Section 175 apparently was enacted to restore uniformity, thought to have been impaired by the Tax Court's 1953 decision, to the tax treatment of conservation expenditures, as well as to encourage such expenditures.⁷ Section 175 provides that taxpayers "engaged in the business of farming" may elect to deduct otherwise capital expenditures "for the purpose of soil or water conservation in respect of land used in farming, or for the prevention of erosion of land used in farming."⁸ The election applies only to expenditures which are not otherwise deductible and which generally would otherwise be capitalized⁹ as part of the cost or other basis of nondepreciable assets, such as land.¹⁰ If the election is not made, the expenditures increase the basis of the property to which they relate.¹¹

The amount of expenditures which can be deducted under section 175 for any one taxable year cannot exceed twenty-five percent of the "gross income derived from farming" during that year.¹² However, any excess can be carried over and deducted in chronological order in succeeding taxable years.¹³ The election to deduct or capitalize is made with respect to the first covered expenditures incurred by the taxpayer in a taxable year beginning after 1953.¹⁴ The election will be binding as to all future covered

⁴ See 4 FED. TAXES (P-H) ¶ 16,212 (1985) (Effective date of § 175 originally was Aug. 16, 1954. This section was amended on Oct. 10, 1968 and Dec. 31, 1976.).

⁵ See *Collingwood v. Commissioner*, 20 T.C. 937, 942 (1953), *acq.* 1954-1 C.B. 4.

⁶ See Rev. Rul. 191, 1954-1 C.B. 68, 69.

⁷ See S. REP. No. 1622, *supra* note 3.

⁸ I.R.C. § 175(a) (1984).

⁹ See *id.*

¹⁰ I.R.C. § 175(c)(1)(A)-(B) (1978); Treas. Reg. § 1.175-1 (1960).

¹¹ Treas. Reg. § 1.175-1.

¹² I.R.C. § 175(b) (1978); Treas. Reg. § 1.175-5(b), T.D. 6649, 1963-1 C.B. 49.

¹³ See note 12 *supra*.

¹⁴ I.R.C. § 175(d)(1) (1978).

expenditures unless the taxpayer obtains consent from the appropriate IRS district director to change such treatment.¹⁵

II. "ENGAGED IN BUSINESS OF FARMING"

The section 175 regulations provide that a taxpayer is "engaged in the business of farming" if the taxpayer "cultivates, operates, or manages a farm for gain or profit, either as owner or tenant."¹⁶ However, taxpayers engaged in forestry or the growing of timber are specifically excluded.¹⁷ Apparently, for one to be "engaged in the business of farming," some part of the risk of loss from the farming operation must be borne by that person. In one illustrative case,¹⁸ the taxpayers paid a nursery to care for citrus seedlings on nursery property until time for transplanting onto the taxpayers' property.¹⁹ The Tax Court pointed out that "[t]he major risk in farming is the loss of a crop due to unforeseen circumstances. Without assuming this risk, one cannot be considered in the business of farming, nor can his expenditures be considered farming expenditures."²⁰

The Tax Court found that, under their contract with the nursery, the taxpayers bore the risk of loss due to unforeseen circumstances even while the seedlings were under the care of the nursery.²¹ They were thus entitled to deduct their expenditures for this care and maintenance.²²

On appeal, the Ninth Circuit affirmed the Tax Court and similarly noted the importance of risk of loss:

Whether or not one is a farmer for tax purposes does not depend on his tilling the soil by his own labor rather than by that of hired hands, tenant farmers, or even professional nursery men. Where, as here, the taxpayers assume the risk that the crop will never be harvested due to unforeseen circumstan-

¹⁵ I.R.C. § 175(e) (1978); Treas. Reg. § 1.175-6(b), (c) (1960).

¹⁶ Treas. Reg. § 1.175-3, T.D. 6649, 1963-1 C.B. 49 (originally enacted Nov. 26, 1960, amended Apr. 18, 1963).

¹⁷ See *id.*

¹⁸ *Maple v. Commissioner*, 37 T.C.M. (P-H) 1041 (1968), *aff'd*, 440 F.2d 1055 (9th Cir. 1971).

¹⁹ *Id.* at 1042.

²⁰ *Id.* at 1049.

²¹ See *id.* at 1041.

²² See *id.*

ces, and the crop is related to the taxpayers' farming endeavors, the expenses they incur with regard to that crop are farming expenses.²³

Although the case did not deal specifically with section 175, both the Tax Court²⁴ and the Ninth Circuit²⁵ cross-referenced the regulations under sections 175 and 182 as to the meaning of "the business of farming." It thus seems clear that the use of agents to supervise and manage the farming operations—with the specified limitation that a landlord renting on a fixed rent basis must materially participate in the business—would not preclude the principal (owner or tenant) from qualifying as one "engaged in the business of farming" under section 175 and for other tax purposes.²⁶

If a partnership is engaged in the business of farming, each partner is also considered to be so engaged.²⁷ On the other hand, a shareholder of a C corporation is not considered to be "engaged in the business of farming" merely because the corporation operates a farm.²⁸

Prior to the effective date of the Subchapter S Revision Act of 1982,²⁹ S corporations were treated in the same manner as C corporations for purposes of section 175.³⁰ However, the Revision Act appears to have made the S corporation substantially identical to a partnership for purposes of section 175 expenditures.³¹ I.R.C. section 1366, enacted as part of the Revision Act,

²³ 440 F.2d at 1057.

²⁴ See 37 T.C.M. at 1049.

²⁵ See 440 F.2d at 1057.

²⁶ See notes 55-56 *infra* and accompanying text.

²⁷ Treas. Reg. § 1.175-3.

²⁸ Cf. Rev. Rul. 141, 1976-1 C.B. 381 (dividends received by taxpayer from corporation engaged in farming do not qualify as farm income).

²⁹ Subchapter S Revision Act of 1982, Pub. L. No. 97-354, 96 Stat. 1669. The new S corporation rules generally are effective for taxable years beginning after 1982. See *id.*

³⁰ See former I.R.C. § 1373 (repealed 1982). Cf. *Brown v. United States*, 37 A.F.T.R.2d (P-H) 1183 (E.D. Ark. 1976) (S corporation shareholders denied deductions for corporation's land clearing and soil and water conservation expenditures); Rev. Rul. 141, 1976-1 C.B. 381 (dividends received by taxpayer from corporation engaged exclusively in farming treated as ordinary dividend income).

³¹ Subchapter S Revision Act of 1982, Pub. L. No. 97-354, § 1, 96 Stat. 1669 provides in part:

The bill provides that the character of items of income, deduction, loss, and credits of the corporation will pass through to the shareholders in the same general manner as the character of such items of a partnership passes to partners. Thus, for example, such items as tax-exempt interest, capital gains and losses, percentage depletion, the source or allocation of foreign income or loss, and foreign income taxes will pass through and retain their character in the hands of shareholders.

adopts a conduit approach to corporate income and expenses which is substantially the same as that applied to partnerships under section 702.³²

New section 1366(a)(1)(A) requires each S corporation shareholder to take into account separately that shareholder's pro rata share of the corporation's "items of income (including tax-exempt income), loss, deduction, or credit the separate treatment of which could affect the liability for tax of any shareholder."³³ Section 1366(b)—which corresponds to section 702(b)³⁴—provides that any such separately stated item of income or expense is to be treated by the shareholder "as if such item were realized directly from the source from which realized by the corporation, or incurred in the same manner as incurred by the corporation."³⁵

The regulations under section 702 provide that each partner is required to take into account separately any expenses incurred by the partnership for soil and water conservation.³⁶ Although there presently are no regulations under new section 1366, the IRS has stated that soil and water conservation expenditures are to be separately taken into account by the shareholders.³⁷

Section 1366(c) provides that "[i]n any case where it is necessary to determine the gross income of a shareholder for purposes of this title, such gross income shall include the shareholder's pro rata share of his gross income of the corporation."³⁸ This provision was intended to parallel the similar provision in section 702(c).³⁹ The regulations under section 702(c) specifically provide that each partner is to take the partnership's gross income into consideration in computing the partner's gross income from farming for purposes of section 175.⁴⁰ An S corporation shareholder presumably will be required to do the same.⁴¹

³² See S. REP. NO. 640, 97th Cong., 2d Sess. 17 (1982).

³³ I.R.C. § 1366(a)(1)(A) (1984 & Supp. 1985).

³⁴ Compare I.R.C. § 1366(b) (1984) with I.R.C. § 702(b) (Aug. 16, 1954).

³⁵ I.R.C. § 1366(b) (Supp. 1985).

³⁶ Treas. Reg. § 1.702-1(a)(8)(i), T.D. 7728, 1980-2 C.B. 236.

³⁷ See I.R.S. PUB. NO. 589, TAX INFORMATION ON S. CORPORATIONS 7 (1983) [hereinafter cited as TAX INFORMATION].

³⁸ I.R.C. § 1366(c) (1984 & Supp. 1985).

³⁹ See S. REP. NO. 640, *supra* note 32.

⁴⁰ See Treas. Reg. § 1.702-1(c)(1)(iv) (Aug. 16, 1954).

⁴¹ See Pub. L. No. 97-354, 96 Stat. 1669 (1982).

The beneficiary of a nongrantor trust which operates a farm is not thereby considered to be engaged in farming.⁴² However, if a terminating trust during its last taxable year has deductions in excess of gross income and if the deductions include expenditures otherwise allowable to the trust under section 175, a beneficiary succeeding to the property of a trust engaged in farming may be able to deduct the excess, including the otherwise allowable section 175 expenditures, under section 642(h)(2).⁴³ The same is undoubtedly true with respect to the beneficiaries of an estate engaged in farming. In contrast, the grantor of a grantor trust presumably would be considered engaged in the business of farming under the same circumstances in which he or she would be so considered if title to the trust property were still in the grantor.⁴⁴

The regulations provide that a taxpayer who operates a farm for recreation or pleasure rather than for profit is not engaged in the business of farming for purposes of section 175.⁴⁵ Some commentators think this is a higher standard for deductibility than that applied in determining whether farm losses are deductible against other income.⁴⁶ However, the final results may be the same.

The regulations under section 165 provide that losses incurred in the operation of a farm for recreation or pleasure are not allowed as deductions against gross income from other sources.⁴⁷ The section 162 regulations provide that if a farm is operated for recreation or pleasure and not on a commercial basis, expenses incurred in connection with the farm will serve only to offset any farm income; any excess expenses over farm income are not deductible.⁴⁸

The regulations under section 175 seem to indicate that covered expenditures are not allowable if the farm is not operated

⁴² See Rev. Rul. 191, 1958-1 C.B. 149.

⁴³ See *id.*

⁴⁴ See I.R.C. § 671 (1984); Treas. Reg. § 1.671-2(c) (1960).

⁴⁵ See Treas. Reg. § 1.175-3.

⁴⁶ See Knobbe, "Farm and Ranch Expenses and Credits," 208-3d *Tax Management* A-11; 4 N. HARL, AGRICULTURAL LAW § 28.22 (1980).

⁴⁷ See Treas. Reg. § 1.165-6(a)(3), T.D. 6712, 1964-1 C.B. 106.

⁴⁸ See Treas. Reg. § 1.162-12(b), T.D. 7198, 1972-2 C.B. 166 (effective date Jan. 1, 1970).

for profit.⁴⁹ However, section 183 may nevertheless allow expenditures otherwise deductible under section 175 to be deducted to the same extent as other expenses associated with recreation or pleasure farming.⁵⁰ If an activity is not engaged in for profit, section 183(b) provides that expenses, which *would be* deductible if the activity were engaged in for profit, are deductible to the extent of the excess, if any, of the gross income from the activity over the deductions which are allowable (such as interest and taxes) without regard to whether the activity is engaged in for profit.⁵¹ The Tax Court has construed section 183(b) as an *allowance* provision which permits deduction, within the specified limits, of expenses which would otherwise be nondeductible because the activity is not being operated on a profit basis.⁵² Under this analysis, both the section 183 regulations that discuss whether an activity is engaged in for profit and the case law on that issue⁵³ should be relevant for purposes of section 175.

A landlord who receives a cash or in-kind rental payment which is based upon farm production is considered to be engaged in the business of farming for purposes of section 175.⁵⁴ A landlord receiving a typical crop-share rent should qualify. On the other hand, a landlord receiving fixed rentals, determined without reference to production, is considered to be engaged in the business of farming for section 175 purposes only if the landlord "materially participates" in the operation or management of the farm.⁵⁵ Material participation is apparently judged by the same standards that apply in determining whether the landlord has self-employment income for Social Security purposes.⁵⁶

⁴⁹ See Treas. Reg. § 1.175-3.

⁵⁰ See Treas. Reg. § 1.183-1(a) (July 13, 1972).

⁵¹ See I.R.C. § 183(b) (1984). See also Treas. Reg. § 1.183-1(b) (1972).

⁵² See *Brannen v. Commissioner*, 78 T.C. 471, 500 (1982), *aff'd*, 722 F.2d 695 (11th Cir. 1984).

⁵³ See, e.g., *Estate of Fuller v. Commissioner*, 9 T.C. 1069 (1947) (farm losses and expenses held not deductible by estate where farm was held for purpose of providing country residence for beneficiaries), *aff'd*, 171 F.2d 704 (3d Cir. 1948), *cert. denied*, 336 U.S. 961 (1949).

⁵⁴ See Treas. Reg. § 1.175-3.

⁵⁵ See *id.* See also Rev. Rul. 137, 1975-1 C.B. 74; Rev. Rul. 606, 1969-2 C.B. 33.

⁵⁶ See I.R.S. PUB. NO. 225, FARMER'S TAX GUIDE 17 (1983) [hereinafter cited as FARMER'S TAX GUIDE].

For purposes of section 175, the term "farm" "is used in its ordinary, accepted sense and includes stock, dairy, poultry, fish, fruit, and truck farms; plantations, ranches, ranges and orchards."⁵⁷ Section 175 limits fish farms to those operations where fish are artificially fed, protected, or cared for, as opposed to merely being caught or harvested.⁵⁸ A horticultural nursery is a farm for purposes of section 175.⁵⁹

III. "LAND USED IN FARMING"

To be deductible under section 175, the covered expenditures must relate to "land used in farming."⁶⁰ "Land used in farming" is defined in section 175 as "land used (before or simultaneously with the covered expenditures . . .) by the taxpayer or his tenant for the production of crops, fruits, or other agricultural products or for the sustenance of livestock."⁶¹ The Ninth Circuit has indicated that the phrase, "used in farming" was intended by Congress "to distinguish between expenses incurred in bringing wild, uncultivated lands into initial production and expenses incurred to conserve soil and water on already cultivated land."⁶² Only the latter expenses would be covered by section 175.⁶³

If the land in question has not previously been used in farming, conservation expenditures incurred before the land is put to a farming use would not be deductible under section 175.⁶⁴ Conservation expenditures would likewise be nondeductible if the land, although previously used in farming, became unsuitable for farming and if the expenditures were incurred to make it again suitable for farming.⁶⁵ However, such expenditures

⁵⁷ Treas. Reg. § 1.175-3.

⁵⁸ *See id.*

⁵⁹ *See* Rev. Rul. 12, 1959-1 C.B. 59; FARMER'S TAX GUIDE, *supra* note 56.

⁶⁰ *See* I.R.C. § 175(a) (1978).

⁶¹ I.R.C. § 175(c)(2) (1978) (Aug. 16, 1954, amended Oct. 22, 1968 and Dec. 31, 1976).

⁶² *Amfac, Inc. v. Commissioner*, 626 F.2d 109, 111 (9th Cir. 1980).

⁶³ *See id.* at 112.

⁶⁴ *See id.*; Treas. Reg. § 1.175-4(b) example 3, T.D. 7740, 1981-1 C.B. 116.

⁶⁵ *See* 626 F.2d at 111. *Cf. Duda & Sons, Inc. v. United States*, 383 F. Supp. 1303, 1307 (M.D. Fla. 1974), *rev'd on other grounds*, 560 F.2d 669 (5th Cir. 1977); *Behring v. Commissioner*, 32 T.C. 1256, 1259-60 (1959), *acq. in result* 1972-1 C.B. 1.

might qualify as deductible land-clearing expenditures under section 182.⁶⁶

The requisite farming use exists in each of the following three situations: (1) The land, even though not being farmed at the time the expenditures were incurred, was used in farming by the taxpayer or the taxpayer's tenant prior to the covered expenditures;⁶⁷ (2) Newly-acquired land, even though not being farmed simultaneously with the covered expenditures, was used in farming by the prior owner and the taxpayer's intended use is a substantial continuation of the prior owner's use;⁶⁸ and (3) The land is used in farming by the taxpayer or the taxpayer's tenant simultaneously with the covered expenditures.⁶⁹

The regulations provide that the land must be used in the "business of farming" for the production of crops, fruits, or other agricultural products, including fish, or for the sustenance of livestock.⁷⁰ Land used for the sustenance of livestock includes livestock grazing land.⁷¹

A taxpayer meets the farming use requirement if the taxpayer or his tenant has previously used the land in farming.⁷² This would be the case, for example, if the expenditures are incurred after the end of one crop season and before the beginning of the next.⁷³ Additionally, where the land was used in farming by the taxpayer or her tenant in one year, expenditures which take the land out of production in the subsequent year are covered.⁷⁴

A prior use could apparently qualify even where the land lay fallow for a number of years before the expenditures were incurred, provided that the land is suitable for farming at the time the expenditures are made and the actual farming use begins

⁶⁶ See I.R.C. § 182 (1984).

⁶⁷ See Treas. Reg. § 1.175-4(a)(2), T.D. 7740, 1981-1 C.B. 116 (Nov. 26, 1960, amended Apr. 18, 1963 and Nov. 26, 1980).

⁶⁸ See *id.*

⁶⁹ See *id.*

⁷⁰ See Treas. Reg. § 1.175-4(a)(1). "Livestock" for this purpose includes cattle, hogs, horses, mules, donkeys, sheep, goats, captive fur-bearing animals, chickens, turkeys, pigeons and other poultry. See *id.*

⁷¹ *Id.*

⁷² See Treas. Reg. § 1.175-4(a)(2).

⁷³ See Treas. Reg. § 1.175-4(b) example 1, T.D. 7740, 1981-1 C.B. 116.

⁷⁴ See *Herndon v. United States*, 203 F. Supp. 536, 537 (E.D.S.C. 1962).

within a reasonable time thereafter.⁷⁵ However, land which has become unsuitable for farming will not be considered land used in farming merely because of prior farming use.⁷⁶ On the other hand, the taxpayer's prior use of the land for farming can qualify even though the conservation expenditures are incurred to make the land suitable for a different farming use.⁷⁷

If the taxpayer acquires the land from someone who used it in farming immediately before the taxpayer's acquisition and if the taxpayer makes covered expenditures before putting the land to a farming use, the farming use requirement is met where the taxpayer's subsequent use is "substantially a continuation of [the prior] use in farming."⁷⁸ Prior regulations provided that there was no "substantial continuation" if the taxpayer put the land to a farming use different from that of its prior owner.⁷⁹

However, courts refused to narrowly construe the "substantial continuation" requirement. Courts interpreted the language in section 175(c)(2) as contemplating two broad categories of uses: use for the production of crops and use for the sustenance of livestock.⁸⁰ Under this interpretation, substantial continuation occurred if the taxpayer's and the predecessor's uses fell within the same general category.⁸¹ For example, covered expenditures made by a taxpayer who acquired land on which to grow table grapes were held deductible under section 175 as a substantial continuation of the predecessor's wheat and cotton production.⁸²

The regulations were changed to their present form in 1980.⁸³ Under the current regulations, substantial continuation exists as long as the taxpayer and the predecessor each puts the land to one of the specified farming uses, even if the uses do not fall

⁷⁵ See *Duda & Sons, Inc. v. United States*, 383 F. Supp. at 1307. See also *Behring v. Commissioner*, 32 T.C. at 1259-60.

⁷⁶ See *Amfac, Inc. v. Commissioner*, 70 T.C. at 310-11. But see *Amfac, Inc. v. Commissioner*, 626 F.2d at 113 (dictum suggesting that prior use might be sufficient even though land is currently not suitable for farming).

⁷⁷ See 203 F. Supp. at 537.

⁷⁸ See Treas. Reg. § 1.175-4(a)(2).

⁷⁹ See former Treas. Reg. § 1.175-4(a)(2) (amended 1980). See also *Estate of Straughn v. Commissioner*, 55 T.C. 21, 24 (1970), *acq.* 1976-2 C.B. 3.

⁸⁰ See, e.g., 55 T.C. at 25; 383 F. Supp. at 1308; 70 T.C. at 309-10.

⁸¹ See cases cited *supra* note 80.

⁸² See *Estate of Straughn v. Commissioner*, 55 T.C. 21.

⁸³ See T.D. 7740, 45 Fed. Reg. 78,634 (1980).

in the same general category.⁸⁴ Thus, if the taxpayer acquires land from one who used it for grazing cattle and incurs covered expenditures to make it suitable for growing grapes, the substantial continuation requirement is satisfied.⁸⁵

Use by a prior owner is important only where the taxpayer incurs covered expenditures before using the acquired land in farming.⁸⁶ If the farming use occurs before or simultaneously with the covered expenditures, the farming use requirement can be satisfied without reference to the prior owner's use.⁸⁷

Section 175(c)(2) defines "land used in farming" as land used for the specified farming purposes before or "simultaneously with" the covered section 175 expenditures.⁸⁸ Before the 1980 changes in the regulations, there was substantial uncertainty as to whether soil and water conservation activities which removed one part of a tract from service could, because other portions of the tract were yet being farmed, be considered as measures upon "land used in farming."

In *Behring v. Commissioner*,⁸⁹ the Tax Court seemed to hold that the simultaneity requirement was met where conservation improvements were made on part of an eighty-acre tract that was taken out of service while the rest of the tract was being farmed.⁹⁰ The court emphasized that the conservation work implemented an integrated plan for the entire eighty acres which was designed and approved by the County Extension office.⁹¹ The court specifically rejected the notion that the conservation improvements and farming use must occur simultaneously on the same spot.⁹²

Behring was tried on a stipulation of facts which were murky at best. No indication was given as to how many of the eighty acres were out of service at any given time while the improve-

⁸⁴ See Treas. Reg. § 1.175-4(b) example 3.

⁸⁵ See *id.*

⁸⁶ See *Herndon v. United States*, 203 F. Supp. at 537-38.

⁸⁷ See *id.*

⁸⁸ See text accompanying note 61 *supra*. The phrase "at the same time" is used in the regulations. See Treas. Reg. § 1.175-4(a).

⁸⁹ 32 T.C. 1256 (1959), *acq. in result* 1972-1 C.B. 1.

⁹⁰ See *id.* at 1260-61.

⁹¹ See *id.* at 1260.

⁹² See *id.* at 1260-61.

ments were being made.⁹³ Moreover, the court implied that the taxpayer's intended farming use might have been a substantial continuation of the use thirty years earlier by the previous owner.⁹⁴ The Service initially acquiesced,⁹⁵ but it subsequently substituted an acquiescence in result only.⁹⁶

In *Herndon v. United States*,⁹⁷ a district court found that land was being used in farming where conservation improvements were made on certain fields while other fields were under cultivation.⁹⁸ The improvements were part of a conservation plan for the entire farm prepared by the local Soil Conservation District authorities.⁹⁹ The *Herndon* court cited *Behring*¹⁰⁰ and likewise did not discuss the respective sizes of the fields under cultivation improvements.¹⁰¹

Later decisions tended to reject the "entity" or "unit" theory, under which using a portion of a unit or entity for farming makes the whole "land used in farming" for purposes of section 175. In *Duda & Sons, Inc. v. United States*,¹⁰² a district court rejected the taxpayer's contention that a 15,000-acre tract should be considered a single farming entity to permit farming activities on portions of the tract to make the whole "land used in farming."¹⁰³ The court also refused to apply the entity theory to a 3,918-acre tract where 2,400 acres were under cultivation and where conservation improvements were being made to the previously uncultivated remainder.¹⁰⁴

The Tax Court in *Amfac, Inc. v. Commissioner*¹⁰⁵ limited its earlier decision in *Behring*. In *Amfac*, land not suitable for cultivation was incrementally cleared, developed, and placed in

⁹³ See *id.*

⁹⁴ See *id.*

⁹⁵ See 1960-1 C.B. 1.

⁹⁶ See 1972-1 C.B. 1.

⁹⁷ 203 F. Supp. 536.

⁹⁸ See *id.* at 537.

⁹⁹ *Id.*

¹⁰⁰ See *id.*

¹⁰¹ See *id.*

¹⁰² 383 F. Supp. 1303 (M.D. Fla. 1974), *rev'd on other grounds*, 560 F.2d 669 (5th Cir. 1977).

¹⁰³ See *id.* at 1307.

¹⁰⁴ See *id.* at 1309.

¹⁰⁵ 70 T.C. 305 (1978), *aff'd*, 626 F.2d 109 (9th Cir. 1980).

cultivation.¹⁰⁶ The taxpayer, relying on *Behring*, argued that farming the developed portions made the entire farm, including those portions undergoing conservation improvements, “land used in farming” for purposes of section 175.¹⁰⁷ However, the court noted that, unlike the land in *Amfac*, all of the land in *Behring* was suitable for farming before the conservation improvements were made.¹⁰⁸ The court indicated that “simultaneous use” does not encompass incremental development of land not previously suitable for farming.¹⁰⁹

The Ninth Circuit, in affirming the Tax Court, went further. It pointed out that certain conservation improvements—such as constructing drainage ditches, building irrigation canals or planting windbreaks—can take place on a small portion of a given piece of land while the remainder is being farmed.¹¹⁰ On the other hand, other types of improvements—such as leveling, grading, terracing and contour furrowing—cannot take place while the land is being farmed.¹¹¹ The court implied that only the area subjected to the first type of conservation improvements would be considered “land used in farming.”¹¹² The court refused to follow *Behring* to the extent it supported a general “unit” theory of simultaneous use.¹¹³

Regulation 1.175-7, added in 1980, rejects the unit theory.¹¹⁴ It requires proportional allocation of conservation expenditures which “directly and substantially” benefit portions of a taxpayer’s land actually used in farming.¹¹⁵ Thus, if conservation improvements benefit a 200-acre farm, only eighty acres of which is actually being farmed, 80/200 or forty percent of the cost of the improvements is allocated to the land actually used in farming. The remaining sixty percent is not deductible under section 175.¹¹⁶ The same allocation formula applies if the land is ac-

¹⁰⁶ See 70 T.C. at 305.

¹⁰⁷ See *id.* at 311-12.

¹⁰⁸ See *id.*

¹⁰⁹ See *id.*

¹¹⁰ See 626 F.2d at 111.

¹¹¹ See *id.*

¹¹² See *id.* at 112.

¹¹³ See *id.*

¹¹⁴ See Treas. Reg. § 1.175-7(c) (1980).

¹¹⁵ See *id.*

¹¹⁶ See Treas. Reg. § 1.175-7(c) example 1.

quired from someone who had farmed only eighty of the 200 acres.¹¹⁷

If the conservation improvements directly and substantially benefit one portion of the land while the other portion receives only minor and incidental benefits, all of the expenditures must be allocated to the portion receiving the substantial benefit.¹¹⁸ Using the previous example, if the eighty acres being farmed were substantially benefitted while the nonfarmed portion received only incidental benefits, all of the expenditures would be with respect to "land used in farming."¹¹⁹ If, on the other hand, only the 120 acres not being farmed received direct and substantial benefit, none of the expenditures would be deductible under section 175; all costs would be allocated to the 120 acres not being farmed.¹²⁰ Section 175 would require the same result if the expenditures were incurred by a lessor who had leased the land with the understanding that the lessee would farm all 200 acres.¹²¹

The regulation provides that a formula other than strict proportional allocation can be used if the alternate method is established, "by clear and convincing evidence," as being more reasonable.¹²² One possible alternative might be an allocation based on varying degrees of benefit to the farmed and nonfarmed portions where the benefit to each portion was more than incidental.

IV. ELIGIBLE EXPENDITURES

Eligible expenditures include those incurred for the following purposes: (1) treatment or moving of earth; (2) water conservation and control measures; (3) removal of brush; (4) growing of windbreaks; (5) payment of taxpayer's share of an assessment by a soil or water conservation or drainage district to reimburse the district for its expenditures to the extent such costs would have been deductible under section 175 if incurred directly by the taxpayer; and (6) payment of taxpayer's share of a district's

¹¹⁷ See *id.*

¹¹⁸ See Treas. Reg. § 1.175-7(c) example 2.

¹¹⁹ See *id.*

¹²⁰ See Treas. Reg. § 1.175-7(c) example 3.

¹²¹ See *id.*

¹²² See Treas. Reg. § 1.175-7(b).

assessment for its acquisition of depreciable property for use in district activities.¹²³

The expenditures must be with respect to "land used in farming" and must be made "in the furtherance of the business of farming."¹²⁴ With the exception of certain assessments by soil and water conservation districts, eligible expenditures do not include amounts which are subject to the section 167 depreciation allowance.¹²⁵ Additionally, section 175 does not apply to expenditures which are deductible without regard to that section.¹²⁶

Eligible expenditures for the treatment or moving of earth include "expenditures for leveling, conditioning, grading, terracing, contour furrowing, and restoration of soil fertility."¹²⁷ Expenditures for subsoiling, cross-chiseling, earth-moving, land planing and floating also are included.¹²⁸

Expenditures incurred to produce vegetation which helps conserve soil or water or which helps prevent erosion are covered under section 175.¹²⁹ Covered vegetation expenditures include, for example, the cost of seed, fertilizer and lime required to produce a soil-binding stand of vegetation as part of a "gully stabilization [program] or in stabilizing severely eroded areas."¹³⁰ Thus, expenses otherwise deductible under section 162 and section 180 are instead deducted under, and subject to, the limits imposed by section 175.¹³¹

Expenditures for "the construction, control, and protection of diversion channels, drainage ditches, irrigation ditches, earthen dams, watercourses, outlets, and ponds" are covered by section 175 if they are incurred primarily for soil or water conservation purposes.¹³²

¹²³ I.R.C. § 175(c)(1) (1984); Treas. Reg. § 1.175-2(a), (c) (1960).

¹²⁴ Treas. Reg. § 1.175-2(a)(1).

¹²⁵ I.R.C. § 175(c)(1)(A). See also I.R.C. § 167(a) (1984).

¹²⁶ I.R.C. § 175(c)(1)(B).

¹²⁷ Treas. Reg. § 1.175-2(a)(1).

¹²⁸ See Estate of Straughn, 55 T.C. at 23. In *Straughn*, "subsoiling" entailed ripping up a compacted layer of subsoil with heavy plows and chisels drawn by tractors to allow grapevines to develop proper root structure. See *id.*

¹²⁹ Treas. Reg. § 1.175-2(b)(2) (1960).

¹³⁰ *Id.* Costs incurred to establish Coastal Bermuda Grass, a soil-binding vegetation, primarily for erosion control, have also been held to be deductible under § 175. See *Herndon v. United States*, 203 F. Supp. at 538-39.

¹³¹ *Id.*

¹³² Treas. Reg. § 1.175-2(a)(1).

The regulations provide the following as examples of soil and water conservation purposes:

- (i) constructing terraces, or the like, to detain or control the flow of water, to check soil erosion on sloping land, to intercept runoff, and to divert excess water to protect outlets; (ii) constructing water detention or sediment retention dams to prevent or fill gullies, to retard or reduce run-off of water, or to collect stock water; and (iii) constructing earthen floodways, levies, or dikes to prevent flood damage to farmland.¹³³

Costs incurred to fill gullies or to construct earthen dams are also subject to section 175.¹³⁴

To be deductible under section 175, the expenditures must be paid or incurred by the taxpayer.¹³⁵ The Service has ruled that the portion of the purchase price of land allocable to earthen tanks (ponds) and earthen dams constructed by a previous owner, is not deductible by the acquiring taxpayer since he did not build them.¹³⁶

The deduction for the costs of brush removal will often be governed by either section 162 or section 182 rather than by section 175.¹³⁷ The Service has ruled that the cost of periodically clearing brush from productive land in order to maintain its productivity constitutes an ordinary and necessary business expense deductible under section 162 rather than a soil and water conservation expenditure governed by section 175.¹³⁸ The Service indicated that such costs would be capital if incurred before the land reached its productive state.¹³⁹ Although this ruling was subsequently declared obsolete,¹⁴⁰ its reasoning seems valid. In *Houston Brothers v. Commissioner*,¹⁴¹ the Board of Tax Appeals similarly concluded that brush removal is a deductible business expense.¹⁴² There, the taxpayer eradicated sprouts and brush on

¹³³ Treas. Reg. § 1.175-2(a)(2).

¹³⁴ See *Coffin v. Commissioner*, 41 T.C. 83 (1963).

¹³⁵ I.R.C. § 175(a).

¹³⁶ Rev. Rul. 606, 1969-2 C.B. 33, *clarified*, Rev. Rul. 137, 1975-1 C.B. 74.

¹³⁷ See I.R.C. §§ 162, 182 (1984 & Supp. 1985).

¹³⁸ See Rev. Rul. 42, 1959-1 C.B. 47.

¹³⁹ See *id.* at 48.

¹⁴⁰ See Rev. Rul. 565, 1976-2 C.B. 449.

¹⁴¹ 22 B.T.A. 51 (1931).

¹⁴² See *id.* at 70.

a dormant portion of a cotton farm so that portion could again be put into cultivation.¹⁴³ The court held that the costs of sprout and brush removal were ordinary and necessary business expenses deductible under what is now section 162.¹⁴⁴ On the other hand, if an expense is incurred to put land into production, it will not be considered as incurred with respect to "land used in farming" unless there is a qualifying prior farming use.¹⁴⁵

If a taxpayer is assessed for a share of soil and water conservation expenditures by a soil or water conservation or drainage district, the taxpayer can deduct the assessment under section 175 as if it were incurred directly by the taxpayer during the year of the assessment.¹⁴⁶ The deduction is taken in the year the assessment is paid or incurred by the taxpayer, depending on the taxpayer's accounting method, rather than in the year the district pays or incurs the expenditure.¹⁴⁷

The term "soil or water conservation or drainage district" includes nonprofit mutual irrigation companies exempt from tax under section 501(c)(12),¹⁴⁸ soil and water conservation districts, drainage districts, irrigation districts, watershed improvement districts, flood control districts, and conservancy districts.¹⁴⁹ Irrigation or drainage companies which operate for profit are not included.¹⁵⁰ Covered activities include those undertaken by the companies or districts for the purpose of furnishing water to farmland, controlling farm water, or draining water from farmland.¹⁵¹

In 1968, section 175(c)(1) was amended, and section 175(f) was added, to govern costs incurred by districts to acquire depreciable property.¹⁵² Prior to these changes, a taxpayer's share of these costs was not deductible under section 175 since the

¹⁴³ See *id.* at 62.

¹⁴⁴ See *id.* at 70.

¹⁴⁵ See notes 67-68, 72-87 *supra* and accompanying text.

¹⁴⁶ See I.R.C. § 175(c)(1); Treas. Reg. § 1.175-2(c).

¹⁴⁷ See Treas. Reg. § 1.175-2(c).

¹⁴⁸ See I.R.C. § 501(c)(12) (1984 & Supp. 1985).

¹⁴⁹ See S. REP. NO. 1497, 90th Cong., 2d Sess. 1, 4.

¹⁵⁰ See *id.*

¹⁵¹ See *id.*

¹⁵² See Pub. L. No. 90-630, 82 Stat. 1328, 1329-30 (1968) (codified as amended at I.R.C. §§ 175(c)(1), 175(f) (1984)). The changes are effective for assessments levied in taxable years ending after Oct. 22, 1968. See Pub. L. No. 90-630, § 5(c), 82 Stat. at 1330.

taxpayer could not have deducted the costs under section 175 had they been paid or incurred directly by the taxpayer.¹⁵³ Moreover, the taxpayer could not take depreciation on the equipment owned by the district.¹⁵⁴ On the other hand, the taxpayer would have been entitled to depreciation if the taxpayer had acquired the depreciable property directly.¹⁵⁵ Congress thought such treatment placed taxpayers in soil or water conservation districts in a less favorable tax position than taxpayers who undertook soil and water conservation activities directly.¹⁵⁶

Under section 175(c)(1) as amended, a taxpayer can claim as section 175 expenses the taxpayer's share of an assessment for the district's acquisition costs of depreciable property to be used in conservation activities. The district must actually acquire ownership of depreciable property for this provision to be relevant.¹⁵⁷ Thus, the Service has ruled that—even though, during the years in issue, there was no provision for the deductibility of an assessment representing the district's cost of acquiring depreciable property—a taxpayer's share of the cost of a water distribution system, used by a district but owned by the government, can be deducted under the general assessment rules of section 175(c)(1).¹⁵⁸ The ruling indicates that the result would be the same under section 175(c) as amended.¹⁵⁹

The amount which is deductible by a particular taxpayer under section 175(c)(1) cannot exceed ten percent of the total assessment for depreciable assets levied against all district members.¹⁶⁰ For example, if the district's total annual assessment is \$1,000,000, \$100,000 of which represents the acquisition costs of depreciable property, no one taxpayer could deduct more than \$10,000 of the total \$100,000 assessment for depreciable property.¹⁶¹ If a particular taxpayer's share of the assessment exceeds the ten percent limit, the excess is considered a capital

¹⁵³ See I.R.C. § 175(c)(1)(A).

¹⁵⁴ See S. REP. NO. 1497, *supra* note 149, at 4.

¹⁵⁵ See I.R.C. § 167(a) (Supp. 1985).

¹⁵⁶ See S. Rep. No. 1497, *supra* note 149, at 3.

¹⁵⁷ See *id.*

¹⁵⁸ See Rev. Rul. 358, 1973-2 C.B. 74.

¹⁵⁹ See *id.*

¹⁶⁰ S. REP. NO. 1497, *supra* note 149, at 4.

¹⁶¹ See *id.* at 5.

expenditure and is added to the basis of the farm property benefitted by the district's conservation activities.¹⁶²

Section 175(f) contains a further limitation. If a taxpayer's deductible assessment with respect to depreciable property for a particular year exceeds, by more than \$500, ten percent of the amounts assessed against the taxpayer with respect to that equipment, the excess must be amortized ratably over the succeeding nine years.¹⁶³ The Farmer's Tax Guide provides an illustration involving a \$2,400 assessment against a 1,200 acre farm. The assessment includes \$1,850 for digging natural drainage ditches and \$550 for depreciable equipment. The total assessment against district members with respect to the equipment is \$8,000.¹⁶⁴ Under section 175(c)(1), the taxpayer's deductible assessment is limited to no more than ten percent of the total assessment with respect to the equipment, or \$800. The entire \$550 would thus be within the ten percent limitation. Ten percent of the \$550 deductible assessment is \$55. The deductible assessment of \$550 exceeds \$55 by \$495, which is less than \$500. Therefore, the entire \$550 relating to the depreciable equipment, as well as the \$1,850 relating to the drainage ditches, is included in the taxpayer's expenditures eligible for deduction under section 175 during the year of the assessment or its payment, depending on the taxpayer's accounting method.¹⁶⁵

On the other hand, assume that \$1,500 of the \$2,400 assessment is for digging drainage ditches and \$900 is for depreciable equipment to be used in the district's irrigation activities. The taxpayer's deductible assessment with respect to the depreciable equipment is limited to ten percent of \$8,000, or \$800. The \$100 of the taxpayer's share which exceeds that limit is added to the taxpayer's basis in the farm.¹⁶⁶

Section 175(f) operates with respect to the \$800 deductible assessment. Ten percent of that amount is \$80. The \$800 deductible assessment exceeds \$80 by \$720, which is more than \$500. Therefore, only \$80 is deductible by the taxpayer in the year the assessment is paid or incurred. The remaining \$720 is

¹⁶² *Id.* See FARMER'S TAX GUIDE, *supra* note 56, at 17.

¹⁶³ See S. REP. NO. 1497, *supra* note 149, at 5.

¹⁶⁴ See FARMER'S TAX GUIDE, *supra* note 56, at 18.

¹⁶⁵ See *id.*

¹⁶⁶ See *id.*

deductible at the rate of \$80 per year over the nine succeeding years.¹⁶⁷

If the land is sold or otherwise disposed of, except by reason of the taxpayer's death, before the nine-year period expires, any undeducted portion of the deductible assessment is added to the land's adjusted basis immediately before its disposition, and cannot be deducted under section 175.¹⁶⁸ Thus, if the taxpayer in the above example were to sell the property during the fifth year following the year of the assessment, \$400 would have been deducted under section 175 (\$80 for the year of assessment and a total of \$320 for the next four years before the year of disposition). The remaining \$400 would be added to the taxpayer's basis in the farm immediately before the sale.¹⁶⁹ If instead of selling the property, the taxpayer were to die in that fifth year following the year of assessment, the remaining \$400 would be considered an expenditure eligible for the deduction under section 175 in the year the taxpayer died.¹⁷⁰

If a district borrows money to acquire depreciable equipment and if it makes more than one assessment against its members to retire the loan, the limitations of section 175(f) apply with respect to the total which is assessed against the taxpayer with respect to the equipment.¹⁷¹ For example, suppose a taxpayer's share of that total assessment is \$2,700, with \$900 assessed initially and the remaining \$1,800 (excluding interest) to be assessed in subsequent years. Assuming that the \$900 initial assessment does not exceed ten percent of the total assessment against all members for that year, the entire \$900 would constitute the taxpayer's deductible assessment for that year.¹⁷² Ten percent of \$2,700 (the taxpayer's eventual total assessment, excluding interest) is \$270, and \$900 exceeds \$270 by \$630. Under section 175(f)(1), only \$270 of the \$900 assessment is included as an eligible expenditure during the year of the initial assessment. The remaining \$630 will be included ratably over the next nine years. If \$900 more is assessed against the taxpayer in the

¹⁶⁷ I.R.C. § 175(f) (1984).

¹⁶⁸ I.R.C. § 175(f)(2).

¹⁶⁹ See FARMER'S TAX GUIDE, *supra* note 56, at 18.

¹⁷⁰ See I.R.C. § 175(f)(3). See also FARMER'S TAX GUIDE, *supra* note 56, at 18.

¹⁷¹ S. REP. No. 1497, *supra* note 149, at 5.

¹⁷² See *id.*

second year, \$230 of that assessment will be included in eligible expenditures for that year and the remaining \$630 will be included ratably over the nine years after that, and so on.¹⁷³

When a series of annual assessments are levied against land to pay for depreciable property acquired by a district, and a taxpayer acquires the land after some of the assessments have been paid by a prior owner, "the prior assessments are to be taken into account in computing the aggregate amounts which have been and will be assessed against the land" for purposes of the limitations in section 175(f)(1).¹⁷⁴

Expenditures eligible for deduction under section 175 do not include expenditures for the "purchase, construction, installation, or improvement of structures, appliances, or facilities which are of a character subject to the allowance for depreciation."¹⁷⁵ An exception, discussed above,¹⁷⁶ applies where a conservation district acquires depreciable property for conservation purposes and passes the cost along to its members through assessments.

The exclusion of depreciable property costs from section 175 does not mean that these costs are not recoverable through depreciation or cost recovery. This exclusion merely means that, rather than being expensed as current deductions under section 175, the costs have to be capitalized and recovered under the general rules for depreciation or cost recovery.¹⁷⁷

Expenditures allocable to the construction and installation of depreciable items include, for example, expenditures for materials, supplies, wages, fuel, hauling and dirt moving.¹⁷⁸ These expenditures must be capitalized as part of the cost basis of the assets to which they relate.¹⁷⁹

The regulations, in effect, presume that the costs of earthen improvements, such as dams and terraces are nondepreciable while the costs of nonearthen improvements, such as tanks, reservoirs, pipes, conduits, canals, dams, wells or pumps composed of masonry, concrete, tile, metal or wood are deprecia-

¹⁷³ See *id.*

¹⁷⁴ See *id.* at 5-6.

¹⁷⁵ I.R.C. § 175(c)(1)(A).

¹⁷⁶ See notes 152-74 *supra* and accompanying text.

¹⁷⁷ See Treas. Reg. § 1.175-2(b)(1). See also FARMER'S TAX GUIDE, *supra* note 56, at 17.

¹⁷⁸ Treas. Reg. § 1.175-2(b)(1).

¹⁷⁹ See Treas. Reg. § 1.1012-1(a) (1980).

ble.¹⁸⁰ This is only a presumption, however, since there is authority for claiming depreciation with respect to certain earthen improvements.

In practice, the presumption against depreciability of earthen improvements forces taxpayers to present competent evidence of useful lives of *particular* structures to rebut the presumption of nondepreciability. For example, the Service has indicated that evidence of "average" lives of earthen ponds generally is insufficient to establish their depreciability in the absence of evidence indicating the useful lives of the particular ponds.¹⁸¹ On the other hand, the Tax Court found the testimony of an accredited appraiser and ranching expert sufficient to establish the useful lives of earthen water tanks and dams on a ranch.¹⁸² In the same case, the court held that the cost of building drainage ditches and terraces to prevent the washout of roads was depreciable where the roads themselves were depreciable.¹⁸³ Similarly, a district court held that earthen dams on a ranch were depreciable over a ten-year period where evidence established that the dams would become filled with silt and, consequently, worthless during that period.¹⁸⁴ Another district court, citing the previous case without further elaboration, found that an earthen dam constructed by a farmer had a useful life of 10 years.¹⁸⁵ In a private letter ruling, the Service stated that a large earthen dam constructed by a manufacturer of paper products to supply water to its plant was depreciable.¹⁸⁶ Another private ruling concluded that the initial cost of constructing a network of earthen levees enclosing ponds used as fish-raising facilities was nondepreciable unless the taxpayer showed that the assets had determinable useful lives.¹⁸⁷ However, the costs of periodically draining and cleaning the ponds and reworking the levees to keep them in

¹⁸⁰ See *id.*

¹⁸¹ See Rev. Rul. 606, 1969-2 C.B. 33, 34, *clarified*, Rev. Rul. 137, 1975-1 C.B. 74.

¹⁸² See *Rudolph Inv. Corp. v. Commissioner*, 31 T.C.M. (CCH) 573, 578 (1972).

¹⁸³ See *id.* The roads were depreciable because they all led to depreciable buildings and "would be abandoned if the improvements were no longer needed." *Id.*

¹⁸⁴ See *Ekberg v. United States*, 5 A.F.T.R.2d (P-H) 979, 981 (D.S.D. 1959), *rev'd on other grounds*, 291 F.2d 913 (8th Cir.), *cert. denied*, 368 U.S. 920 (1961).

¹⁸⁵ See *Fancher v. United States*, 10 A.F.T.R.2d (P-H) 5925, 5930 (D.S.D. 1962).

¹⁸⁶ See IRS Letter Rul. 7,725,002 (undated).

¹⁸⁷ See IRS Letter Rul. 8,105,035 (Oct. 30, 1980).

usable condition were determined to be depreciable because the intervals between these operations were capable of reasonable estimation.¹⁸⁸ Similarly, the Tax Court held the earthen components of a ranch's irrigation system to be nondepreciable, but the court allowed the cost of "draglining" the irrigation ditches to clear sediment, an operation which had to be repeated every ten years or so, to be amortized over the ten-year period.¹⁸⁹

A likely effect of the presumption of nondepreciability is that a taxpayer claiming the cost of an earthen improvement as an eligible section 175 expenditure will not be challenged on the ground that the expenditure relates to a depreciable asset and is thus not deductible under section 175.

If a tenant constructs improvements on leased property, the tenant either depreciates the cost of the property over its useful life or amortizes it over the remaining lease term, whichever is shorter.¹⁹⁰ It seems clear that a tenant who incurs conservation expenditures for improvements, which normally would be depreciable, cannot deduct those expenditures under section 175 where the tenant actually amortizes the cost of the improvement. The improvement in that case is "of a character subject to the allowance for depreciation."¹⁹¹ However, a tenant who constructs an improvement on leased property should be able to amortize the cost over the remaining lease term, even though the improvement has an indefinite useful life and thus would not normally be subject to depreciation.¹⁹² The regulations under section 167 provide that the amortization deduction claimed by a tenant over the lease term, if shorter than the useful life of the asset involved, "shall be *in lieu of* allowances for depreciation."¹⁹³ Consequently, a tenant's expenditures for a conservation improvement would presumably be "of a character subject to the allowance for depreciation" only if the improvement has a determinable useful life and depreciation could be taken with a longer lease term.¹⁹⁴

¹⁸⁸ See *id.*

¹⁸⁹ See *Wolfsen Land & Cattle Co. v. Commissioner*, 72 T.C. 1, 12-13 (1979).

¹⁹⁰ Treas. Reg. §§ 1.162-11(b)(1) (1960), 1.167(a)-4 (1960).

¹⁹¹ See Treas. Reg. §§ 1.162-11(b)(1), 1.167(a)-4.

¹⁹² Cf. *Brown v. United States*, 37 A.F.T.R.2d (P-H) at 1186.

¹⁹³ See Treas. Reg. § 1.167(a)-4 (emphasis added).

¹⁹⁴ See *id.*

Section 175 is generally designed to provide a deduction where the expenditures are not otherwise recoverable through current or deferred deductions. This exclusionary process saves otherwise recoverable expenditures from being subjected to the section 175 limitations—the binding effect of the election and the annual limitation on the amount deductible.¹⁹⁵ A tenant who can amortize nondepreciable improvement costs, however, is apparently in a position to choose between section 175 and the amortization deductions. An interesting question is whether a tenant's choice to amortize the cost of nondepreciable improvements, which would otherwise qualify as section 175 expenditures, would constitute an election *not* to deduct current and future soil and water conservation expenditures under section 175.¹⁹⁶

Section 175 is generally intended to provide a current deduction for conservation expenditures where such a deduction is otherwise unavailable. Consequently, if the expenditure can be deducted under some other provision, section 175 generally does not apply.¹⁹⁷ Certain expenses clearly fall outside section 175. Section 175 does not apply to expenses for interest and taxes, which are deductible under sections 163 and 164 without regard to section 175.¹⁹⁸

At times, the distinction is uncertain between currently deductible business expenses and capital expenditures which can be currently deducted, if at all, only under section 175. Thus, the cost of eradicating brush from productive land may be deductible under section 162 even though the removal also serves conservation purposes.¹⁹⁹ Where the productivity of land was threatened by soil erosion and terracing was found not to have increased the value of the land, the Tax Court has held expenditures incurred to construct earthen terraces to be currently deductible as ordinary and necessary "repairs" to the land.²⁰⁰ However, the Service has indicated it will follow that case only on substantially

¹⁹⁵ Treas. Reg. § 1.175-2(b).

¹⁹⁶ See text accompanying notes 261-65 *infra* for a discussion of this issue.

¹⁹⁷ See I.R.C. § 175(c)(1)(B).

¹⁹⁸ Treas. Reg. § 1.175-2(b)(2).

¹⁹⁹ See *Houston Bros. v. Commissioner*, 22 B.T.A. at 51; Rev. Rul. 42, 1959-1 C.B. 47, *declared obsolete*, Rev. Rul. 565, 1976-2 C.B. 449. See also notes 138-42 *supra* and accompanying text.

²⁰⁰ See *Collingwood v. Commissioner*, 20 T.C. at 943.

similar facts and will presume that terrace-building costs are capital expenditures in the absence of convincing evidence to the contrary.²⁰¹ The costs of maintaining and repairing the terraces, on the other hand, will ordinarily be currently deductible business expenses not covered by section 175.²⁰² The same is true of repair and maintenance expenses with respect to other completed soil and water conservation structures.²⁰³

If the expenditures relate primarily to conservation activities, they may be governed by section 175 even though they normally are deductible under other provisions. For example, the costs of establishing a stand of vegetation primarily to conserve soil or water or to prevent erosion is governed by section 175.²⁰⁴ This includes the costs of fertilizer, lime, or other soil-enrichment expenditures which would normally be deductible under section 162 or section 180.²⁰⁵ On the other hand, if the vegetation or crop has commercial value and the conservation aspects are only incidental, section 175 does not apply to the otherwise currently deductible expenses incurred to produce the vegetation or crop.²⁰⁶ Similarly, conservation expenditures which do not relate to depreciable property are governed by section 175 even if the expenditures are also of a type which might qualify as deductible land-clearing expenditures under section 182.²⁰⁷

V. LIMITATION ON DEDUCTION

Conservation expenditures deducted under section 175 in a particular taxable year cannot exceed twenty-five percent of the "gross income derived from farming" during that year.²⁰⁸ Any excess can be carried forward to future years.²⁰⁹

The regulations²¹⁰ define "gross income from farming" as the gross income "derived in 'the business of farming' . . . , from the production of crops, fruits, or other agricultural prod-

²⁰¹ See Rev. Rul. 191, 1954-1 C.B. 68, 69.

²⁰² See *id.*

²⁰³ See Treas. Reg. § 1.175-2(b)(2).

²⁰⁴ *Id.*

²⁰⁵ See *id.*; Treas. Reg. § 1.180-1(a) (1961).

²⁰⁶ Treas. Reg. § 1.175-2(b)(2).

²⁰⁷ Treas. Reg. § 1.182-3(b)(2) (1965).

²⁰⁸ I.R.C. § 175(b).

²⁰⁹ *Id.*

²¹⁰ See Treas. Reg. § 1.175-5(a)(2) (1960).

ucts, including fish, or from livestock (including livestock held for draft, breeding, or dairy purposes).”²¹¹ The gross income is not limited to that derived from the land with respect to which the conservation expenditures are made.²¹² For example, if one tract of land is taken out of production while conservation improvements are being made, the gross income from the farmer’s productive tracts would supply the “gross income from farming” against which the twenty-five percent limitation would be applied. The non-productive tract would still have to qualify as “land used in farming,” which means it would have to have been in production prior to having been taken out of service for purposes of the improvements.²¹³

The regulations imply that “gross income from farming” generally includes only that income generated in the ordinary course of business, such as crop sales. Gains from the sale of farm assets, such as land and farm machinery, used to produce such income are generally excluded.²¹⁴ Interestingly, gains from the sale of livestock held for draft, dairy, or breeding purposes are included, even though this livestock could obviously play the same role in the production of farm income as farm equipment and land.²¹⁵

The regulations do not reveal the reason for including gains from the sale of certain livestock in the definition of “gross income from farming,” while excluding gains from land and equipment sales. This distinction may represent the view that sales of all livestock, including those held for draft, dairy, or breeding purposes, are much more likely to occur in the ordinary course of business than sales of equipment and land. Such factors as weather and disease play a greater role in the timing of all types of livestock sales than is the case with sales of farm equipment and land. The Service has relied on the section 175 definition of gross income from farming in a ruling interpreting section 6073(b), which permits a later filing date for declarations of estimated tax for those who meet specified “gross income

²¹¹ See notes 15-59 *supra* and accompanying text for a discussion of this.

²¹² Treas. Reg. § 1.175-5(a)(2).

²¹³ For a discussion of the farming use requirement, see text accompanying notes 67-68, 72-87 *supra*.

²¹⁴ See Treas. Reg. § 1.175(a)(2).

²¹⁵ See *id.*

from farming or fishing” requirements.²¹⁶ According to the ruling, Congress allows the later filing date for farmers since it is hard for them to estimate their farm income early in the year because of such uncontrollable factors as weather, plant and animal diseases, insects and other pests.²¹⁷ The Service noted that while these factors are generally not relevant to sales of farm equipment and land, they could have a direct bearing on the sales of all types of livestock, including draft, dairy and breeding livestock. This in turn indicates that the gains from the sales of such livestock should be included in determining whether a farmer meets the gross income from farming requirements specified by section 6073(b), while the gains from the sale of farm equipment and land should not.²¹⁸

Sales of draft, dairy and breeding livestock are excluded from Schedule F.²¹⁹ They are also excluded when computing net earnings from self-employment for purposes of determining the self-employment tax.²²⁰ The Tax Court has held that sales of both farm equipment and breeding animals may be in the ordinary course of a farming operation where the sales are incidental to the operation of the farm, serve to dispose of assets no longer economically productive or useful in the farming operation, and do not represent a total or partial termination of the farming operation.²²¹ Losses from such sales are therefore attributable to the taxpayer’s “trade or business” of farming and can be taken into account in determining net operating loss carrybacks and carryforwards.²²² This approach also seems preferable in determining gross income from farming for purposes of section 175.

Since the gross income must be derived from the “business of farming,” the rules previously discussed for determining when a landlord is so engaged would apply.²²³ Thus, a landlord re-

²¹⁶ See Rev. Rul. 26, 1963-1 C.B. 295, *modified*, Rev. Rul. 366, 1980-2 C.B. 343. I.R.C. § 6073(b) (1984) allows farmers and fishermen to file declarations of estimated income tax “at any time on or before January 15 of the taxable year succeeding the taxable year.”

²¹⁷ See Rev. Rul. 26, 1963-1 C.B. 295, 296.

²¹⁸ See *id.*

²¹⁹ IRS Form 1040, Schedule F, Farm Income and Expenses (1983).

²²⁰ See I.R.C. § 1402(a)(3)(C) (1984 & Supp. 1985); Treas. Reg. § 1.1402(a)-6(a) (1963).

²²¹ See *Goble v. Commissioner*, 23 T.C. 593 (1954), *acq.* 1955-2 C.B. 6.

²²² *Id.* at 598-99.

²²³ See notes 54-56 *supra* and accompanying text.

ceiving rent based on farm production is engaged in the business of farming, and the income is gross income derived from farming.²²⁴ The landlord receiving a fixed rental, on the other hand, is not engaged in the business of farming unless the landlord materially participates in the operation or management of the farm.²²⁵

If a partnership is "engaged in the business of farming," each partner is considered to be so engaged.²²⁶ Consequently, each partner's share of the partnership's "gross income from farming" is included in that partner's "gross income from farming."²²⁷

On the other hand, income received by the beneficiary of a trust engaged in farming cannot be considered "gross income from farming" received by that beneficiary for purposes of determining the deductibility of conservation expenditures on the beneficiary's own farm property.²²⁸ The same should be true for the beneficiary of an estate engaged in farming.²²⁹ However, this stricture may not apply to one who is considered the grantor of a grantor trust. Such a grantor is generally required to treat the income and expenses of the trust as if realized or paid by the grantor directly.²³⁰

C corporation shareholders clearly do not have gross income derived from farming as a result of the corporation's farming activities. The corporation, rather than the shareholders, makes the election and deducts any eligible conservation expenditures.²³¹ The same is true of a Subchapter S corporation not subject to the Subchapter S Revision Act of 1982.²³² However, shareholders of S corporations governed by the new rules are apparently treated in substantially the same manner as partners in a partnership for this purpose.²³³ Section 1366²³⁴ provides a "pass-

²²⁴ Treas. Reg. §§ 1.175-3, 1.175-5(a)(2).

²²⁵ Treas. Reg. § 1.175-3.

²²⁶ *Id.*

²²⁷ See Treas. Reg. § 1.702-1(c)(1)(iv), T.D. 6649, 1963-1 C.B. 49 (1980). See also Treas. Reg. § 1.175-5(b).

²²⁸ Rev. Rul. 191, 1958-1 C.B. 149.

²²⁹ *Cf. id.*

²³⁰ See I.R.C. § 671; Treas. Reg. § 1.671-2(c).

²³¹ *Cf. Brown v. United States*, 37 A.F.T.R.2d (P-H) at 1185.

²³² See *id.*

²³³ See I.R.C. § 702 (1984 & Supp. 1985).

²³⁴ Pub. L. No. 97-354, § 1366, 96 Stat. 1677-79.

through” treatment of income and deductions which parallels the conduit approach of section 702 with respect to partners in a partnership.²³⁵ Although no regulations have yet been issued under new section 1366, the IRS lists soil and water conservation expenses as expenses which must be separately stated by the S corporation and taken into account separately by the shareholders.²³⁶ This treatment corresponds with established practice under the partnership rules.²³⁷

Government payments received with respect to “land used in farming” by one “engaged in the business of farming,” as those terms are defined for purposes of section 175, and which are required to be included in gross income, presumably constitute “gross income from farming” for section 175 purposes. The Service has conceded that payments received by a taxpayer from the Department of Agriculture as part of its soil and water conservation program are gross income derived from farming for purposes of section 175.²³⁸ However, payments received under certain federal and state cost-sharing conservation programs may be excluded from income under certain circumstances where the payments are not for expenses which are currently deductible.²³⁹ Commodities received under the government’s Payment-In-Kind (PIK) Program for the 1983 crop year are treated as if they were produced by the receiving taxpayer.²⁴⁰ Income from the sale of such commodities is therefore considered gross income from farming for purposes of section 175.²⁴¹

If the eligible conservation expenditures in a given taxable year exceed twenty-five percent of the gross income derived from farming for that year, the excess is carried over to succeeding taxable years and deducted in chronological order.²⁴² This means that any excess carried over from year one to year two will be

²³⁵ See S. REP. NO. 640, *supra* note 32, at 17.

²³⁶ See TAX INFORMATION, *supra* note 37, at 7.

²³⁷ See Treas. Reg. § 1.702-1(a)(8)(i).

²³⁸ Coffin v. Commissioner, 41 T.C. at 85.

²³⁹ I.R.C. § 126 (1984); Temp. Treas. Reg. §§ 16A.126-1 to -2, .1255-1 to -2, 26 C.F.R. §§ 16A.126-1 to -2, .1255-1 to -2 (1984). See also FARMER’S TAX GUIDE, *supra* note 56, at 9.

²⁴⁰ Payment-in-Kind Treatment Act of 1983, Pub. L. No. 98-4, § 2(a)(2), 97 Stat. 7.

²⁴¹ See H.R. REP. NO. 14, 98th Cong., 1st Sess., 18-19 (1983), *reprinted in* 1983 U.S. CODE CONG. & AD. NEWS 3, 19-20.

²⁴² I.R.C. § 175(b).

aggregated with eligible year two conservation expenditures and the total will then be deducted in year two, subject to the limitation that the deduction not exceed twenty-five percent of the gross income derived from farming for year two. If there is an excess over the gross income limitation for year two, the excess will be carried over to year three, with the year one excess having been deducted first in year two.²⁴³

The regulations provide that expenditures in excess of the deductible limitations may be carried over "during the taxpayer's entire existence."²⁴⁴ The lifespan of the carryover is thus concurrent with that of the taxpayer who incurs the expenditures rather than with a particular farming enterprise or land with respect to which the expenditures have been incurred. For example, if a taxpayer goes out of the farming business, any unused carryovers cannot be added to the taxpayer's basis in any farmland being disposed of for the purposes of determining gain or loss.²⁴⁵ The benefit of the carryovers will be lost if the taxpayer never again engages in farming. On the other hand, if the taxpayer subsequently purchases or rents another farm and resumes farming operations, the carryovers from the previous farming operations can be offset against the gross income from the subsequent farming operations.²⁴⁶

In farm partnerships, the twenty-five percent limitation is applied at the partner level rather than at the partnership level.²⁴⁷ Thus, the partner's distributive share of the partnership's gross income from farming is added to any gross income the taxpayer may have from farming operations outside the partnership. Similarly, the partner's share of any eligible conservation expenditures paid or incurred by the partnership is added to any such expenditures incurred by the partner with respect to nonpartnership operations.²⁴⁸ The combined expenditures are then deductible by the partner to the extent they do not exceed twenty-five percent of the combined gross income from farming.²⁴⁹ The lifespan of any excess carryovers is that of the partner.²⁵⁰

²⁴³ See Treas. Reg. § 1.175-5(b).

²⁴⁴ See *id.*

²⁴⁵ Treas. Reg. § 1.175-6(e) (1960).

²⁴⁶ *Id.*

²⁴⁷ Treas. Reg. § 1.175-5(b).

²⁴⁸ See *id.*

²⁴⁹ Cf. Rev. Rul. 141, 1966-1 C.B. 56.

²⁵⁰ Treas. Reg. § 1.175-5(b). See notes 244-46 *supra* and accompanying text.

It appears that S corporation shareholders are now governed by the same rules as partners for many purposes, including the treatment of soil and water conservation expenses as separately stated items.²⁵¹ Whether the treatment of soil and water conservation expenses incurred by the S corporation will be subject to all the rules governing the same expenses when incurred by a partnership is uncertain at this time.

The eligible conservation expenditures which are actually deductible under section 175, to the extent of the twenty-five percent limitation, can be taken into account for purposes of computing the taxpayer's net operating loss for a particular taxable year.²⁵² This includes conservation expenditures carried forward from prior years to the extent they are within the twenty-five percent limitation for the year the net operating loss is being determined.²⁵³ As a part of that net operating loss, the expenditures are subject to carryback and carryforward under section 172.²⁵⁴ However, once incorporated into a net operating loss, the conservation expenditures lose their character as section 175 expenditures for purposes of the twenty-five percent limitation in any year to which the net operating loss might be carried.²⁵⁵

VI. MAKING THE ELECTION TO DEDUCT OR CAPITALIZE

An election to deduct rather than to capitalize conservation expenditures under section 175 is made by claiming the deductions on the tax return for the first taxable year in which such expenditures are paid or incurred.²⁵⁶ Since section 175 applies only to expenditures which must otherwise be capitalized, the failure to deduct eligible expenditures in the year during which they are first paid or incurred constitutes an effective election to capitalize.²⁵⁷ In that case, the expenditures are capitalized as part of the basis of the property to which they relate.²⁵⁸

²⁵¹ See notes 29-41 *supra* and accompanying text.

²⁵² Treas. Reg. § 1.175-5(a)(3).

²⁵³ *Id.*

²⁵⁴ See I.R.C. § 172(a) (1984).

²⁵⁵ Treas. Reg. § 1.175-5(a)(3).

²⁵⁶ I.R.C. § 175(d)(1).

²⁵⁷ See FARMER'S TAX GUIDE, *supra* note 56, at 18.

²⁵⁸ See Treas. Reg. § 1.175-1.

While a failure to deduct any such expenditures in the first year should clearly constitute an election to capitalize them, it appears that a proper election to deduct the expenditures may require that they be deducted as *conservation* expenditures, rather than business expenses.²⁵⁹ The Tax Court has held that the election to deduct under section 175 was not properly made where the expenditures were deducted as ordinary and necessary business expenses rather than conservation expenditures, and where it appeared that the taxpayer did not consider the expenditures to be conservation expenditures covered by section 175.²⁶⁰ Although the opinion provides little analysis, thereby diluting its value as precedent, it should nonetheless serve as a warning of the need for care in claiming the deductions.

The foregoing discussion raises the issue of a tenant's amortization of nondepreciable improvements on leased property.²⁶¹ If a tenant chooses to amortize the cost of the improvements which would otherwise qualify as soil and water conservation expenditures, would the tenant be considered to have made a binding election *not* to use section 175? The answer should be no. The elective process contemplated by section 175 involves a decision whether to deduct the expenditures under section 175 or to capitalize them as part of the basis of the property.²⁶² That choice assumes that the expenditure can only be deducted under section 175, which may not be the case with respect to a tenant's nondepreciable improvements on leased property.²⁶³ The Tax Court Memorandum decision discussed in the previous paragraph dealt with expenditures *improperly* deducted under section 162 rather than section 175. To the extent that a tenant's amortization deduction is *properly* claimed without regard to section 175, it seems that the claimed deduction should not constitute an election as to other current or future section 175 expenditures. Under the literal terms of section 175, deductions claimed under another section should also be ignored in computing any limi-

²⁵⁹ See *id.*

²⁶⁰ See Roy L. Harding, 29 T.C.M. (CCH) 789, 794 n.5 (1970).

²⁶¹ See notes 190-96 *supra* and accompanying text.

²⁶² See I.R.C. § 175(a).

²⁶³ See Treas. Reg. § 1.167(a)-4, T.D. 6500, 25 Fed. Reg. 11,402 (1960) as amended by T.D. 6520, 25 Fed. Reg. 13,692 (1960).

tation on section 175 deductions,²⁶⁴ since the depreciation provision contained in section 182 is absent from section 175. The former section specifically provides that depreciation on equipment used in clearing land is included in the section 182 expenditures subject to the maximum deduction limitation imposed by that section.²⁶⁵ The absence of such a provision in section 175 suggests that otherwise proper depreciation on equipment used in making soil and water conservation improvements is not included as part of the section 175 "expenditures" for purposes of the maximum deduction limitation of section 175. The same would seem to be true of a tenant's amortization deduction if properly claimed without regard to section 175.

Where the consent of the district director is required in order to deduct or capitalize conservation expenditures, the request must be made in writing and filed not later than the due date of the tax return for the taxable year for which consent is sought.²⁶⁶ Although the regulations do not expressly state whether the return due date includes extensions, the Service has privately ruled that extensions are included.²⁶⁷

Where the election to deduct does not require consent, as is the case in the first year in which such expenditures are paid or incurred, the return on which the deductions are claimed presumably has to be timely filed, even during periods of approved extensions. Supportive of this conclusion is a private letter ruling which indicated that extensions of time granted under section 6081 are implied for those regulations that do not specifically include such extensions.²⁶⁸ Furthermore, a district court has held that the election to deduct conservation expenditures incurred by a rancher in a year for which no tax return was filed cannot be subsequently made in a claim for refund for that year after assessment and payment of a deficiency.²⁶⁹

Once the election to deduct or capitalize is made, the treatment elected applies to all eligible conservation expenditures for

²⁶⁴ See I.R.C. § 175(b).

²⁶⁵ See I.R.C. § 182(d)(2)(A) (1984).

²⁶⁶ Treas. Reg. § 1.175-6(d) (1960).

²⁶⁷ See IRS Letter Rul. 8,238,005. As to the formal requirements of the written request, see Treas. Reg. § 1.175-6(d).

²⁶⁸ See IRS Letter Rul. 8,238,005.

²⁶⁹ See *Fancher v. United States*, 10 A.F.T.R.2d (P-H) at 5930.

the year of the election and for subsequent years.²⁷⁰ The treatment can be changed in subsequent years only with the consent of the district director of the internal revenue district in which the taxpayer's return is filed.²⁷¹ If the election is made to deduct the expenditures, then all allowable expenditures must be deducted to the extent of the twenty-five percent limitation, and they cannot be carried over in the expectation of greater income in a subsequent year.²⁷²

In the case of a farm partnership's expenditures, the election is made by the partnership rather than by the partners.²⁷³ This election does not bind the partners as to expenditures made by them in their farming operations outside the partnership.²⁷⁴ However, if the partnership elects to capitalize its conservation expenditures, a partner who elects to deduct nonpartnership expenditures is presumably not able to include his share of the partnership gross income from farming for purposes of computing the twenty-five percent limitation with respect to the nonpartnership expenditures.²⁷⁵ S corporation shareholders presumably are in the same position. Like the partnership, the S corporation, rather than its shareholders, makes the election with respect to any expenditures incurred by the corporation.²⁷⁶ In the case of a nongrantor trust or an estate, the election is made by the trust or estate.²⁷⁷

The taxpayer's election to deduct or capitalize eligible conservation expenditures generally applies to all such expenditures incurred by the taxpayer in the year of election and in subsequent years.²⁷⁸ However, a taxpayer who has not made a general election to deduct conservation expenditures may request authorization to deduct those expenditures attributable to a special project or single farm while capitalizing the remainder.²⁷⁹ Con-

²⁷⁰ Treas. Reg. § 1.175-6(e).

²⁷¹ Treas. Reg. § 1.175-6(c) (1960).

²⁷² Rev. Rul. 394, 1973-2 C.B. 73. *See also* Brown v. United States, 37 A.F.T.R.2d (P-H) at 1183.

²⁷³ Treas. Reg. § 1.703-1(b)(1) (1960).

²⁷⁴ *Id.*

²⁷⁵ *See id.*

²⁷⁶ *See* Brown v. United States, 37 A.F.T.R.2d (P-H) at 1183; I.R.C. § 1363(c) (1984); IRS Letter Rul. 8,238,005.

²⁷⁷ *Cf.* Rev. Rul. 191, 1958-1 C.B. 149.

²⁷⁸ Treas. Reg. § 1.175-6(e).

²⁷⁹ *Id.*

versely, a taxpayer who has made such a general election may request permission to capitalize eligible expenditures attributable to a special project or single farm.²⁸⁰

Permission to deduct or capitalize expenditures attributable to a particular project presumably binds the taxpayer to the elected treatment with respect to all eligible conservation expenditures paid or incurred during the first taxable year for which consent is given, and during all subsequent taxable years until the project is completed, unless consent is given to change that treatment.²⁸¹ On the other hand, special consent with respect to the expenditures attributable to a single farm presumably applies to all subsequent expenditures attributable to that farm, unless consent to change is obtained, as long as the taxpayer continues to be "engaged in the business of farming" and the particular farm continues to qualify as "land used in farming."²⁸²

An interesting question arises in regard to the income of a single farm or project subject to a special election. For example, if permission is received to capitalize all of the eligible conservation expenditures relating to a single farm, while the expenditures relating to other farms are deducted, is the farm income from that single farm still "gross income derived from farming" which can be aggregated with other farm income for purposes of the twenty-five percent limitation? It would seem that the income from the farm subject to the special election should not be available to increase the deductions with respect to other farms, but the regulations are silent on this matter.

Section 1252 provides for the "recapture" of part or all of the expenditures which have been deducted under section 175 if the land to which the expenditures relate is disposed of before the taxpayer has held it for more than nine years.²⁸³ This section is rather complex and is beyond the scope of this article.

CONCLUSION

Section 175 is highly complex and technical. Nevertheless, the section should be an important factor in the farmer's con-

²⁸⁰ *Id.*

²⁸¹ *See id.*

²⁸² *See id.*

²⁸³ *See* I.R.C. § 1252 (1984 & Supp. 1985).

servation efforts. A thoughtful integration of tax planning and farm management can enable the farmer to use section 175 to simultaneously accomplish two worthy goals—the improvement of his land and the reduction of his taxes.