Private Letter Rulings

Private Letter Ruling 9211007, 12/03/1991, IRC Sec(s). 180

UIL No. 0180.00-00; 0263.00-00

Headnote:

Reference(s): Code Sec. 180;

FARM CORPORATION LACKING BENEFICIAL OWNERSHIP MAY NOT DEPRECIATE FERTILIZER IN FARM LAND.

A corporate farm is owned and operated by an individual, who is the president/treasurer, a 64-percent shareholder, and the corporation's primary employee. A second individual is the corporate secretary, a 36-percent shareholder, and an employee. The two shareholders, in their capacity as individuals, bought a parcel of farm property and the dwelling situated on the property. The corporation was to buy the other buildings, irrigators, and, specifically, the "residual fertilizer supply" in the land.

Simultaneous with the acquisition of the land by the two shareholders, leases were executed leasing the land to the farm corporation. Before the shareholders' acquisition of the property, the seller had owned the property for 14 years. Every year the seller had applied a truckload of fertilizer to the land -- a practice that reportedly resulted in an increased level of fertilizer in the soil (the "residual fertilizer supply"). The farm corporation claimed depreciation deductions for the amount it paid for the "residual fertilizer supply."

The Service has ruled in technical advice that the farm corporation is not entitled to depreciate the fertilizer under section 180. Citing Helvering v. F.& R. Lazarus & Co., 308 U.S. 252 (1939), the Service noted that the taxpayer claiming the depreciation deduction for fertilizer must be the beneficial owner of the fertilizer. In the instant case, the Service said, the individual shareholders were the beneficial owners.

Even if the corporation were the beneficial owner, the Service said, it would not be permitted to depreciate the fertilizer because it did not establish the presence and extent of the fertilizer, and it did not show that it was exhausting the fertilizer in the soil.

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Date: December 3, 1991

TR-32-159-91

District Director

Taxpayer's Name: ***

Taxpayer's Address: ***

Taxpayer's Identification No.: ***

Years Involved: Fiscal years ending

Date of Conference: ***

Issue

Whether the Taxpayer who purchased the alleged “residual fertilizer supply” of a parcel of land may amortize its cost over a given period of time.

Facts

The Taxpayer is a corporate farm owned and operated by A, who is the president/treasurer, a 64% shareholder, and the primary employee of the Taxpayer. B is the corporate secretary, a 36% shareholder, and also an employee of the Taxpayer.

On February 26, 1988, A entered into a purchase agreement for farm property located in c, and finalized acquisition of the property on March 15, 1988. The terms of the sale provided that A and B, as individuals were to purchase the land and dwelling. The Taxpayer was to purchase the other buildings, irrigators, pumps, wells, grain bins, and, specifically, the “residual fertilizer supply” in the land. The Taxpayer, A, and B paid a total of D for the farm property.

Simultaneous with the acquisition of the land by A and B, leases were executed leasing the land to the Taxpayer. The terms of these leases provided that the Taxpayer, the lessee, assume the properties in question for the period of one year commencing on March 15, 1988. The leases were automatically renewable unless the lessee or lessor conveyed a wish to terminate the agreement prior to January 1 of each subsequent year.

Prior to the acquisition of the property by A and B, the seller owned the property for approximately 14 years. Every year the seller would allegedly apply a semi-truck load of fertilizer to the land. This practice reportedly resulted in an increased level of fertilizer in the soil, referred to by the Taxpayer as the “residual fertilizer supply.”

The Taxpayer claimed amounts on its depreciation schedule for tax years ending 1/31/89 and 1/31/90 that reflect amortization over a 7-year period of the amount the Taxpayer paid for the “residual fertilizer supply.”

Law AND RATIONALE

Section 180 of the Internal Revenue Code provides that a taxpayer engaged in the business of farming may elect to treat as expenses which are not chargeable to capital account expenditures which are paid or incurred by the taxpayer during the tax year for the purchase or acquisition of fertilizer, lime, ground limestone, marl, or other materials to enrich, neutralize, or condition land used in farming, or for the application of these materials to such land. These expenditures shall be allowed as a deduction.

Section 263(a) of the Code generally requires the capitalization of amounts paid for improvements or betterments made to increase the value of any property. Section 263(a)(1)(D), however, excepts from this general rule expenditures by farmers for fertilizer deductible under section 180. If a taxpayer does not make a section 180 election for farm fertilization expenditures, they are not deductible under section 180, but are chargeable to a capital account. This account is amortizable over the period of the fertilizer's effectiveness. See, I.T. 3,843, 1947-1 C.B. 12, obsoleted by Rev. Rul. 67-123, 1967-1 C.B. 383 [1] (the cost of lime spread on farmland constituted an exhaustible capital expenditure that should be amortized over the period of its effectiveness if the benefit of the limiting extends over a period of several years). Thus, a taxpayer may amortize the capitalized cost of fertilizer applied to farmland over a specified period of time if the taxpayer in fact paid or incurred costs for the fertilizer and is exhausting it.

Although capitalized farm fertilization costs may be amortized, a taxpayer must be beneficial owner of the fertilizer in order to be permitted an amortization deduction for it. See Helvering v. F. & R. Lazarus & Co., 308 U.S. 252, 254

(1939). In the present case, individuals A and B acquired the land containing the alleged residual fertilizer supply, which was incorporated into the land and, for all practicable purposes, was inseparable from the land. This fertilizer reportedly made the land more productive than it otherwise would have been. Although the Taxpayer allegedly purchased any residual fertilizer supply found in the land, the Taxpayer was able to derive the benefit from it only by entering into a land lease agreement with landowners A and B. Through the landowners' control over whom to lease the land (as well as their discretion to terminate leases), the landowners derived the benefit of fertilizer on the acquired land and were the beneficial owners of it. Thus, because individuals A and B were the beneficial owners of any fertilizer on the land, the Taxpayer may not amortize any of its costs related to the fertilizer.

Additionally, in order for a taxpayer to claim an amortization deduction for exhaustion of fertilizer acquired with land, the taxpayer must establish the presence and extent of the fertilizer. In the present case, the previous land owner applied fertilizer to the land annually. The Taxpayer had the soil tested in order to ascertain the level of its fertility. However, the Taxpayer did not measure, nor was data provided to indicate, the level of soil fertility attributable to fertilizer applied to the land by the previous owner. Other information submitted by the Taxpayer concerned the level of fertility for similar parcels of land in the area. Because of the variability of soil fertility in general, these comparison studies do not provide a basis upon which to measure the increase in the level of fertility in the land in question. Thus, the Taxpayer failed to establish the extent of any residual fertilizer.

Finally, in order to amortize the cost of the fertilizer supply over a period of time, the Taxpayer must in fact be exhausting the fertilizer in the soil. The Taxpayer in this case submitted soil test reports evidencing the level of fertility in the soil. These reports show that the level of fertility in the majority of the parcels was not declining. Although it may be assumed that the level of fertility in the soil will decline through the raising of crops and natural causes, the Taxpayer has provided no evidence indicating the period over which the fertility attributable to the residual fertilizer will be exhausted, and if in fact what was claimed as the residual fertility level was declining.

Conclusion

The Taxpayer is not the beneficial owner of the alleged residual fertilizer supply and, therefore, is not allowed amortization deductions for it. Additionally even if the Taxpayer were the beneficial owner, amortization deductions would not be allowable because the Taxpayer has not established the extent of any residual fertilizer or the period of its effectiveness.

A copy of this technical advice memorandum is to be given to the Taxpayer. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.
[1]

I.T. 3,843 was obsoleted in response to the addition of section 180 to the Code.