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The Meaning of “Trusts” in Claiming Section 179 Depreciation

-by Neil E. Harl¹

Few provisions in the Internal Revenue Code outrank, in importance, Section 179 which provides an election to expense eligible depreciable business assets.² Although the allowance for 2014 has dropped to $25,000³ with a $200,000 phase-out,⁴ the prospects are for an increase to be legislated in 2014 or early 2015, probably retroactive to January 1, 2014. The Administration budget proposal calls for permanently setting the annual § 179 deduction at $500,000 with a $2,000,000 phase-out.⁵ The House of Representative’s proposal (the Camp plan) would set the annual § 179 deduction at $250,000 with an $800,000 phase-out.⁶

Eligibility of estates and trusts

One of the more puzzling features of the § 179 deduction is the subsection specifying that property acquired by estates or trusts is not eligible for the deduction.⁷ In light of the rapid increase in the use of revocable inter vivos trusts in recent years in farm and ranch estate and business planning, at first blush that would appear to pose a serious obstacle to claiming § 179 depreciation.

Grantor trusts. However, it appears that a high percentage of revocable inter vivos trusts are “grantor trusts” and there is compelling authority that such trusts are essentially disregarded for federal income tax purposes.⁸ The regulations state that, by virtue of the control retained over the revocable inter vivos trust, if a grantor of a trust is treated as the owner of an entire trust (which is the case with most grantor trusts), the grantor takes into account in computing the grantor’s income tax liability all items of income, deduction and credit to which the grantor would have been entitled had the trust not been in existence during the period the grantor is treated as the owner.⁹ In fact, the Chief Counsel’s Office has bluntly stated, as recently as 2013, that grantor trusts “. . . are disregarded as entities separate from their owners for all federal income tax purposes.”¹⁰ In effect, the grantor has treated the trust property as though it were the grantor’s property.¹¹

That is not a new idea. In a 1985 ruling, Rev. Rul. 85-13,¹² the Internal Revenue Service took the position that a grantor is treated as the owner of the trust over which dominion and control are retained. That ruling involved the question, passed on earlier by a Court of Appeals case,¹³ of whether a trust continues to be viewed as a separate entity in transactions between the grantor and the trust where, for example, an unsecured note was exchanged for the entire trust corpus. In that case, the court held that the trust continues

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to be a separate entity. IRS, in the 1985 ruling, disagreed with that conclusion and emphasized that, by exercising dominion and control over the grantor trust, either by retaining a power over or an interest in the trust, the grantor has treated the trust property as though it were the grantor’s property.\(^\text{13}\)

This suggests, convincingly, that grantor trusts are not ineligible to claim § 179 depreciation.

**What if an irrevocable trust is involved?** It seems clear that an irrevocable trust is unable to claim § 179 depreciation.\(^\text{14}\) The very nature of an irrevocable trust prevents the grantor of the trust from exercising dominion and control over the trust.

But what if an irrevocable trust owns stock in an S corporation (or other pass-through entity) that claims § 179 depreciation? Does that preclude a claim by the S corporation for § 179 depreciation if one shareholder is an ineligible trust? Or does it result in the irrevocable trust being ineligible to report its proportionate share of § 179 depreciation? Or does it mean that the provision on trust ineligibility is ignored if the pass-through entity is otherwise eligible to claim § 179 depreciation?

Interestingly, the regulations issued under § 179 provide an answer (at least a partial answer) to that question.\(^\text{15}\) The regulations state that, since the § 179 election is not available for trusts and estates, a partner or S corporation shareholder that is a trust or estate may not deduct its allocable share of the § 179 depreciation elected by the pass-through entity.\(^\text{16}\) The pass-through entity’s income tax basis in § 179 property is not to be reduced to reflect any part of the § 179 depreciation that is allocable to the estate or trust. Accordingly, the pass-through entity is specifically allowed to claim a depreciation deduction under § 168 (the regular depreciation provision) with respect to any allocable basis resulting from the trust’s or estate’s inability to claim its allocable portion of the § 179 depreciation.\(^\text{17}\) There is no mention of the economic benefit being passed to the irrevocable trust or ineligible estate. In fact, it is clear that the irrevocable trust or estate is not to benefit in any way, directly or indirectly, from the pass-through entity’s election to claim § 179 depreciation.

**The lesson from all of this**

Irrevocable trusts (and estates) should be forewarned, before acquiring an ownership interest in a pass-through entity, that, if § 179 depreciation is claimed by the entity, no benefit can flow from the election to the irrevocable trust or estate. The level of § 179 depreciation claimable in recent years, and signals now being sent that § 179 depreciation is favored as encouraging economic growth going forward, suggest convincingly that the magnitude of the differential treatment between and among the owners of the entity can be substantial.

**ENDNOTES**


4. CCH Tax Briefings, 2014 Fiscal Year (FY) 2015 Budget Proposals.


7. CCA 201343021, June 17, 2013.


10. Id.


16. Id.

17. Id.

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