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Depreciation of Landscaping

A Fresh Perspective

By Zoel W. Daughtrey

To the casual observer landscaping is an item normally associated with residential property in an aesthetic sense. But landscaping is also integrally associated with business and commercial property. While the emphasis is on aesthetic qualities with regard to residential property, commercial landscaping leads to an evaluation of budgets and financial considerations. And it well should, because commercial landscaping does involve an allocation and expenditure of funds — in the initial outlay for the design and execution of the landscaping and in its maintenance. Yet even with the economic significance of landscaping and the current emphasis on environmental quality there is a scarcity of references in the accounting literature with regard to the treatment of landscape costs.

Landscaping can become a major cost of construction in many situations. In the case of golf and country clubs in non-forested terrain the cost of landscaping is very significant. Many municipalities have established a minimum landscaping requirement for mobile home parks. (For example, Los Angeles County requires a minimum of one tree per space and also requires

that 5 per cent of the gross area be used for landscaping purposes.)¹ Apartment and condominium developments and industrial construction in "greenbelt" locations also require significant capital outlays for landscaping. Thus the subject of landscape depreciation becomes significant for many entities.

Current Accounting Treatment

The very few references to landscaping in the accounting literature include such typical comments as "... if the improvement made by the owner is rather permanent in nature, such as landscaping, then the item is properly chargeable to the Land account"² and "Generally, landscaping is considered part of the land, and therefore non-depreciable."³ Landscaping apparently has not been considered as a depreciable asset in the area of financial accounting. Due to the lack of authoritative documents in the financial accounting literature regarding the proper treatment of landscaping, the only remaining authoritative literature which can be considered is that regarding the tax treatment of landscaping.

Discussion of the Accelerated Cost Recovery System is omitted, since this article is exclusively concerned with the treatment of landscaping depreciation in a financial accounting context. The article does not propose a revision of the Accelerated Cost Recovery System as the income tax system focuses on the equitable collection of revenue and not on the proper financial accounting treatment of depreciable assets and the allocation of depreciation expense to the relevant accounting periods.

Early decisions of the Tax Court held that landscaping materials were non-depreciable because they were more closely associated with the land than with depreciable buildings (*Algernon Blair*⁴ and *Herbert Shainberg*⁵). In a later case (*Alabama - Georgia Syrup Company*⁶) the Tax Court changed its position and held that shrubbery planted around a recreation lodge was depreciable over a ten-year period. The petitioner had charged the amount expended for shrubbery to maintenance expense and the Internal Revenue Service in response requested that the expenditure be capitalized over a ten-year period. No explanation was offered for the selection of a ten-year life but it represented a crack in the door for future taxpayers to capitalize and depreciate landscaping. Still later in *Trailmont Park*⁷ the Tax Court ruled that the costs of clearing, grading, terracing and landscaping were an integral part of the construction of a mobile home park and were depreciable over the fifteen-year life of the trailer pads and patios. The court rejected the contention of the Internal Revenue Service that a portion of these costs was not depreciable. It is noteworthy that in this case the court adhered to the view that the life of the landscaping was integrally related to the life of other assets with a relatively easily determinable life.

This concept was expanded upon in *Revenue Ruling 74-265*⁸ in which the Internal Revenue Service ruled that landscaping consisting of shrubbery and ornamental trees immediately adjacent to the buildings in a newly constructed apartment complex is property depreciable over the life of the buildings if the replacement of the buildings at the expiration of their useful lives will destroy the landscaping. However, other landscaping on the grounds, considered general land

improvement, is not depreciable property but rather is considered inextricably associated with the land. As such, this part of the landscaping cost is added to the basis in the land and is not depreciable. This type of reasoning totally ignores both the independent value and the independent life span of landscaping.

This is a brief synopsis of the current status of the depreciation of landscaping. The subject has not been treated independently in the financial accounting literature and the tax authorities have only treated landscaping as a depreciable asset when it is integrally related to a more conventional depreciable asset (i.e. a building). Thus a rational and logical unified approach to the subject of landscaping depreciation is needed. This paper will lay the groundwork for such an approach.

In developing a rationale for landscape depreciation, a valid related subject to be considered is the treatment of other land improvements for depreciation purposes. A consideration of other land improvements should shed light on the theoretically correct treatment of landscaping depreciation. The tax literature must again be consulted due to the lack of financial accounting literature dealing with the treatment of this subject.

Golf greens and trees would seem to be closely related to landscaping and thus their treatment by the Internal Revenue Service should be considered. In establishing a golf green excellent turf able to withstand heavy traffic is required. It is an expensive process to provide the tile drainage, gravel and sand base, topsoil, irrigation system and low-growing, dense turf necessary for a green. The Internal Revenue Service has issued a ruling⁹ that expenditures incurred in the original construction of greens on a golf course must be added to the original cost of the land and are not subject to an allowance for depreciation. Subsequent operating expenses for sod, seed, soil and other maintenance constitute ordinary and necessary business expenses which are deductible currently. The ruling was tested in the Tax Court a few years later in *The Edinboro Company*.¹⁰ This company purchased a golf course and allocated part of the purchase price to the greens. Then it attempted to depreciate the greens. The golf course, as well as its improvements, such as tees,

greens and fairways, was ruled non-depreciable because of its unlimited life. The taxpayer introduced no evidence as to the duration of the useful life of greens and tees and the court further ruled that the taxpayer was insulated from depreciation since he had leased the golf course to a country club (with a maintenance clause).

Critical issues involve establishing an expected useful life and determining a definite cost.

In a related situation a District Court in California ruled that permanent pastures had a determinable life and thus were depreciable.¹¹ The taxpayer had purchased a ranch and allocated part of the purchase price to the permanent pasture. He was able to satisfy the court as to the replacement cost for the reestablishment of the pasture and also as to its expected life. Thus the taxpayer could reasonably allocate a portion of the purchase price to the pasture, and, coupled with the estimated remaining life, he had a strong argument for the allowance of depreciation. The facts which turned the decision to the taxpayer's side were the considerations that the permanent pasture was not natural growth, it was required to be reseeded periodically to maintain its usefulness, and the economic life was determinable. It would appear that a similar argument could be advanced for landscaping based on the estimated life span of various species.

Orchards have proved to be another fertile field for taxpayers to advance the validity of a depreciation allowance. *Revenue Procedure 62-21* establishes guidelines for depreciation of trees and vines by stating that such trees and vines producing nuts, fruits and citrus crops will be subject to depreciation when depreciable lives have been established based on geographic, climatic, genetic, economic and other factors.

Thus depreciation has been allowed for pastures and orchard trees, but disallowed for golf greens. Critical issues would appear to be the establishment of an expected useful life and the allocation of a definite cost to the asset.

Proposed Valuation Methods

The treatment of casualty losses of landscape materials provides some degree of guidance in the development of valuation methods for depreciation purposes. The only authoritative pronouncements concerning the calculations of landscape casualty losses are those issued by the Tax Court and the Internal Revenue Service. The Tax Court in numerous decisions^{13, 14, 15}, has stated that the amount of the deduction for casualty to ornamental trees is measured by the difference between the fair market value of the estate immediately before and immediately after the casualty, but the amount of the deduction may not exceed the taxpayer's adjusted basis in the estate. Where the taxpayers does not establish basis for measuring the alleged loss, no deduction will be allowed.

The Internal Revenue Service has ruled that values of individual shade or ornamental trees computed by the use of a "shade tree evaluation" formula may not be used to determine the amount of a casualty loss to non-business residential property.¹⁶ The use of such a formula produces a hypothetical value of individual trees that is not related to the fair market values of the property as a whole, according to the Internal Revenue Service. However, it would appear reasonable to use such a formula to assist in the allocation of basis between the land and the landscaping, especially in a business context.

In trying to arrive at a valuation method for landscaping the logical starting point is cost. In those situations where the business is starting with a bare landscape, cost becomes the readily identifiable criterion to arrive at basis — in a manner similar to other purchased separable assets.

However, when land with existing landscape materials is purchased there is an immediate problem in determining the basis of the landscaping. It can be proposed that this type

TABLE I
Cost Allocation Formulas

$$\text{Relative Replacement Cost of Landscaping} = \frac{\text{Replacement Cost of Landscaping}}{\text{Total Fair Market Value of Land}} \times \text{Purchase Price}$$

$$\text{Allocated Cost of Land} = \frac{\text{Total Fair Market Value of Land less Replacement Cost of Landscaping}}{\text{Total Fair Market Value of Land}} \times \text{Purchase Price}$$

of purchase be handled the same as any lump-sum purchase. The total cost should be allocated among the various assets on the basis of their relative fair market values. If the fair market value of the land per se and the fair market value of the landscaping can be determined, then the allocation of cost is a simple mathematical calculation. Two methods are proposed for the determination of fair market value of landscaping.

Most specimen shrubs, small evergreens, and trees up to twelve inches in trunk diameter can be readily transplanted and thus have a replacement value. Replacement costs have been an approach to plant values that has been generally acceptable to courts and to insurance adjustors.¹⁷ Usually the appraiser can establish replacement values through actual quotations from local nurserymen, landscape contractors, or by reference to nursery catalogs. Where no values for specific species, cultivars or varieties can be established, the appraiser may use prices listed for plants of similar kind and size.

To compute the value of trees over twelve inches in trunk diameter, the basic formula method of the International Society of Arboriculture can be used.¹⁸ This is a complex formula which considers the size, species, condition, and location to arrive at a fair market value. It should be restated that the Internal Revenue Service does not currently accept such an evaluation system.

Analysis of the following situations will assist in clarifying the proposed treatment of landscaping:

Fact Situation 1: The assumption is made that the land in question is void

of landscaping. Thus the landscaping must be purchased separately and planted. In this case the actual cost of landscape materials provides the appropriate basis for landscaping depreciation.

In many business situations landscaping represents a major capital expenditure.

Fact Situation 2: In this situation the land is purchased with existing trees and shrubs. The trees and shrubs are small, being less than twelve inches in diameter. It is recommended that the relative replacement cost be used as a basis for depreciation. First, the actual replacement cost is determined by appraisal. Then the relevant proportional part of the replacement cost (i.e., replacement cost as a percentage of the fair market value of the land) is multiplied by the purchase price of the land to arrive at an allocation of purchase price between the land per se and the landscaping. In formula terms, the relative replacement cost is expressed in Table I. Conversely, the amount of the purchase price allocated to the bare land also is expressed in Table I. In this manner the cost of the property can be fairly allocated between the land itself and the land-

scaping, thus allowing the basis of the landscaping to be established for depreciation purposes.

Fact Situation 3: The land is purchased with existing trees and shrubs which are relatively large, being greater than twelve inches in diameter. In this case, the formula method of the International Society of Arboriculture is recommended as a means of arriving at a basis for depreciation. The fair market value of the landscaping is calculated based on the use of the formula and this figure is divided by the total fair market value of the land to arrive at a percentage of total fair market value to be allocated to the landscaping. This percentage is then multiplied by the purchase price of the land to allocate the proper amount of the purchase price to the landscaping.

Fact Situation 4: The land is purchased with existing trees and shrubs, but the landscaping is inadequate. Thus additional landscaping is added. In this case, the basis for depreciation of the landscaping that is an integral part of the original purchase should be determined as per Fact Situations 2 and 3. An allocation of the purchase price between land and landscaping will be made based on replacement costs of the landscaping, the formula method to arrive at relative fair market value of the landscaping, or both. The landscaping that is added after the land purchase will be depreciated using an actual cost basis.

The above situations are summarized in Table II. Thus there are existing methods available to arrive at the reasonable fair market value of landscaping. It is only a matter of applying acceptable techniques to arrive at a value that reflects economic reality.

TABLE II
Determination of Depreciation Methods for Landscaping

<u>Initial Landscape Description</u>	<u>Source of Landscape Materials</u>	<u>Size of Trees and Shrubs</u>	<u>Proposed Basis for Landscape Depreciation</u>
Raw Land	Purchased separately and planted after land acquired	All Sizes	Actual Cost of Materials
Landscaped Land	Purchased as integral part of land	Less than 12 inches in diameter	Relative Replacement Cost (See Note 1)
Landscaped Land	Purchased as integral part of land	Greater than 12 inches in diameter	Relative Fair Market Value based on ISA* Formula (See Note 2)
Partially Landscaped Land	Partially purchased as integral part of land, partially purchased separately and planted after land acquired	Use above criteria for each identifiable source of landscaping	Use above criteria for each source of landscaping independently

Note 1. Relative Replacement Cost = $\frac{\text{Replacement Cost}}{\text{Total Fair Market Value of Land}} \times \text{Purchase Price}$

Note 2. Relative Fair Market Value of Landscaping = $\frac{\text{Fair Market Value of Landscaping}}{\text{Total Fair Market Value of Land}} \times \text{Purchase Price}$

*ISA = International Society of Arboriculture

Summary

Little attention has been devoted to the consideration of plants as depreciable assets. However, in many business situations landscaping represents a major capital expenditure. It can be readily shown that plants are assets and that they have a determinable life. Thus landscaping should be subject to the allowance for depreciation. Determining cost of landscaping can be a problem, but by using replacement cost or the formula developed by the International Society of Arboriculture a fair market value can be calculated which can be used in the allocation of a lump-sum purchase price. Ω

NOTES

¹Ronald R. Horn. "Mobile Home Parks On-Site Costs." *The Real Estate Appraiser*, September-October, 1970. pp. 24-31.

²Donald E. Kieso and Jerry J. Weygandt. *Intermediate Accounting*. Second Edition. John Wiley and Sons, New York. 1977. p. 437.

³J. Warren Higgins. "Depreciation: Real Property," *The Real Estate Appraiser*. January-February, 1976. pp. 51-53.

⁴*Algernon-Blair, Inc.*, 29 TC 1205 (1958).

⁵*Herbert Shainberg*, 33 TC 241 (1959).

⁶*Alabama-Georgia Syrup Company*. 36 TC 747 (1961).

⁷*Trailmont Park, Inc.*, 30 TCM 871, TC Memo 1971-212.

⁸*Revenue Ruling 74-265*, 1974-1 CB 56.

⁹*Revenue Ruling 55-290*, 1955-1 CB 320.

¹⁰*The Edinboro Company*, 224 FSupp 301 (1963), 63-2 USTC P.9759, 12 AFTR2d 5838.

¹¹*Todd W. Johnston*, (DC) 55-1 USTC P.9421.

¹²*Revenue Procedure 62-21*, 1962 CB 418.

¹³*Barret*, 202 F2d 804 (1953), 53-1 USTC P.9284.

¹⁴*Graham*, 35 TC 273 (1960).

¹⁵*Hull*, 32 TCM 977, TC Memo 1973-209.

¹⁶*Revenue Ruling 68-29*, 1968-1 CB 74.

¹⁷Council of Tree and Landscape Appraisers. *Guide for Establishing Values of Trees and Other Plants*, International Society of Arboriculture, Urbana, Illinois. 1979. p. 5.

¹⁸*Ibid*, p. 10.



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