

books and records of the expenditures to which the election relates.

(2) *Change to a different method or period.* Application for permission to change to a different method of treating research or experimental expenditures or to a different period of amortization for deferred expenses shall be in writing and shall be addressed to the Commissioner of Internal Revenue, Attention: T:R, Washington, DC, 20224. The application shall include the name and address of the taxpayer, shall be signed by the taxpayer (or his duly authorized representative), and shall be filed not later than the end of the first taxable year in which the different method or different amortization period is to be used (unless subparagraph (3) of this paragraph, relating to extensions of time, is applicable). The application shall set forth the following information with regard to the research or experimental expenditures which are being treated under section 174(b) as deferred expenses:

(i) Total amount of research or experimental expenditures attributable to each project;

(ii) Amortization period applicable to each project; and

(iii) Unamortized expenditures attributable to each project at the beginning of the taxable year in which the application is filed.

In addition, the application shall set forth the length of the new period or periods proposed, or the new method of treatment proposed, the reasons for the proposed change, and such information as will identify the project or projects to which the expenditures affected by the change relate. If permission is granted to make the change, the taxpayer shall attach a copy of the letter granting the permission to his income tax return for the first taxable year in which the different method or period is to be effective.

(3) *Special rules.* If the last day prescribed by law for filing a return for any taxable year for which the deferred method provided in section 174(b) has been adopted falls before January 2, 1958, consent is hereby given for the taxpayer to change from such method and adopt a different method of treating research or experimental expenditures, provided that on or before Janu-

ary 2, 1958, he submits to the district director for the district in which the return was filed the information required by subparagraph (2) of this paragraph, relating to a change to a different method or period. For any taxable year for which the different method is adopted pursuant to this subparagraph, an amended return reflecting such method shall be filed on or before January 2, 1958.

(c) *Example.* The application of this section is illustrated by the following example:

*Example.* N Corporation is engaged in the business of manufacturing chemical products. On January 1, 1955, work is begun on a special research project. N Corporation elects, pursuant to section 174(b), to defer the expenditures relating to the special project and to amortize the expenditures over a period of 72 months beginning with the month in which benefits from the expenditures are first realized. On January 1, 1955, N Corporation also purchased for \$57,600 a building having a remaining useful life of 12 years as of the date of purchase and no salvage value at the end of the period. Fifty percent of the building's facilities are to be used in connection with the special research project. During 1955, N Corporation pays or incurs the following expenditures relating to the special research project:

Salaries .....	\$15,000
Heat, light and power .....	700
Drawings .....	2,000
Models .....	6,500
Laboratory materials .....	8,000
Attorneys' fees .....	1,400
Depreciation on building attributable to project (50 percent of \$4,800 allowable depreciation) .....	2,400
<b>Total research and development expenditures .....</b>	<b>36,000</b>

The above expenditures result in a process which is marketable but not patentable and which has no determinable useful life. N Corporation first realizes benefits from the process in January 1956. N Corporation is entitled to deduct the amount of \$6,000 (\$36,000×12 months÷72 months) as deferred expenses under section 174(b) in computing taxable income for 1956.

**§ 1.175-1 Soil and water conservation expenditures; in general.**

Under section 175, a farmer may deduct his soil or water conservation expenditures which do not give rise to a deduction for depreciation and which are not otherwise deductible. The amount of the deduction is limited annually to 25 percent of the taxpayer's

gross income from farming. Any excess may be carried over and deducted in succeeding taxable years. As a general rule, once a farmer has adopted this method of treating soil and water conservation expenditures, he must deduct all such expenditures (subject to the 25-percent limitation) for the current and subsequent taxable years. If a farmer does not adopt this method, such expenditures increase the basis of the property to which they relate.

**§ 1.175-2 Definition of soil and water conservation expenditures.**

(a) *Expenditures treated as a deduction.*

(1) The method described in section 175 applies to expenditures paid or incurred 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, but only if such expenditures are made in the furtherance of the business of farming. More specifically, a farmer may deduct expenditures made for these purposes which are for (i) the treatment or moving of earth, (ii) the construction, control, and protection of diversion channels, drainage ditches, irrigation ditches, earthen dams, watercourses, outlets, and ponds, (iii) the eradication of brush, and (iv) the planting of windbreaks. Expenditures for the treatment or moving of earth include but are not limited to expenditures for leveling, conditioning, grading, terracing, contour furrowing, and restoration of soil fertility. For rules relating to the allocation of expenditures that benefit both land used in farming and other land of the taxpayer, see § 1.175-7.

(2) The following are examples of soil and water conservation: (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 protected 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.

(b) *Expenditures not subject to section 175 treatment.* (1) The method described in section 175 applies only to expendi-

tures for nondepreciable items. Accordingly, a taxpayer may not deduct expenditures for the purchase, construction, installation, or improvement of structures, appliances, or facilities subject to the allowance for depreciation. Thus, the method does not apply to depreciable nonearthen items such as those made of masonry or concrete (see section 167). For example, expenditures in respect of depreciable property include those for materials, supplies, wages, fuel, hauling, and dirt moving for making structures such as tanks, reservoirs, pipes, conduits, canals, dams, wells, or pumps composed of masonry, concrete, tile, metal, or wood. However, the method applies to expenditures for earthen items which are not subject to a depreciation allowance. For example, expenditures for earthen terraces and dams which are nondepreciable are deductible under section 175. For taxable years beginning after December 31, 1959, in the case of expenditures paid or incurred by farmers for fertilizer, lime, etc., for purposes other than soil or water conservation, see section 180 and the regulations thereunder.

(2) The method does not apply to expenses deductible apart from section 175. Adoption of the method is not necessary in order to deduct such expenses in full without limitation. Thus, the method does not apply to interest (deductible under section 163), nor to taxes (deductible under section 164). It does not apply to expenses for the repair of completed soil or water conservation structures, such as costs of annual removal of sediment from a drainage ditch. It does not apply to expenditures paid or incurred primarily to produce an agricultural crop even though they incidentally conserve soil. Thus, the cost of fertilizing (the effectiveness of which does not last beyond one year) used to produce hay is deductible without adoption of the method prescribed in section 175. For taxable years beginning after December 31, 1959, in the case of expenditures paid or incurred by farmers for fertilizer, lime, etc., for purposes other than soil or water conservation, see section 180 and the regulations thereunder. However, the method would apply to expenses incurred to produce vegetation primarily