

Part III – Administrative, Procedural, and Miscellaneous

GO Zone Bonus Depreciation Recapture

Notice 2008-25

SECTION 1. PURPOSE

This notice provides guidance with respect to the recapture of the 50-percent additional first year depreciation deduction provided by § 1400N(d) of the Internal Revenue Code (GO Zone additional first year depreciation deduction) for qualified Gulf Opportunity Zone property (GO Zone property), including specified Gulf Opportunity Zone extension property (GO Zone extension property). Specifically, this notice explains how the recapture rules described in section 6 of Notice 2006-77, 2006-40 I.R.B. 590, apply to GO Zone property that is relinquished in a like-kind exchange or as a result of an involuntary conversion.

SECTION 2. BACKGROUND AND GO ZONE PROPERTY

.01 Section 1400N(d) generally allows a 50-percent additional first year depreciation deduction for GO Zone property. The GO Zone additional first year depreciation deduction is allowable in the taxable year in which the GO Zone property is placed in service by the taxpayer. The computation of the allowable GO Zone additional first year depreciation deduction and the otherwise allowable depreciation deduction for GO Zone property (including GO Zone extension property) is made in accordance with rules similar to the rules for 50-percent bonus depreciation property in

§ 1.168(k)-1(d)(1)(i), (1)(iii), and (2) of the Income Tax Regulations. Further, rules similar to the special rules in § 1.168(k)-1(f) apply for purposes of the GO Zone additional first year depreciation deduction.

.02 GO Zone property is depreciable property that meets all of the requirements in § 1400N(d)(2) and in section 2.02 of Notice 2006-77, as clarified, modified, and amplified by section 5 of Notice 2007-36, 2007-17 I.R.B. 1000. GO Zone extension property is depreciable property that meets all of the requirements in § 1400N(d)(6)(B) and in section 4 of Notice 2007-36. One of the requirements of GO Zone property and GO Zone extension property is that substantially all of the use of the property must be in the GO Zone and in the active conduct of a trade or business by the taxpayer in the GO Zone. Section 3.01 of Notice 2006-77 defines the term “substantially all” as meaning 80 percent or more during each taxable year. Depreciable property described in § 1400N(d)(2)(B) and in section 2.03 of Notice 2006-77 is not eligible for the GO Zone additional first year depreciation deduction.

.03 The counties and parishes in Alabama, Louisiana, and Mississippi that comprise the GO Zone are listed on page 2 of IRS Publication 4492, Information for Taxpayers Affected by Hurricanes Katrina, Rita, and Wilma, under Gulf Opportunity (GO) Zone (Core Disaster Area).

.04 Section 1400N(d)(5) provides that for purposes of § 1400N(d), rules similar to the recapture rules under § 179(d)(10) apply with respect to any GO Zone property that ceases to be GO Zone property. Section 6 of Notice 2006-77 provides the rules for applying the recapture requirement described in § 1400N(d)(5). The Treasury Department and the Internal Revenue Service have learned that taxpayers are

uncertain how to apply these recapture rules to GO Zone property (including GO Zone extension property) relinquished by a taxpayer in a like-kind exchange under § 1031 or as a result of an involuntary conversion under § 1033. This notice clarifies the application of the recapture rule in § 1400N(d)(5) to such property.

SECTION 3. RECAPTURE RULES UNDER § 1400N(d)(5)

.01 In General. Section 1400N(d)(5) provides that for purposes of § 1400N(d), rules similar to the recapture rules under § 179(d)(10) and § 1.179-1(e) apply with respect to any GO Zone property that ceases to be GO Zone property. For example, GO Zone property will cease to be GO Zone property when the property is no longer substantially used in the GO Zone or in the active conduct of a trade or business by the taxpayer in the GO Zone. For purposes of this section 3, GO Zone property also includes GO Zone extension property.

.02 Application.

(1) In general. Except as provided in section 3.02(2) or (3) of this notice, if GO Zone property is no longer GO Zone property in the hands of the same taxpayer at any time before the end of the GO Zone property's recovery period as determined under § 167(f)(1) or § 168, as applicable, then the taxpayer must recapture in the taxable year in which the GO Zone property is no longer GO Zone property (the recapture year) the benefit derived from claiming the GO Zone additional first year depreciation deduction for such property. The benefit derived from claiming the GO Zone additional first year depreciation deduction for the property is equal to the excess of the total depreciation claimed (including the GO Zone additional first year depreciation deduction) for the property for the taxable years before the recapture year over the total depreciation that

would have been allowable for the taxable years before the recapture year as a deduction under § 167(f)(1) or § 168, as applicable, had the GO Zone additional first year depreciation deduction not been claimed (regardless of whether such excess reduced the taxpayer's tax liability). The amount to be recaptured is treated as ordinary income for the recapture year. For the recapture year and subsequent taxable years, the taxpayer's deductions under § 167(f)(1) or § 168, as applicable, are determined as if no GO Zone additional first year depreciation deduction was claimed with respect to the property. If, subsequent to the recapture year, a change in the use of the property results in the property again being GO Zone property, then the GO Zone additional first year depreciation deduction is not allowable for the property.

(2) Coordination of recapture rules with § 1245 and § 1250. Except as provided in section 3.02(3) of this notice, there is no recapture under this section 3 if § 1245(a) or § 1250(a) applies to the disposition of the property.

(3) Application of recapture rules in a like-kind exchange or involuntary conversion.

(a) If GO Zone property is transferred by a taxpayer in a like-kind exchange or as a result of an involuntary conversion (relinquished property) and the property acquired by the taxpayer in the like-kind exchange or involuntary conversion (replacement property) is GO Zone property in the hands of the taxpayer, there is no recapture under section 3.02(1) of this notice.

(b) If GO Zone property is transferred by a taxpayer in a like-kind exchange or as a result of an involuntary conversion (relinquished property) and the replacement property is not GO Zone property in the hands of the taxpayer and is not substantially

used in the GO Zone or in the active conduct of a trade or business by the taxpayer in the GO Zone, there is recapture under section 3.02(1) of this notice. The amount to be recaptured and the resulting increase in basis under section 3.02(1) of this notice are determined before the application of § 1031, § 1033, § 1245, or § 1250. For purposes of this section 3.02(3), the term “substantially” means 80 percent or more during each taxable year.

(c) If GO Zone property is transferred by a taxpayer in a like-kind exchange or as a result of an involuntary conversion (relinquished property) and the replacement property is not GO Zone property in the hands of the taxpayer but is substantially used in the GO Zone and in the active conduct of a trade or business by the taxpayer in the GO Zone, there is no recapture under section 3.02(1) of this notice. However, if after the acquisition of the replacement property, that property ceases to be substantially used in the GO Zone or in the active conduct of a trade or business by the taxpayer in the GO Zone, there is recapture under section 3.02(1) of this notice. Similarly, there is recapture under section 3.02(1) of this notice if, after the acquisition of the replacement property, that property is transferred by the taxpayer in another like-kind exchange or another involuntary conversion and the subsequent replacement property is not GO Zone property in the hands of the taxpayer and is not substantially used in the GO Zone or in the active conduct of a trade or business by the taxpayer in the GO Zone.

If there is recapture under section 3.02(1) of the notice pursuant to this section 3.02(3)(c), the recapture year is the first taxable year in which the replacement property (or subsequent replacement property) ceases to be substantially used in the GO Zone or in the active conduct of a trade or business by the taxpayer in the GO Zone. In

determining the benefit derived from claiming the GO Zone additional first year depreciation deduction, the depreciation of both the relinquished property and replacement property is taken into account.

.03 Examples. The following examples illustrate the provisions of this section 3.

(a) Example 1. H, a calendar-year taxpayer, owns and operates a furniture store in the GO Zone. In December 2006, H purchases a new delivery truck for \$50,000 and places it in service for use in H's business. For 2006, this delivery truck is GO Zone property and is 5-year property under § 168(e). H depreciates its 5-year property placed in service in 2006 using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and the half-year convention. During 2007, the delivery truck is used less than 80 percent in the GO Zone.

(i) For 2006, H is allowed the GO Zone additional first year depreciation deduction of \$25,000 for the delivery truck (unadjusted depreciable basis of \$50,000 multiplied by .50). In addition, H's depreciation deduction allowable in 2006 for the remaining adjusted depreciable basis of \$25,000 for the delivery truck (the unadjusted depreciable basis of \$50,000 reduced by the GO Zone additional first year depreciation deduction of \$25,000) is \$5,000 (the remaining adjusted depreciable basis of \$25,000 multiplied by the annual depreciation rate of .20 for recovery year 1). Thus, H's depreciation deduction allowable in 2006 for the delivery truck totals \$30,000.

(ii) For 2007, because the delivery truck does not meet the substantially all (80 percent) requirement described in section 3.01 of Notice 2006-77, the delivery truck is no longer GO Zone property. Accordingly, for 2007, H must recapture as ordinary

income \$20,000 (\$30,000 depreciation claimed by H for the truck before 2007 less the \$10,000 depreciation that would have been allowable for the truck before 2007 had the GO Zone additional first year depreciation deduction not been claimed (unadjusted depreciable basis of \$50,000 multiplied by the cumulative annual depreciation rate of .20 before 2007)). In addition, H's depreciation deduction allowable in 2007 for the delivery truck is \$16,000 (unadjusted depreciable basis of \$50,000 multiplied by the annual depreciation rate of .32 for recovery year 2) (determined as if no GO Zone additional first year depreciation deduction was claimed for the truck).

(b) Example 2. Assume the same facts as in Example 1, except that during 2008, the delivery truck is used 80 percent or more in the GO Zone. The GO Zone additional first year depreciation deduction is not allowable for the delivery truck even though the truck is GO Zone property in the hands of H in 2008. Thus, H's depreciation deduction allowable in 2008 for the delivery truck is \$9,600 (unadjusted depreciable basis of \$50,000 multiplied by the annual depreciation rate of .1920 for recovery year 3) (determined as if no GO Zone additional first year depreciation deduction was claimed for the truck).

(c) Example 3. J, a calendar-year taxpayer, owns and operates a manufacturing plant in the GO Zone. In January 2007, J purchases new equipment for \$100,000 and places it in service for use in J's business. The equipment is GO Zone property and is 5-year property under § 168(e). J depreciates its 5-year property placed in service in 2007 using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method of depreciation,

a 5-year recovery period, and the half-year convention. During 2008, J sells the equipment for \$65,000.

(i) For 2007, J is allowed the GO Zone additional first year depreciation deduction of \$50,000 for the equipment (unadjusted depreciable basis of \$100,000 multiplied by .50). In addition, J's depreciation deduction allowable in 2007 for the remaining adjusted depreciable basis of \$50,000 for the equipment (the unadjusted depreciable basis of \$100,000 reduced by the GO Zone additional first year depreciation deduction of \$50,000) is \$10,000 (the remaining adjusted depreciable basis of \$50,000 multiplied by the annual depreciation rate of .20 for recovery year 1). Thus, J's depreciation deduction allowable in 2007 for the equipment totals \$60,000.

(ii) For 2008, because the equipment is sold and § 1245(a) applies to this sale, there is no recapture under section 3.02(1) of this notice pursuant to section 3.02(2) of this notice. In addition, because the half-year convention applies to the equipment, J is entitled to $\frac{1}{2}$ of the depreciation deduction allowable for 2008. Thus, J's depreciation deduction allowable in 2008 for the equipment is \$8,000 (one half of the remaining adjusted depreciable basis of \$50,000 multiplied by the annual depreciation rate of .32 for recovery year 2). Consequently, the adjusted basis of the equipment for determining gain or loss is \$32,000 (the unadjusted depreciable basis of \$100,000 less the depreciation deduction allowable for 2007 and 2008 totaling \$68,000). Accordingly, J recognizes gain of \$33,000 from the sale of the equipment. All of this recognized gain is ordinary income pursuant to § 1245(a).

(d) Example 4. K, a calendar-year taxpayer, owns and operates restaurants. In February 2007, K completed construction of a new building in New Orleans (New

Orleans building) and placed it in service for use in K's business. The total cost of the building is \$4,000,000. For 2007, the New Orleans building is GO Zone property and is nonresidential real property under § 168(e). K depreciates its nonresidential real property placed in service in 2007 using the optional depreciation table that corresponds with the general depreciation system, the straight-line method of depreciation, a 39-year recovery period, and the mid-month convention. In March 2008, K exchanges the New Orleans building for a new building in Hancock County, Mississippi (Hancock building), in a transaction described in § 1031(a). The Hancock building is placed in service by K in March 2008 for use in K's business, is GO Zone property in the hands of K, and is nonresidential real property under § 168(e).

(i) For 2007, K is allowed the GO Zone additional first year depreciation deduction for the New Orleans building in the amount of \$2,000,000 (unadjusted depreciable basis of \$4,000,000 multiplied by .50). In addition, K's depreciation deduction allowable in 2007 for the remaining adjusted depreciable basis of \$2,000,000 (the unadjusted depreciable basis of \$4,000,000 reduced by the GO Zone additional first year depreciation deduction of \$2,000,000) is \$44,940 (the remaining adjusted depreciable basis of \$2,000,000 multiplied by the annual depreciation rate of .02247 for the 2nd month in recovery year 1). Thus, K's depreciation deduction allowable in 2007 for the New Orleans building totals \$2,044,940.

(ii) For 2008, because K exchanged GO Zone property for GO Zone property, there is no recapture under section 3.02(1) of this notice pursuant to section 3.02(3)(a) of this notice. Thus, for 2008, pursuant to § 1.168(i)-6(e)(2)(i), the depreciation deduction allowable for the New Orleans building is \$10,683 (the remaining adjusted

depreciable basis of \$2,000,000 multiplied by the annual depreciation rate of .02564 for the recovery year 2, multiplied by 2.5/12). Consequently, the adjusted depreciable basis of the New Orleans building at the time of the like-kind exchange is \$1,944,377 (unadjusted depreciable basis of \$4,000,000, less the depreciation deduction allowable of \$2,044,940 in 2007, less the depreciation deduction allowable of \$10,683 in 2008).

(iii) For 2008, because the Hancock building is GO Zone property in the hands of K, K is allowed the GO Zone additional first year depreciation deduction for the Hancock building in the amount of \$972,189 (depreciable exchanged basis of \$1,944,377 multiplied by .50). K decides to use the optional depreciation table to calculate depreciation on the depreciable exchanged basis of the Hancock building. Consequently, pursuant to § 1.168(i)-6(e)(2)(ii), K's depreciation deduction allowable in 2008 for the remaining depreciable exchanged basis of \$972,188 (the depreciable exchanged basis of \$1,944,377 reduced by the GO Zone additional first year depreciation deduction of \$972,189) is \$20,188 (the remaining depreciable exchanged basis of \$972,188 multiplied by the annual depreciation rate of .02564 for the recovery year 2 as modified by the transaction coefficient of 1.0230 $[1 / (1 - .02247)]$, multiplied by 9.5/12). Thus, K's depreciation deduction allowable in 2008 for the Hancock building totals \$992,377.

(e) Example 5. Assume the same facts as in Example 4, except that in March 2008, K exchanges the New Orleans building for a new building in Maryland (Maryland building), in a transaction described in § 1031(a). The Maryland building is placed in service by K in March 2008 for use in K's business and is nonresidential real property under § 168(e).

(i) Because Maryland is not in the GO Zone, the Maryland building is not GO Zone property and is not substantially used in the GO Zone and in the active conduct of a trade or business by K in the GO Zone. Thus, pursuant to section 3.02(3)(b) of this notice, there is recapture under section 3.02(1) of this notice of the benefit derived from claiming the GO Zone additional first year depreciation deduction for the New Orleans building. Consequently, for 2008, K must recapture as ordinary income \$1,955,060 (\$2,044,940 depreciation claimed by K for the New Orleans building before 2008 less the \$89,880 depreciation that would have been allowable for the New Orleans building before 2008 had the GO Zone additional first year depreciation deduction not been claimed (unadjusted depreciable basis of \$4,000,000 multiplied by the cumulative annual depreciation rate of .02247 before 2008)). In addition, pursuant to § 1.168(i)-6(e)(2)(i), K's depreciation deduction allowable in 2008 for the New Orleans building is \$21,367 (the unadjusted depreciable basis of \$4,000,000 multiplied by the annual depreciation rate of .02564 for the recovery year 2, multiplied by 2.5/12) (determined as if no GO Zone additional first year depreciation deduction was claimed for the New Orleans building). The adjusted depreciable basis of the New Orleans building at the time of the like-kind exchange is \$3,888,753 (unadjusted depreciable basis of \$4,000,000, less the depreciation deduction allowable of \$2,044,940 in 2007, plus the recapture amount of \$1,955,060 in 2008, less the depreciation deduction allowable of \$21,367 in 2008).

(ii) For 2008, because the Maryland building is not GO Zone property, K is not allowed the GO Zone additional first year depreciation deduction for the Maryland building. K decides to use the optional depreciation table to calculate depreciation on

the depreciable exchanged basis of the Maryland building. Thus, pursuant to § 1.168(i)-6(e)(2)(ii), K's depreciation deduction allowable in 2008 for the depreciable exchanged basis of \$3,888,753 for the Maryland building is \$80,751 (the depreciable exchanged basis of \$3,888,753 multiplied by the annual depreciation rate of .02564 for the recovery year 2 as modified by the transaction coefficient of 1.0230 $[1 / (1 - .02247)]$, multiplied by 9.5/12).

(f) Example 6. Assume the same facts as in Example 4, except the Hancock building is not a new building, but a building that has been used by another taxpayer in its business since 2003. As a result, the Hancock building is not GO Zone property.

(i) Even though the Hancock building is not GO Zone property, the Hancock building is substantially used in the GO Zone and in the active conduct of a trade or business by K in the GO Zone. Consequently, pursuant to section 3.02(3)(c) of this notice, there is no recapture under section 3.02(1) of this notice with respect to the New Orleans building. Thus, for 2008, pursuant to § 1.168(i)-6(e)(2)(i), the depreciation deduction allowable for the New Orleans building is \$10,683 (the remaining adjusted depreciable basis of \$2,000,000 multiplied by the annual depreciation rate of .02564 for the recovery year 2, multiplied by 2.5/12). Consequently, the adjusted depreciable basis of the New Orleans building at the time of the like-kind exchange is \$1,944,377 (unadjusted depreciable basis of \$4,000,000, less the depreciation deduction allowable of \$2,044,940 in 2007, less the depreciation deduction allowable of \$10,683 in 2008).

(ii) For 2008, because the Hancock building is not GO Zone property, K is not allowed the GO Zone additional first year depreciation deduction for the Hancock building. K decides to use the optional depreciation table to calculate depreciation on

the depreciable exchanged basis of the Hancock building. Thus, pursuant to § 1.168(i)-6(e)(2)(ii), K's depreciation deduction allowable for 2008 for the depreciable exchanged basis of \$1,944,377 is \$40,375 (the depreciable exchanged basis of \$1,944,377 multiplied by the annual depreciation rate of .02564 for the recovery year 2 as modified by the transaction coefficient of 1.0230 $[1 / (1 - .02247)]$, multiplied by 9.5/12).

(g) Example 7. Assume the same facts as in Example 6, except that in March 2009, K exchanges the Hancock building for a new building in Texas (Texas building), in a transaction described in § 1031(a). The Texas building is placed in service by K in March 2009 for use in K's business and is nonresidential real property under § 168(e).

(i) Because Texas is not in the GO Zone, the Texas building is not GO Zone property and is not substantially used in the GO Zone and in the active conduct of a trade or business by K in the GO Zone. Consequently, pursuant to section 3.02(3)(c) of this notice, K's exchange of the Hancock building (the replacement property) for the Texas building (subsequent replacement property) causes K to recapture the benefit derived from claiming the GO Zone additional first year depreciation deduction for the New Orleans building under section 3.02(1) of this notice. Thus, for 2009, K must recapture as ordinary income \$1,904,000 (\$2,095,998 depreciation claimed by K for the New Orleans and Hancock buildings before 2009 less the \$191,998 depreciation that would have been allowable for the New Orleans and Hancock buildings before 2009 had the GO Zone additional first year depreciation deduction not been claimed, which is the total of the amounts as determined in (a) and (b) below (\$89,880 for the 2007 depreciation allowable for the New Orleans building, plus \$21,367 for the 2008

depreciation allowable for the New Orleans building, plus \$80,751 for the 2008 depreciation allowable for the Hancock building)):

(a) For the New Orleans building, the depreciation that would have been allowable for the New Orleans building in 2007 had the GO Zone additional first year depreciation deduction not been claimed is \$89,880 (unadjusted depreciable basis of \$4,000,000 multiplied by the annual depreciation rate of .02247 for the 2nd month for recovery year 1). In addition, pursuant to § 1.168(i)-6(e)(2)(i), K's depreciation that would have been allowable for the New Orleans building in 2008 had the GO Zone additional first year depreciation deduction not been claimed in 2007 is \$21,367 (the unadjusted depreciable basis of \$4,000,000 multiplied by the annual depreciation rate of .02564 for the recovery year 2, multiplied by 2.5/12). The adjusted depreciable basis of the New Orleans building at the time of the like-kind exchange (determined as if no GO Zone additional first year depreciation deduction was claimed for the New Orleans building) is \$3,888,753 (unadjusted depreciable basis of \$4,000,000, less the depreciation deduction allowable of \$89,880 in 2007, less the depreciation deduction allowable of \$21,367 in 2008).

(b) For the Hancock building, K's depreciable exchanged basis would have been \$3,888,753 if the GO Zone additional first year depreciation deduction was not claimed for the New Orleans building. Thus, pursuant to § 1.168(i)-6(e)(2)(ii), K's depreciation deduction allowable in 2008 for the depreciable exchanged basis of \$3,888,753 for the Hancock building is \$80,751 (the depreciable exchanged basis of \$3,888,753 multiplied by the annual depreciation rate of .02564 for the recovery year 2 as modified by the transaction coefficient of $1.0230 [1 / (1 - .02247)]$, multiplied by

9.5/12) (determined as if no GO Zone additional first year depreciation deduction was claimed for the New Orleans building).

(ii) For 2009, K's depreciation deduction allowable for the Hancock building, pursuant to § 1.168(i)-6(e)(2)(i), is \$21,250 (the depreciable exchanged basis of \$3,888,753 multiplied by the annual depreciation rate of .02564 for the recovery year 3 as modified by the transaction coefficient of 1.0230 $[1 / (1 - .02247)]$, multiplied by 2.5/12) (determined as if no GO Zone additional first year depreciation deduction was claimed for the New Orleans building). Thus, the adjusted depreciable basis of the Hancock building at the time of the like-kind exchange for the Texas building is \$3,786,752 (depreciable exchanged basis of \$3,888,753, less the depreciation deduction allowable of \$80,751 in 2008, less the depreciation deduction allowable of \$21,250 in 2009) (determined as if no GO Zone additional first year depreciation deduction was claimed for the New Orleans building).

(iii) For 2009, K decides to use the optional depreciation table to calculate depreciation on the depreciable exchanged basis of the Texas building. Thus, pursuant to § 1.168(i)-6(e)(2)(ii), K's depreciation deduction allowable in 2009 for the depreciable exchanged basis of \$3,786,752 for the Texas building is \$80,746 (the depreciable exchanged basis of \$3,786,752 multiplied by the annual depreciation rate of .02564 for the recovery year 3 as modified by the transaction coefficient of 1.0505 $[1 / (1 - .02247 + .02564)]$, multiplied by 9.5/12).

SECTION 4. EFFECT ON OTHER DOCUMENTS

Section 6 of Notice 2006-77, 2006-40 I.R.B. 590, is clarified and amplified to read as provided in section 3 of this notice.

SECTION 5. EFFECTIVE DATE

This notice is effective February 11, 2008.

SECTION 6. DRAFTING INFORMATION

The principal author of this notice is Ruba Nasrallah of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, contact Ms. Nasrallah or Douglas Kim at (202) 622-4930 (not a toll-free call).