

IRS ISSUES NOTICE EXPLAINING GO ZONE RECAPTURE RULES FOR LIKE KIND EXCHANGES OF GO ZONE PROPERTY

The IRS issued Notice 2008-25 explaining how the recapture rules for the 50% bonus depreciation under the GO Zone legislation applies to GO Zone property involved in either a like kind exchange under Section 1031 of the Internal Revenue Code (the "Code") or an involuntary conversion under Section 1033 of the Code.

In general, for qualified GO Zone property, taxpayers can claim a 50% bonus depreciation deduction for the qualified Go Zone property. However, this depreciation deduction is subject to recapture if the property ceases to be substantially used in the GO Zone or in the active conduct of a trade or business by the taxpayer. 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 under the normal depreciation rules, then the taxpayer must generally 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 bonus depreciation deduction. The benefit derived from claiming this bonus depreciation deduction is equal to the excess of the total depreciation claimed, including the bonus depreciation, for the property for the taxable years before the recapture year over the

total depreciation that would have been allowable for the taxable years prior to the recapture year under the normal depreciation rules. The recapture amount will be treated as ordinary income in the recapture year.

The Notice provides guidance on the application of the recapture rule in situations involving like kind exchanges or involuntary conversions. Specifically, the Notice provides as follows:

1. If GO Zone property is transferred by taxpayer in a like kind exchange or as a result of an involuntary conversion and the property acquired by the taxpayer in the exchange or conversion is GO Zone property in the hands of the taxpayer, then there is no recapture. Furthermore, as illustrated in Section 3.03(d), Example 4, of the Notice, the replacement property could qualify for additional GO Zone bonus depreciation. This amounts to a "double bonus" because the bonus depreciation was taken on the original property and then again on the replacement property.
2. If GO Zone property is transferred by taxpayer in an exchange or a conversion and the replacement property is not GO Zone property in the hands of the taxpayer and is not substantially used in the

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active conduct of a trade or business by the taxpayer in the GO Zone, then there is recapture.

3. If GO Zone property is transferred by a taxpayer in a like kind exchange or as a result of an involuntary conversion and the replacement property is not GO Zone property in the hands of the taxpayer but the replacement property is substantially used in the active conduct of a trade or business by the taxpayer in the GO Zone, then there is no recapture.

The above rules make it clear that if a taxpayer enters into a like kind exchange of GO Zone property or is subject to an involuntary conversion of GO Zone property, then the replacement property must at least

be used in the active conduct of a trade or business in the GO Zone to avoid recapture. If the replacement property is located or used outside of the GO Zone or is not used in the active trade or business of the taxpayer, then recapture will be triggered. The Notice contains several helpful examples that illustrate the application of the recapture rule as well as the like kind exchange rule.



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