

Part III – Administrative, Procedural, and Miscellaneous

GO Zone Bonus Depreciation Additional Guidance

Notice 2007-36

SECTION 1. PURPOSE

This notice provides guidance with respect to 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 specified Gulf Opportunity Zone extension property (GO Zone extension property). This notice also provides additional guidance with respect to the original use requirement described in § 1400N(d)(2)(A)(iii) for qualified Gulf Opportunity Zone property (GO Zone property), including GO Zone extension property.

SECTION 2. BACKGROUND

.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.

.02 GO Zone property is depreciable property that meets all of the requirements provided in § 1400N(d)(2) and in section 2.02 of Notice 2006-77, 2006-40 I.R.B. 590. One of these requirements is that the original use of the property must commence with the taxpayer in the GO Zone on or after August 28, 2005. Another requirement is that the property must be placed in service by the taxpayer on or before December 31, 2007

(December 31, 2008, in the case of qualified nonresidential real property and residential rental property). 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 Section 1400N(d)(6), added by section 120 of the Tax Relief and Health Care Act of 2006 (TRHCA), Pub. L. No. 109-432, 120 Stat. 2922, extends the placed-in-service date requirement for GO Zone extension property. Section 1400N(d)(6)(A) provides that in the case of any GO Zone extension property, § 1400N(d)(2)(A) is applied without regard to § 1400N(d)(2)(A)(v), which is the placed-in-service date requirement described in section 2.02 of this notice. Section 1400N(d)(6)(B) provides that Go Zone extension property is property substantially all of the use of which is in one or more specified portions of the GO Zone (as described in section 3 of this notice) and that is either (I) nonresidential real property or residential rental property that is placed in service by the taxpayer on or before December 31, 2010, or (II) in the case of a taxpayer who places a building described in (I) in service on or before December 31, 2010, property described in § 168(k)(2)(A)(i) if substantially all of the use of such property is in such building and such property is placed in service by the taxpayer not later than 90 days after such building is placed in service. In the case of any GO Zone extension property that is nonresidential real property or residential rental property, § 1400N(d)(6)(D) provides that the GO Zone additional first year depreciation deduction is applicable only to the extent of the adjusted basis of such property attributable to manufacture, construction, or production before January 1, 2010. For further guidance, see section 4 of this notice.

.04 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). In defining GO Zone extension property, § 1400N(d)(6)(C) provides that the term “specified portions of the GO Zone” means those portions of the GO Zone that are in any county or parish that is identified by the Secretary as being a county or parish in which hurricanes occurring during 2005 damaged (in the aggregate) more than 60 percent of the housing units in such county or parish that were occupied (determined according to the 2000 Census). The Joint Committee on Taxation’s explanation of TRHCA references the data compiled, and published on February 12, 2006, in Current Housing Unit Damage Estimates Hurricanes Katrina, Rita, and Wilma, which is available at www.dhs.gov/xlibrary/assets/GulfCoast_HousingDamageEstimates_021206.pdf in identifying the counties and parishes that qualify as specified portions of the GO Zone. See Staff of Joint Committee of Taxation, Technical Explanation of H.R. 6408, the “Tax Relief and Health Care Act of 2006,” as Introduced in the House on December 7, 2006, at 40, n.52 (December 7, 2006). For further guidance, see section 3 of this notice.

.05 With respect to the original use requirement described in section 2.02 of this notice, section 2.02(3) of Notice 2006-77 provides that rules similar to the original use rules in § 1.168(k)-1(b)(3) of the Income Tax Regulations apply. In addition, used property will satisfy the original use requirement so long as the property has not been previously used within the GO Zone. The Treasury Department and the Internal Revenue Service have learned that taxpayers are uncertain how to apply the original

use requirement to transactions involving reconditioned or rebuilt property in the GO Zone. This notice clarifies the application of the original use requirement in § 1400N(d)(2)(A)(iii) for GO Zone property, including GO Zone extension property.

SECTION 3. SPECIFIED PORTIONS OF THE GO ZONE

Solely for purposes of § 1400N(d)(6), the portions of the GO Zone that are the specified portions of the GO Zone are:

.01 Alabama: No counties.

.02 Louisiana: The parishes of Calcasieu, Cameron, Orleans, Plaquemines, St. Bernard, St. Tammany, and Washington.

.03 Mississippi: The counties of Hancock, Harrison, Jackson, Pearl River, and Stone.

SECTION 4. GO ZONE EXTENSION PROPERTY

.01 Definition. GO Zone extension property is depreciable property that meets all of the following requirements:

(1) Property that is described in § 1400N(d)(2)(A)(i), (ii), (iii), and (iv), and in sections 2.02(1), (2), (3), and (4) of Notice 2006-77 (as modified by section 5 of this notice);

(2) Property that is not described in § 1400N(d)(2)(B) and in section 2.03 of Notice 2006-77;

(3) Substantially all of the use of the property is in one or more specified portions of the GO Zone (as defined in section 3 of this notice). For purposes of this section 4.01(3), the term “substantially all” means 80 percent or more during each taxable year. If greater than 20 percent of the use of the property is outside the

counties and parishes designated as being part of the specified portions of the GO Zone, then the property is not GO Zone extension property under § 1400N(d)(6); and

(4)(a) Property that is nonresidential real property (as defined in § 168(e)(2)(B)) or residential rental property (as defined in § 168(e)(2)(A)) and depreciated under § 168 and placed in service by the taxpayer on or before December 31, 2010; or

(b) In the case of a taxpayer that places in service on or before December 31, 2010, a building (as defined in § 1.48-1(e)(1)) that is described in section 4.01(4)(a) of this notice and is GO Zone extension property, property that is described in § 168(k)(2)(A)(i) and § 1.168(k)-1(b)(2)(i) if substantially all of the use of such property is in the building and such property is placed in service by the taxpayer not later than 90 calendar days after the building is placed in service by the taxpayer. For purposes of this section 4.01(4)(b), the term “substantially all” means 80 percent or more during each taxable year. If greater than 20 percent of the use of the property is not in the building, then the property is not GO Zone extension property. Further, land improvements that are not in the building (for example, the sidewalks surrounding the building) are not GO Zone extension property. Moreover, if the building that is described in section 4.01(4)(a) of this notice and is GO Zone extension property is a multi-story building and the floors of that building are placed in service by the taxpayer on different dates, the taxpayer must place in service the property described in this section 4.01(4)(b) not later than 90 calendar days after the entire building is placed in service by the taxpayer but not later than March 31, 2011.

.02 Determination of Adjusted Basis Qualifying for the GO Zone Additional First Year Depreciation Deduction.

(1) Property described in § 1400N(d)(6)(B)(ii)(I) and section 4.01(4)(a) of this notice.

(a) In general. In the case of GO Zone extension property described in § 1400N(d)(6)(B)(ii)(I) and section 4.01(4)(a) of this notice (GO Zone extension real property), § 1400N(d)(6)(D) provides that the GO Zone additional first year depreciation deduction is available only for the adjusted basis of such property attributable to manufacture, construction, or production before January 1, 2010. The amounts of adjusted basis of the property attributable to manufacture, construction, or production before January 1, 2010, are referred to as “progress expenditures.”

(b) Determination of progress expenditures. For purposes of § 1400N(d)(6)(D), progress expenditures for GO Zone extension real property that is manufactured, constructed, or produced generally is the amount paid or incurred that is properly chargeable to capital account with respect to the property. The amount that is properly chargeable to capital account for purposes of § 1400N(d)(6)(D) also includes any other costs paid or incurred by the taxpayer, such as interest, or any other direct or indirect costs that are required to be capitalized under § 263A(a) and the regulations thereunder with respect to the manufacture, construction, or production of the property.

For GO Zone extension real property actually manufactured, constructed, or produced by the taxpayer, the amount paid or incurred by the taxpayer is properly chargeable to capital account at the time and to the extent that the amount is properly includible in computing basis of the property under the taxpayer’s method of accounting, such as, for example, after the requirements of § 461 (including the economic performance requirement of § 461(h)) are satisfied.

In the case of GO Zone extension real property that is manufactured, constructed, or produced for the taxpayer by another person under a written binding contract (as defined in § 1.168(k)-1(b)(4)(ii)), the amount that is properly chargeable to capital account for purposes of § 1400N(d)(6)(D) includes any payments by the taxpayer under the contract that represent part of the purchase price of the property but only to the extent progress is made in manufacture, construction, or production of the property, or, to the extent costs are incurred by the taxpayer earlier than payments are made (determined on a cumulative basis for the property), any part of that price for which the taxpayer has satisfied the requirements of § 461 (including the economic performance requirement of § 461(h)). In the case of an accrual method taxpayer, the taxpayer has made a payment if the transaction would be considered a payment by a taxpayer using the cash receipts and disbursements method of accounting. Solely for purposes of this paragraph, the written binding contract must be entered into before the manufacture, construction, or production of the property to be delivered under the contract is completed.

With respect to GO Zone extension real property that is manufactured, constructed, or produced by another person and is purchased by the taxpayer after the manufacture, construction, or production of the property is completed, only the part of the purchase price attributable to the cost of manufacture, construction, or production of the GO Zone extension real property before January 1, 2010, is eligible for the GO Zone additional first year depreciation deduction.

(2) Property described in § 1400N(d)(6)(B)(ii)(II) and section 4.01(4)(b) of this notice. The progress expenditure rule in § 1400N(d)(6)(D) and section 4.02(1) of this

notice does not apply to the GO Zone extension property described in § 1400N(d)(6)(B)(ii)(II) and section 4.01(4)(b) of this notice (GO Zone extension personal property). Accordingly, the unadjusted depreciable basis (as defined in § 1.168(b)-1(a)(3)) of such GO Zone extension personal property is eligible for the GO Zone additional first year depreciation deduction (assuming all requirements are met).

SECTION 5. ORIGINAL USE REQUIREMENT FOR THE GO ZONE ADDITIONAL FIRST YEAR DEPRECIATION DEDUCTION

.01 In general. For purposes of the GO Zone additional first year depreciation deduction, depreciable property will meet the requirements of § 1400N(d)(2)(A)(iii) if the original use of the property commences with the taxpayer in the GO Zone on or after August 28, 2005. Except as provided in rules similar to the original use rules in § 1.168(k)-1(b)(3)(iii) (sale-leaseback, syndication, and certain other transactions) and in § 1.168(k)-1(b)(3)(iv) (fractional interests in property), original use means the first use to which the property is put, whether or not that use corresponds to the use of the property by the taxpayer. Thus, additional capital expenditures paid or incurred by a taxpayer to recondition or rebuild property that is acquired by purchase or owned by the taxpayer satisfy the original use requirement because it is the first use to which the improvement is put.

The cost of reconditioned or rebuilt property does not satisfy the original use requirement because the reconditioned or rebuilt property has been previously used. However, for purposes of the GO Zone additional first year depreciation deduction, used property (including reconditioned or rebuilt property) will satisfy the original use requirement so long as the property has not been previously used within the GO Zone.

Thus, unlike the rules in § 1.168(k)-1(b)(3)(i), the portion of the cost of reconditioned or rebuilt property that is attributable to the cost of capital expenditures that were not previously used within the GO Zone will satisfy the original use requirement, regardless of whether or not the underlying property (before being reconditioned or rebuilt) to which the capital expenditures relate was previously used either inside or outside of the GO Zone. The question of whether property is reconditioned or rebuilt property is a question of fact. For purposes of this section 5.01, property that contains used parts will not be treated as reconditioned or rebuilt if the cost of the used parts is not more than 20 percent of the total cost of the property, whether acquired or self-constructed.

Rules similar to the rules in § 1.168(k)-1(b)(3)(ii), (iii), and (iv) also apply for purposes of the original use requirement for the GO Zone additional first year depreciation deduction.

.02 Examples. The following examples illustrate the provisions of this section 5.

Example 1. In July 2005, A, a calendar-year taxpayer, placed in service a new building that is located in the GO Zone. During 2007, A incurs \$2,000,000 of capital expenditures to renovate and expand such building. In October 2007, A places these capital expenditures in service for use in A's trade or business. The \$2,000,000 of capital expenditures incurred by A satisfies the original use requirement. Assuming all other requirements are met, A may claim the GO Zone additional first year depreciation deduction for the \$2,000,000 of capital expenditures, regardless of whether the \$2,000,000 is added to the basis of the building or is capitalized as a separate asset.

Example 2. In March 2007, B, a calendar-year taxpayer, purchases from C for \$5,000,000 a damaged building that is located in the GO Zone and has been previously

used in C's trade or business. In August 2007, B incurs \$4,000,000 of capital expenditures to renovate the building. In November 2007, B places the building in service for use in B's trade or business. The \$5,000,000 purchase price does not qualify for the GO Zone additional first year depreciation deduction because the building was previously used by C within the GO Zone and, therefore, the original use requirement is not met. However, the \$4,000,000 of capital expenditures incurred by B satisfies the original use requirement. Assuming all other requirements are met, B may claim the GO Zone additional first year depreciation deduction for the \$4,000,000 of capital expenditures, regardless of whether the \$4,000,000 is added to the basis of the building or is capitalized as a separate asset.

Example 3. D owns a building in the GO Zone that was used in D's trade or business prior to Hurricane Katrina. This building was badly damaged by Hurricane Katrina. Since that hurricane, the building has been closed. D incurs \$3,000,000 of capital expenditures to renovate and improve the closed building. All of the \$3,000,000 capital expenditures are components and properties not previously used in the GO Zone. Upon completion of the improvements in March 2007, D decides to sell the still-closed building instead of placing the renovated building in service. In May 2007, D sells the building to E for \$8,000,000. At the time of the sale, the fair market value of the improvements made by D is \$3,000,000. None of the improvements made by D were placed in service by D and, therefore, D could not take a depreciation deduction with respect to the improvements. In June 2007, E places the building (with the improvements) in service for use in E's trade or business. Of E's total cost of the building (\$8,000,000), \$5,000,000 is attributable to the part of the building previously

used in the GO Zone and \$3,000,000 is attributable to the improvements made by D that were not previously used in the GO Zone. Consequently, 62.5 percent of E's total cost of the building is attributable to used components and property and, thus, E has purchased a reconditioned or rebuilt building. Of E's total cost of the building (\$8,000,000), \$5,000,000 does not qualify for the GO Zone additional first year depreciation deduction because this amount is attributable to property previously used in the GO Zone. However, the remaining amount of \$3,000,000 is for improvements that were not previously used in the GO Zone and, thus, satisfies the original use requirement. Assuming all other requirements are met, E may claim the GO Zone additional first year depreciation deduction for the \$3,000,000 cost of the improvements.

Example 4. The facts are the same as in Example 3, except that D incurs \$7,000,000 of capital expenditures to renovate and improve the closed building, all of the \$7,000,000 capital expenditures are components and properties not previously used in the GO Zone, and the fair market value of these improvements at the time of the sale of the building to E is \$7,000,000. Of E's total cost of the building (\$8,000,000), \$1,000,000 is attributable to the part of the building previously used in the GO Zone and \$7,000,000 is attributable to the improvements made by D that were not previously used in the GO Zone. Consequently, only 12.5 percent of E's total cost of the building is attributable to used parts and, thus, E is treated as purchasing a new building (and not a reconditioned or rebuilt building). Thus, E's total cost of the building (\$8,000,000) satisfies the original use requirement. Assuming all other requirements are met, E may claim the GO Zone additional first year depreciation deduction for the \$8,000,000 cost of the building.

SECTION 6. EFFECT ON OTHER DOCUMENTS

Section 2.02(3) of Notice 2006-77, 2006-40 I.R.B. 590, is clarified, modified, and amplified to read as provided in section 5 of this notice.

SECTION 7. DRAFTING INFORMATION

The principal author of this notice is Douglas H. Kim of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice, contact Mr. Kim at (202) 622-3110 (not a toll-free call).