

PART III

GO Zone Bonus Depreciation

Under present law, a taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system (MACRS).

Most new business equipment can be either depreciated over its class life or expensed immediately under Internal Revenue Code Section 179. Under the GO Zone Act, taxpayers are now allowed an additional depreciation deduction equal to 50% of the depreciable basis of qualified Gulf Opportunity Zone property for the first year the property is placed in service. This additional first-year depreciation deduction is calculated after any Section 179 deduction, but before the regular depreciation deduction. The following conditions must exist in order to qualify for this additional depreciation:

- The property acquired must be qualified GO Zone property (see list below).
- Substantially all of the use of the property must be in the GO Zone and be in the active conduct of the taxpayer's trade or business.
- The original use of the property in the GO Zone must commence with the taxpayer on or after Aug. 28, 2005 (but the property may have been used property outside of the GO Zone prior to the taxpayer's acquisition).
- Must be placed in service before Dec. 31, 2008, for residential and non-residential real property and Dec. 31, 2007, for all other property.
- Must elect out if not deducting in the current year.
- No Alternative Minimum Tax depreciation adjustment.

Qualified property for the GO Zone bonus deduction includes:

- Tangible personal property with a MACRS or ADS recovery period of 20 years or less
- Computer software other than software that would be amortized over 15 years
- Water/utility property
- Qualified leasehold improvement property
- Non-residential real property
- Residential real property

The IRS has stated it will issue further guidance on what is 'the active conduct of a trade or business.'

The property must be acquired by purchase by the taxpayer on or after Aug. 28, 2005, but only if no written binding contract for the acquisition of such property was in effect before Aug. 28, 2005. However, property is not precluded from qualifying for the additional first-year depreciation merely because a written binding contract to acquire a component of the property is in effect prior to Aug. 28, 2005.

A taxpayer may choose to elect out of the additional first-year depreciation. If a taxpayer makes such an election with respect to any class of property during any taxable year, then it applies to all property in the same class placed in service during such taxable year.

Key limitations

Certain property is ineligible for the 50% bonus depreciation, including any property acquired by what the legislation defines as an excluded business:

- Casinos
- Liquor stores
- Golf courses and country clubs
- Massage parlors
- Hot tub facilities
- Sun tan facilities
- Race tracks

In addition, the bonus depreciation cannot be used for:

- Listed property that is not used more than 50% in business. Passenger automobiles may not qualify at all.
- Qualified revitalization buildings
- Property, any portion of which is financed with proceeds of tax-exempt bonds

While the 50% depreciation provision can apply to used property, it only applies if this is the property's first use in the GO Zone.

Because new GO Zone property cannot qualify for both tax-exempt bond financing and the 50% bonus depreciation, some businesses will find themselves in the position of assessing which provision is most advantageous for a given capital investment. It is an "either/or" proposition, meaning businesses must choose between tax-exempt financing and the bonus depreciation benefit. For some projects, the present value benefit of the depreciation may outweigh the financial benefits of a tax-exempt financing. In the event a business prefers the depreciation benefit, however, the project may still be financed with taxable bonds. Contact a finance or tax professional for help in assessing your project.

Businesses must also be aware of the requirement that the property be used in the "active conduct" of trade or business. This term is not defined in the legislation. However, other Internal Revenue Code provisions and regulations have defined similar provisions. It would appear that any leasing activity that is not involving substantial operations would not qualify for this bonus depreciation.

If in any subsequent year, the property ceases to be qualified GO Zone property, then the general recapture rules under Section 179(d)(10) will apply, and the taxpayer may have to recapture as ordinary income any excess benefit the taxpayer received by claiming the first-year additional depreciation deduction.

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