

PART VII

Cleanup, Remediation, and Timber Reforestation Costs

Taxpayers in a trade or business may claim a 50% deduction for costs paid or incurred in the GO Zone on or after Aug. 28, 2005, and before Jan. 1, 2008, to clean up and remove debris from real property or to demolish structures. The tax law, prior to Aug. 28, 2005, provided that if a building used in a trade or business was demolished, the cost of the demolition and the remaining basis in the demolished building had to be capitalized and added to the basis of the land on which the structure was located (see Section 280(B) of the Internal Revenue Code).

In dealing with hurricane losses, the cleanup cost and adjusted basis of the structure that was damaged can be used in computing the casualty loss caused by the storms. If business property is totally destroyed, the casualty losses are the adjusted basis of the property regardless of fair market value. Of course, the amount of the casualty loss that is otherwise deductible is reduced by any insurance proceeds or other recovery reimbursement received or expected to be received.

The new Act allows the taxpayer to claim a current deduction for 50% of any qualified GO Zone cleanup cost. These include costs from removal of debris from or the demolition of structures on real property located in the zone. Any unrecovered basis of the building or structure at the time of the demolition to the extent it is not taken into casualty loss still must be added to the basis of the land as under present law.

Land, of course, cannot be depreciated or amortized. Under present law, the treatment of the cost of debris removal depends on the nature of the costs incurred. For example, the cost of debris removal after a storm may, in some cases, constitute an ordinary and necessary business expense that is deductible in the year paid or incurred. In other situations, the cost of debris removal may constitute part of the replacement cost of the property that was damaged. In those situations, the costs are capitalized and added to the taxpayer's basis in the structure.

Under the GO Zone Act, taxpayers are permitted a deduction for 50% of any qualified GO Zone cleanup costs paid or incurred in the window from Aug. 28, 2005, to Jan. 1, 2008. The other 50% is handled in accordance with present law. A qualified GO Zone cleanup cost is an amount paid or incurred for the removal of debris from, or the demolition of structures on, real property located in the GO Zone, to the extent the amount would otherwise be capitalized. In order to qualify, the property must be held for use in a trade or business, for the production of income, or as inventory.

Because the law does not limit this write-off to businesses that existed before the storm, investors may also be able to use this provision to their advantage by purchasing damaged property in the GO Zone, conducting cleanup and demolition with the benefit of the 50% deduction, and selling the property for a profit.

Expensing for Environmental Remediation Costs

Under present law, taxpayers could have elected to deduct or expense certain environmental remediation expenditures that would otherwise be chargeable to the capital account that were paid or incurred prior to Jan. 1, 2006 (see Section 198 of the Code). The GO Zone Act extends the Section 198 expensing provision for two years, through Dec. 31, 2007, for qualified contaminated sites located in the GO Zone.

While petroleum products generally were not regarded as hazardous substances for purposes of Section 198, under the GO Zone Act petroleum products are generally treated as

hazardous substances for purposes of applying the expense provision within the GO Zone. This provision provides for expenditures paid or incurred to abate contamination on or after Aug. 28, 2005, and before Dec. 31, 2007.

Reforestation Expenditures

Under present law, a taxpayer may elect to deduct a limited amount of certain reforestation expenditures that would otherwise be required to be capitalized (see Section 194(b) of the Code). Deduction for any taxable year is generally limited to \$10,000, or \$5,000 if married and filing separately. All members of a control group of corporations are treated as a single taxpayer for purposes of the \$10,000 limit. If a partnership or S corporation incurs reforestation expenditures, the \$10,000 limit applies separately to the partnership or S corporation and to each separate partner or shareholder.

The expenditures must be for qualified timber property and they can include such costs as direct costs incurred in connection with forestation or reforestation by planting or artificial or natural seeding, including costs for site preparation, seed and seeding, labor and tools and depreciation on equipment in planting or seeding. Qualified timber property means a wood lot or other site that will contain trees in significant commercial quantities and that is held by the taxpayer for planting, cultivating, caring for and cutting trees for sale or use in commercial production of timber products.

The GO Zone Act doubles, for certain taxpayers, the present law expensing limit for reforestation expenditures paid or incurred between Aug. 28, 2005, and Jan. 1, 2008, for qualified timber property located in the GO Zone. For qualified timber property that is located in the Rita GO Zone, and no portion of which is located in the Gulf Opportunity Zone, the applicable time window is between Sept. 23, 2005, and Jan. 1, 2008.

The amount by which the expensing limit is increased, however, is limited to the amount of reforestation expenditures actually paid or incurred during the relevant portion of the taxable year. This provision in the GO Zone Act applies only to taxpayers with aggregate holdings of qualified timber property that do not exceed 500 acres at any time during the taxable year. The provision does not apply to corporations whose stock is publicly traded or to real estate investment trusts.

An additional provision of the GO Zone Act permits a new 5-year net operating loss carryback for certain timber losses. Under present law, the net operating loss arising from a "farming loss" can be carried back five years, but "farming losses" do not include losses incurred in the commercial production of timber products. Under the GO Zone Act, for purposes of determining a farming loss, certain taxpayers are allowed to count losses attributable to qualified timber property. Again, the benefit is limited to taxpayers with aggregate holdings of qualified timber property that do not exceed 500 acres at any time during the taxable year.