

PLANNING ALERT

BUSINESS, TAX, AND ESTATE PLANNING CURRENT DEVELOPMENTS

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ARE THE GO ZONE TAX BENEFITS GONE?

Bonus Depreciation For Self-Constructed Property

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After the devastation caused by Hurricane Katrina on August 27, 2005, Congress enacted the 2005 Gulf Opportunity Zone Act (the "Act") to provide incentives for rebuilding in the areas impacted by the hurricane. One incentive permits taxpayers to deduct additional depreciation in the year qualifying assets are placed in service.

BONUS DEPRECIATION

50% Bonus First-Year Depreciation. The Act provides taxpayers with an additional first-year depreciation allowance in an amount equal to 50% of the adjusted basis of qualified GO Zone property. Qualified GO Zone property is property that meets all of the following requirements:

- (1) The property falls within a specified category. Notably, the categories include tangible personal property with a recovery period of 20 years or less, qualified leasehold improvement property, nonresidential real property and residential rental property;
- (2) Substantially all of the use of the property is in the GO Zone and the property is used in an active conduct of a trade or business;
- (3) The original use of the property in the GO Zone commences with the taxpayer on or after August 28, 2005;
- (4) The property is acquired by the taxpayer by purchase on or after August 28, 2005, and no written binding contract for the purchase of the property was in existence prior to August 28, 2005; and
- (5) The property must be placed in service by the taxpayer on or before December 31, 2007 (**December 31, 2008, in the case of non-residential real property and residential rental property**).

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An obscure and ambiguous provision in the GO Zone legislation (I.R.C. § 1400N(d)(3)(B)) may deny tax benefits for many GO Zone projects that otherwise qualify for GO Zone tax benefits. A literal reading of that Code Section would require a taxpayer to begin construction of a building prior to January 1, 2008, even if the building was placed in service by the applicable deadlines for projects in the GO Zone. The application of the provision in such a manner would be inconsistent with the legislative history of the initial GO Zone Act and the recent amendments to the GO Zone Act that extended the placed in service deadline for projects on the Coast. A December 31, 2007 deadline for starting construction was not mentioned in the legislative history to the original Act or to the amendments to the Act. Many commentators and practitioners have thus assumed the provision was a drafting error or was inapplicable to the construction of buildings.

This provision could inhibit projects that otherwise would start in 2008 and thereafter. The GO Zone provisions exist as economic stimulus measures at a time when needed more than ever. The public policy for passage of the GO Zone legislation will be frustrated by the provision since the Act was intended to promote economic activity and rebuilding of the Gulf Coast.

SELF-CONSTRUCTED PROPERTY RULE

The obscure provision relates to “self-constructed property.”

A taxpayer that manufactures, constructs or produces property for its own use meets the acquisition requirement if it begins manufacturing, constructing or producing the property after August 27, 2005 **and before January 1, 2008.**

Therefore, in order for a taxpayer to be entitled to additional depreciation on otherwise qualifying self-constructed real property placed in service after December 31, 2007, construction must have commenced prior to January 1, 2008. This deadline for taxpayers beginning construction of “self-constructed property” even applies to

property that is located in Gulf Coast counties (Hancock, Harrison, Jackson, Pearl River and Stone in Mississippi) for which the placed in service deadline was extended to December 31, 2010.

“Self-Constructed Property”

The term “self-constructed property” not only includes property that a taxpayer is actually constructing for its own use but also includes property constructed by another person for the taxpayer under a written binding contract entered into prior to construction.

When Does Construction Begin?

The relevant Treasury Regulations provide that construction is considered to begin when the physical work of a significant nature begins. Physical work does not include preliminary activities such as planning or designing, securing financing, exploring or researching. Furthermore, preliminary work, such as clearing a site, test drilling to determine soil conditioning or excavation does not constitute the beginning of construction.

Attempts to Conform Rules to Respective Placed in Service Deadline

We are now working with state officials and members of the Mississippi Congressional delegation to find a legislative vehicle in which to include a technical correction to eliminate the deadline for beginning construction of self-constructed property so as to merely require that the property be placed in service by the appropriate placed in service deadline.

Pending Self-Constructed Property Projects

If you have any questions or comments regarding the contents of this newsletter and how the application of the self-constructed property rules may affect a project, please contact us.

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About the Author



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Mr. Brown joined Copeland, Cook, Taylor & Bush in 2003. His practice areas are federal and state taxation, estate planning, business succession, corporate law, finance and general business. Throughout his career as an attorney and certified public accountant (CPA), Mr. Brown has advised closely-held businesses and their owners in wealth creation and wealth preservation strategies, including business acquisitions and divestitures, executive compensation programs, business succession plans and estate plans. Mr. Brown has also taught tax and accounting courses at Mississippi State University and has been a seminar speaker on various income tax and estate planning subjects. Bill can be reached at (601) 427-1222 or by email at: bbrown@cctb.com.

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