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Application of Section 179(f) for Qualified Real Property

Notice 2013-59

I. PURPOSE

This notice provides guidance with respect to issues related to the enactment of § 315(d) of the American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, 126 Stat. 2313 (January 2, 2013) (ATRA), which extended the application of § 179(f) of the Internal Revenue Code from any taxable year beginning in 2010 or 2011 to any taxable year beginning in 2010, 2011, 2012, or 2013. For these years, § 179(f) expands the definition of property qualifying for § 179 to include qualified real property (as defined in § 179(f)(1) and (2)). This notice also provides allocation methodologies for determining the portion of the gain that is attributable to § 1245 property upon the sale or other disposition of qualified real property.

II. BACKGROUND

(1) In general. Section 179(a) allows a taxpayer to elect to treat the cost (or a portion of the cost) of any § 179 property as an expense for the taxable year in which the taxpayer places the property in service. Section 179(b)(1) and section 179(b)(2) prescribe a dollar limitation on the aggregate cost of § 179 property that can be treated as an expense under § 179(a). The dollar limitation is the amount under § 179(b)(1) (the § 179(b)(1) limitation), reduced (but not below zero) by the amount by which the cost of § 179 property placed in service during the taxable year exceeds the amount

under § 179(b)(2) (the § 179(b)(2) limitation). Prior to the enactment of ATRA, the § 179(b)(1) limitation was $500,000 for taxable years beginning in 2010 and 2011, $125,000 for taxable years beginning in 2012, and $25,000 for taxable years beginning after 2012. The § 179(b)(2) limitation was $2,000,000 for taxable years beginning in 2010 and 2011, $500,000 for taxable years beginning in 2012, and $200,000 for taxable years beginning after 2012. ATRA changed the limitations for taxable years beginning in 2012 or 2013 to $500,000 under § 179(b)(1) and $2,000,000 under § 179(b)(2).

Section 179(b)(3)(A) provides that a taxpayer's § 179 deduction for any taxable year, after application of the § 179(b)(1) and (2) limitations, is limited to the taxpayer's taxable income for that taxable year that is derived from the taxpayer's active conduct of any trade or business during that taxable year ("taxable income limitation"). Section 179(b)(3)(B) provides that the amount of any cost of § 179 property elected to be expensed in a taxable year that is disallowed as a § 179 deduction under the taxable income limitation may be carried forward for an unlimited number of years ("carryover of disallowed deduction") and may be deducted under § 179(a) in a future taxable year subject to the same limitations.

Section 179(d)(1) defines § 179 property as meaning § 1245 property (as defined in § 1245(a)(3)) that is: (1) tangible property to which § 168 applies and that is acquired by purchase (as defined in § 179(d)(2) and § 1.179-4(c) of the Income Tax Regulations) for use in the active conduct of a trade or business; or (2) computer software described in § 179(d)(1)(A)(ii) and that is acquired by purchase for use in the active conduct of a trade or business. Section 179 property does not include any property described in

§ 50(b) or air conditioning or heating units.

(2) Qualified real property. If a taxpayer elects to apply § 179(f), § 179 property also includes qualified real property. Prior to the enactment of ATRA, § 179(f) applied to qualified real property placed in service in any taxable year beginning in 2010 or 2011. ATRA extended the application of § 179(f) to qualified real property placed in service in any taxable year beginning in 2010, 2011, 2012, or 2013. Qualified real property means property that is: (1) of a character subject to an allowance for depreciation; (2) acquired by purchase (as defined in §§ 179(d)(2) and 1.179-4(c)) for use in the taxpayer's active conduct of a trade or business; (3) not described in § 50(b); and (4) not air conditioning or heating units. In addition, qualified real property must be § 1250 property that is: (1) qualified leasehold improvement property as defined in §§ 168(e)(6), 168(k)(3), and 1.168(k)-1(c); (2) certain qualified restaurant property as defined in § 168(e)(7); or (3) qualified retail improvement property as defined in § 168(e)(8).

For purposes of applying the § 179(b)(1) limitation ($500,000) for any taxable year beginning in 2010, 2011, 2012, or 2013, § 179(f)(3) provides that not more than $250,000 of the aggregate cost (as defined in §§ 179(d)(3) and 1.179-4(d)) of § 179 property that is treated as an expense under § 179(a) for the taxable year can be attributable to qualified real property. Thus, the maximum amount of qualified real property that may be expensed under § 179(a) for any taxable year beginning in 2010, 2011, 2012, or 2013 is $250,000.

Prior to the enactment of ATRA, § 179(f)(4) provided that, notwithstanding

§ 179(b)(3)(B), a taxpayer that elected to apply § 179(f) and elected to expense under §179(a) the cost (or a portion of the cost) of qualified real property placed in service during any taxable year beginning in 2010 or 2011 could not carryover to any taxable year beginning after 2011 the amount of any cost of such property that was disallowed as a § 179 deduction under the taxable income limitation of § 179(b)(3)(A). To the extent any disallowed § 179 deduction attributable to qualified real property for any taxable year beginning in 2010 (the 2010 disallowed § 179 deduction) was not used in any taxable year beginning in 2011, that amount was treated as not being subject to a § 179 election and instead was treated as property placed in service on the first day of the taxpayer's last taxable year beginning in 2011 for purposes of computing depreciation. Similarly, to the extent any disallowed § 179 deduction attributable to qualified real property for any taxable year beginning in 2011 (the 2011 disallowed § 179 deduction) was not used in the taxpayer's last taxable year beginning in 2011, that amount was treated as not being subject to a § 179 election and instead was treated as property placed in service on the first day of the taxpayer's last taxable year beginning in 2011 for purposes of computing depreciation.

ATRA amended § 179(f)(4) to provide that, notwithstanding § 179(b)(3)(B), the amount of any cost of qualified real property elected to be expensed under § 179(a) for any taxable year beginning in 2010, 2011, 2012, or 2013 that is disallowed as a § 179 deduction under the taxable income limitation of § 179(b)(3)(A) cannot be carried over to a taxable year beginning after 2013. To the extent that any § 179 deduction attributable to qualified real property is not allowed to be carried over to a taxable year

beginning after 2013, that amount is to be treated as an amount for which an election under § 179 was not made and that amount is treated as property placed in service on the first day of the taxpayer's last taxable year beginning in 2013 for purposes of computing depreciation.

The amendments made by the ATRA are effective retroactively to taxable years beginning after December 31, 2011.

A deduction under § 179 is treated as an amortization deduction for purposes of the recapture rules that apply to dispositions of certain depreciable property. In general, § 1245(a)(1) provides that upon a disposition of § 1245 property, the amount by which the lower of (1) the recomputed basis of the property (as defined in § 1245(a)(2)), or (2) the amount realized on a sale, exchange, or involuntary conversion of the property (or the fair market value of the property on any other disposition), exceeds the adjusted basis of the property is treated as ordinary income. This gain must be recognized notwithstanding any other provision of the Code. For purposes of this notice, the term "total amount realized" refers to the amount realized on a sale, exchange, or involuntary conversion of the property, or the fair market value of the property on any other disposition, as applicable.

Pursuant to § 1245(a)(3)(C), the term "§ 1245 property" includes property that is or has been property of a character subject to the allowance for depreciation provided in § 167 and that is so much of any real property (other than property described in § 1245(a)(3)(B)) that has an adjusted basis in which there are reflected adjustments for amortization under § 179.

III. ELECTION TO APPLY § 179(f) TO QUALIFIED REAL PROPERTY

A taxpayer may elect to apply § 179(f) and elect to expense under § 179(a) the cost (or a portion of the cost) of qualified real property placed in service by the taxpayer during any taxable year beginning in 2010, 2011, 2012, or 2013 by filing an original or amended Federal tax return for that taxable year in accordance with procedures similar to those in § 1.179-5(c)(2) and section 7 of Rev. Proc. 2008-54, 2008-2 C.B. 722, 725. If a taxpayer elects or elected to apply § 179(f) and elects or elected to expense under § 179(a) a portion of the cost of qualified real property placed in service by the taxpayer during any taxable year beginning in 2010, 2011, 2012, or 2013, the taxpayer is permitted to increase the portion of the cost of such property expensed under § 179(a) by filing an amended Federal tax return for that taxable year. Any such increase in the amount expensed under § 179 is not deemed to be a revocation of the prior election for that taxable year.

IV. CARROVER OF 2010 OR 2011 DISALLOWED § 179 DEDUCTION FOR QUALIFIED REAL PROPERTY

The Treasury Department and the Internal Revenue Service (Service) recognize that a taxpayer that treated the amount of a 2010 disallowed § 179 deduction or a 2011 disallowed § 179 deduction as property placed in service on the first day of the taxpayer's last taxable year beginning in 2011 may want to carryover that amount to any taxable year beginning in 2012 or 2013 in accordance with § 179(f)(4) (as amended by ATRA). Accordingly, a taxpayer that treated the amount of a 2010 disallowed § 179 deduction or a 2011 disallowed § 179 deduction as property placed in service on the

first day of the taxpayer's last taxable year beginning in 2011 may either (1) continue that treatment, or (2) if the period of limitations for assessment under § 6501(a) is open, amend its Federal tax return for the last taxable year beginning in 2011 to carryover the 2010 disallowed § 179 deduction or the 2011 disallowed § 179 deduction to any taxable year beginning in 2012 or 2013. However, if the taxpayer's last taxable year beginning in 2011 is open under the period of limitations for assessment under § 6501(a) and an affected succeeding taxable year is closed under the period of limitations for assessment under § 6501(a), the taxpayer must continue to treat the amount of a 2010 disallowed § 179 deduction or a 2011 disallowed § 179 deduction as property placed in service on the first day of the taxpayer's last taxable year beginning in 2011.

The amended Federal tax return for the taxpayer's last taxable year beginning in 2011 must include any collateral adjustments to taxable income or the tax liability (for example, the amount of depreciation allowed or allowable in the last taxable year beginning in 2011 for the amount of the 2010 disallowed § 179 deduction or the 2011 disallowed § 179 deduction). Such collateral adjustments also must be made on amended Federal tax returns for any affected succeeding taxable years. The amended returns for the taxpayer's last taxable year beginning in 2011 and for any affected succeeding taxable years must be filed within the time prescribed by law for filing an amended return for such taxable years.

V. ALLOCATION OF CARRYOVER DISALLOWED AMOUNT

(1) <u>Section 179 property is only qualified real property</u>. If a taxpayer elects to expense under § 179(a) only qualified real property for any taxable year beginning in

2010, 2011, 2012, or 2013 and some or all of the cost of that qualified real property is disallowed as a § 179 deduction under the taxable income limitation for that taxable year, the aggregate amount of the carryover of disallowed deduction for that taxable year is attributed entirely to the qualified real property.

(2) Section 179 property includes qualified real property and other properties. If a taxpayer elects to expense under § 179(a) qualified real property and other types of § 179 property for any taxable year beginning in 2010, 2011, 2012, or 2013 and some or all of the cost of the § 179 property (including the qualified real property) is disallowed as a § 179 deduction under the taxable income limitation for that taxable year, the aggregate amount of the carryover of disallowed deduction for that taxable year must be allocated pro rata between the qualified real property and the other types of § 179 property. Pursuant to § 179(f)(4)(D), the aggregate amount of the carryover of disallowed deduction for the taxable year that is allocated to the qualified real property is determined by multiplying the aggregate amount of the carryover of disallowed deduction for the taxable year by a percentage that equals:

(a) the aggregate amount attributable to qualified real property placed in service during such taxable year, increased by the portion of any amount carried over to such taxable year from a prior taxable year which is attributable to qualified real property, divided by

(b) the total amount of § 179 property placed in service during such taxable year, increased by the aggregate amount carried over to such taxable year from any prior taxable year.

(3) Examples.

(a) Example 1 -- Disallowed § 179 deduction and allocation of the carryover of disallowed deduction to qualified real property. During 2012, Company Y, a calendar year taxpayer, purchased and placed in service equipment that costs $100,000 and is § 179 property, and qualified real property that costs $200,000. For 2012, Company Y did not have any other asset purchases and did not have any carryover of disallowed deduction from prior taxable years, and has a taxable income limitation of $180,000. For 2012, Company Y elected to apply § 179(f) and elected under § 179(a) to expense the entire cost of the equipment and the entire cost of the qualified real property. Because of the taxable income limitation, the maximum § 179 deduction Company Y can claim for 2012 is $180,000. As a result, Company Y has a $120,000 carryover of disallowed deduction to 2013. This $120,000 carryover amount is allocated pro rata between the qualified real property and equipment placed in service by Company Y during 2012. Thus, $80,000 of the carryover amount is allocated to the qualified real property and $40,000 of the carryover amount is allocated to the equipment.

2012 § 179 Carryover Amount	$120,000
Allocation Ratio ($200,000 QRP / $300,000 Total § 179 Property)	66.67%
Carryover Amount Allocated to Qualified Real Property	$80,000

2012 § 179 Carryover Amount	$120,000
Allocation Ratio ($100,000 Equipment / $300,000 Total § 179 Property)	33.33%
Carryover Amount Allocated to Equipment	$40,000

(b) Example 2 – Treatment of the carryover of disallowed deduction attributable to qualified real property in a taxable year beginning after 2013. The facts are the same

as in Example 1. In 2013, Company Y did not have any asset purchases and did not have any taxable income. As a result, no portion of the $80,000 carryover of disallowed deduction from 2012 that is attributable to the qualified real property can be used by Company Y in its 2013 taxable year. Because disallowed § 179 deductions relating to qualified real property cannot be carried over to taxable years beginning after December 31, 2013, no portion of the $80,000 carryover of disallowed deduction from 2012 that is attributable to the qualified real property can be carried over to 2014 pursuant to § 179(f)(4)(A). Accordingly, Company Y is treated as if the § 179 election made in 2012 to expense $80,000 of the cost of the qualified real property placed in service in 2012 had not been made. The $80,000 cost of the qualified real property is treated as placed in service by Company Y on January 1, 2013 (the first day of Company Y's last taxable year beginning in 2013) for purposes of computing depreciation. The $40,000 carryover of disallowed deduction from 2012 that is allocated to the equipment is carried over to 2014 under § 179(b)(3)(B).

VI. DISPOSITION AND OTHER TRANSFERS OF QUALIFIED REAL PROPERTY

(1) In general. Upon a sale or other disposition of qualified real property in a taxable year beginning in 2010, 2011, 2012, or 2013, or a transfer of qualified real property in a taxable year beginning in 2010, 2011, 2012, or 2013 in a transaction in which gain or loss is not recognized in whole or in part (including transfers at death), immediately before the disposition or transfer, the adjusted basis of the qualified real property is increased by the amount of any outstanding carryover of disallowed deduction attributable to that property. Thus, the carryover of the disallowed deduction

cannot be deducted by the transferor or the transferee of the qualified real property. See § 1.179-3(f). However, the preceding two sentences of this paragraph VI(1) do not apply to a sale or other disposition of qualified real property, or a transfer of qualified real property in a transaction in which gain or loss is not recognized in whole or in part (including transfers at death), in the taxpayer's last taxable year beginning in 2013 or any subsequent taxable year.

(2) Applicability of § 1245 and § 1250.

(a) Amounts treated as §§ 1245 and 1250 property. To the extent the unadjusted basis of the qualified real property is reduced by the § 179 deduction (after the application of paragraph VI(1) of this notice), the amount of that reduction is treated as § 1245 property. See § 1245(a)(3)(C). The remaining unadjusted basis of the qualified real property is treated as § 1250 property.

(b) Allocation methodologies for determining § 1245 recapture. A taxpayer may use any reasonable allocation methodology for determining the portion of the gain that is attributable to § 1245 property upon the sale or other disposition of qualified real property. Below are two examples of reasonable allocation methodologies. The Service will not challenge any other reasonable methodology used by a taxpayer for determining the portion of gain that is attributable to the § 1245 property upon the sale or other disposition of qualified real property. The two reasonable allocation methodologies operate as follows:

(i) Pro rata allocation methodology. Under the pro rata allocation methodology, the taxpayer allocates pro rata the total amount realized (e.g., sales price)

upon a sale or other disposition of qualified real property between the § 1245 property and the § 1250 property. The total amount realized that is allocated to the § 1245 property is determined by multiplying the total amount realized by the percentage that equals the amount that is treated as § 1245 property (as determined under paragraph VI(2)(a) of this notice), divided by the total unadjusted basis of the qualified real property. The remaining amount of the total amount realized is allocated to the § 1250 property.

Next, the taxpayer will determine the portion of the gain that is attributable to the § 1245 property. The gain attributable to the § 1245 property equals the total amount realized that is allocated to the § 1245 property (as determined under the preceding paragraph) less the adjusted basis of the amount that is treated as § 1245 property (as determined under paragraph VI(2)(a) of this notice). The remaining amount of the gain or loss is attributable to the § 1250 property.

Finally, the taxpayer will determine whether all or a portion of the gain that is attributable to the § 1245 property (as determined under the preceding paragraph) is treated as ordinary income under § 1245(a). Except as provided in § 1245(b), the amount treated as ordinary income under § 1245(a) is equal to the lower of (1) the recomputed basis of the § 1245 property, or (2) the total amount realized that is allocated to the § 1245 property (as determined under the first paragraph of the pro rata allocation methodology), less the adjusted basis of the § 1245 property.

(ii) Gain allocation methodology. Under the gain allocation methodology, the taxpayer allocates the gain from the sale or other disposition of qualified real property

between the § 1245 property and the § 1250 property. The gain that is allocated to the § 1245 property is equal to the lower of (A) the amount of the gain, or (B) the amount of the unadjusted basis of the qualified real property that is treated as § 1245 property (as determined under paragraph VI(2)(a) of this notice). All of the gain that is allocated to the § 1245 property is treated as ordinary income under § 1245(a). The remaining amount of the gain is allocated to the § 1250 property.

(3) Examples.

(a) Example 1 -- Sale of qualified real property in 2014 that had a 2012 unused carryover of disallowed deduction. During April 2012, Company Y purchased for $20,000 and placed in service qualified leasehold improvement property that is qualified real property ("2012 qualified real property"). For 2012, Company Y did not have any other asset purchases and did not have any carryover of disallowed deduction from prior taxable years, and has a taxable income limitation of $12,000. For 2012, Company Y elected to apply § 179(f) and elected under § 179(a) to expense the entire cost of the 2012 qualified real property. Because of the taxable income limitation, the maximum § 179 deduction Company Y claimed for 2012 is $12,000. As a result, Company Y has an $8,000 carryover of disallowed deduction to 2013. Pursuant to § 179(f)(4)(D), this $8,000 carryover amount is allocated entirely to the 2012 qualified real property. As a result of the § 179 election to expense the entire cost of the 2012 qualified real property, Company Y's adjusted basis in the 2012 qualified real property on December 31, 2012, was zero.

In 2013, Company Y did not have any asset purchases and did not have any

taxable income. As a result, the $8,000 carryover of disallowed deduction from 2012 that is attributable to the 2012 qualified real property cannot be used by Company Y in its 2013 taxable year. Because disallowed § 179 deductions relating to qualified real property cannot be carried over to taxable years beginning after December 31, 2013, the $8,000 cannot be carried over to 2014. Accordingly, Company Y is treated as if it did not make the § 179 election in 2012 to expense $8,000 of the $20,000 cost of the 2012 qualified real property. The $8,000 of the $20,000 cost of the 2012 qualified real property is treated as placed in service by Company Y on January 1, 2013, for purposes of computing depreciation (the first day of Company Y's last taxable year beginning in 2013). See § 179(f)(4)(C).

Under § 168 Company Y depreciated its qualified leasehold improvement property placed in service in 2013 using the optional depreciation table that corresponds with the general depreciation system, the straight-line method of depreciation, a 15-year recovery period, and the half-year convention. Company Y also elected not to deduct the 50 percent additional first-year depreciation deduction provided by § 168(k) for any property placed in service during 2013. In December 2014, Company Y sells the 2012 qualified real property to an unrelated party for $15,000. The adjusted basis of this property for purposes of determining gain or loss is $7,467 (unadjusted basis of $20,000, less § 179 deduction of $12,000, less depreciation allowed and allowable of $533 for 2013 and 2014. The gain from the sale of the 2012 qualified real property is $7,533 (sales price of $15,000 less adjusted basis of $7,467).

(i) Pro rata allocation methodology. Company Y uses the pro rata allocation

methodology provided in paragraph VI(2)(b)(i) of this notice. Pursuant to § 1245(a)(3)(C) and paragraph VI(2)(a) of this notice, $12,000 of the unadjusted basis of the 2012 qualified real property is treated as § 1245 property (the § 179 deduction of $12,000 claimed on the unadjusted basis of $20,000). This § 1245 property has an adjusted basis of zero as of the date of the sale and, pursuant to § 1245(a)(2), a recomputed basis of $12,000 (adjusted basis of $0 plus § 179 deduction of $12,000). The remaining unadjusted basis of $8,000 is treated as § 1250 property, which has an adjusted basis of $7,467, as of the date of the sale.

Under the pro rata allocation methodology, Company Y allocates pro rata the sales price of $15,000 between the § 1245 property and § 1250 property. Thus, $9,000 of the $15,000 sales price is allocated to the § 1245 property ($15,000 sales price multiplied by ($12,000 that is treated as § 1245 property divided by the $20,000 total unadjusted basis of the 2012 qualified real property)) and $6,000 of the $15,000 sales price is allocated to the § 1250 property.

As a result, of the total gain of $7,533, a gain of $9,000 is attributable to the § 1245 property ($9,000 sales price attributable to the § 1245 property less a zero adjusted basis for this § 1245 property) and a loss of $1,467 is attributable to the § 1250 property ($6,000 sales price attributable to the § 1250 property less the $7,467 adjusted basis for this § 1250 property). All of the $9,000 gain attributable to the § 1245 property is treated as ordinary income under § 1245. The loss of $1,467 attributable to the § 1250 property is subject to § 1231.

(ii) Gain allocation methodology. Company Y uses the gain allocation

methodology provided in paragraph VI(2)(b)(ii) of this notice. Under the gain allocation methodology, Company Y allocates the gain of $7,533 from the sale of the 2012 qualified real property between § 1245 property and § 1250 property. The gain that is allocated to the § 1245 property is equal to the lower of (A) the amount of the gain of $7,533, or (B) $12,000, which is the amount of the unadjusted basis of the 2012 qualified real property that is treated as § 1245 property (the § 179 deduction of $12,000 claimed on the unadjusted basis of $20,000). Thus, all of the gain of $7,533 is allocated to the § 1245 property and is treated as ordinary income under § 1245(a). None of the gain is allocated to the § 1250 property.

(b) Example 2 – Sale of qualified real property in 2014 that had a 2012 unused carryover of disallowed deduction. The facts are the same as in Example 1, except that in December 2014, Company Y sells the 2012 qualified real property to an unrelated party for $25,000. The adjusted basis of this property for purposes of determining gain or loss is $7,467 (unadjusted basis of $20,000, less § 179 deduction of $12,000, less depreciation allowed and allowable of $533 for 2013 and 2014). The gain from the sale of the 2012 qualified real property is $17,533 (sales price of $25,000 less adjusted basis of $7,467).

(i) Pro rata allocation methodology. Company Y uses the pro rata allocation methodology provided in paragraph VI(2)(b)(i) of this notice. Pursuant to § 1245(a)(3)(C) and paragraph VI(2)(a) of this notice, $12,000 of the unadjusted basis of the 2012 qualified real property is treated as § 1245 property (the § 179 deduction of $12,000 claimed on the unadjusted basis of $20,000). This § 1245 property has an

adjusted basis of zero as of the date of the sale and, pursuant to § 1245(a)(2), a recomputed basis of $12,000 (adjusted basis of $0 plus § 179 deduction of $12,000). The remaining unadjusted basis of $8,000 is treated as § 1250 property, which has an adjusted basis of $7,467, as of the date of the sale.

Under the pro rata allocation methodology, Company Y allocates pro rata the sales price of $25,000 between the § 1245 property and § 1250 property. Thus, $15,000 of the $25,000 sales price is allocated to the § 1245 property ($25,000 sales price multiplied by ($12,000 that is treated as § 1245 property divided by the $20,000 total unadjusted basis of the 2012 qualified real property)) and $10,000 of the $25,000 sales price is allocated to the § 1250 property.

As a result, of the total gain of $17,533, a gain of $15,000 is attributable to the § 1245 property ($15,000 sales price attributable to the § 1245 property less a zero adjusted basis for this § 1245 property) and a gain of $2,533 is attributable to the § 1250 property ($10,000 sales price attributable to the § 1250 property less the $7,467 adjusted basis for this § 1250 property). Of the $15,000 gain attributable to the § 1245 property, $12,000 is treated as ordinary income under § 1245 and $3,000 is subject to § 1231. Because Company Y depreciated the amount that is treated as § 1250 property ($8,000) using the straight-line method of depreciation, § 1250 recapture does not apply and all of the $2,533 gain attributable to the § 1250 property is subject to § 1231.

(ii) Gain allocation methodology. Company Y uses the gain allocation methodology provided in paragraph VI(2)(b)(ii) of this notice. Under the gain allocation

methodology, Company Y allocates the gain of $17,533 from the sale of the 2012 qualified real property between § 1245 property and § 1250 property. The gain that is allocated to the § 1245 property is equal to the lower of (A) the amount of the gain of $17,533, or (B) $12,000, which is the amount of the unadjusted basis of the 2012 qualified real property that is treated as § 1245 property (the § 179 deduction of $12,000 claimed on the unadjusted basis of $20,000). Thus, of the total gain of $17,533, a gain of $12,000 is allocated to the § 1245 property and a gain of $5,533 is allocated to the § 1250 property.

All of the $12,000 gain attributable to the § 1245 property is treated as ordinary income under § 1245. Because Company Y depreciated the amount that is treated as § 1250 property ($8,000) using the straight-line method of depreciation, § 1250 recapture does not apply and all of the $5,533 gain attributable to the § 1250 property is subject to § 1231.

VII. DRAFTING INFORMATION

The principal author of this notice is Winston H. Douglas of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure, contact Mr. Douglas on (202) 622-4930 (not a toll free call).