GULF OPPORTUNITY ZONE ACT OF 2005 (H.R. 4440)

On December 21, 2005, the President signed the Gulf Opportunity Zone Act of 2005 to provide tax benefits for the Gulf Opportunity Zone[1] (the "GO Zone") and certain areas affected by Hurricanes Rita and Wilma. The following is a summary of certain provisions in the legislation.

BUSINESS RELIEF

Bonus Depreciation

Allows businesses to claim a first-year depreciation deduction equal to fifty (50%) percent of the cost of qualified property investments made in the GO Zone. However, the basis of the property and the depreciation allowances in the year of purchase and later must be appropriately adjusted to reflect the additional first-year depreciation. The original use of the property must commence on or after August 28, 2005 , by the taxpayer in the GO Zone. Used property will qualify so long as it is has not previously been used in the GO Zone. Further, substantially all of the use of the property must be in the GO Zone and must be used in the active conduct of a trade or business by the taxpayer in the GO Zone. Qualified property will also include certain nonresidential real property and residential rental property. The first-year depreciation deduction is also allowed for Alternative Minimum Tax purposes. The provision applies to property acquired on or after August 28, 2005 (no binding contract can be in effect before August 28, 2005) and that is placed in service on or before December 31, 2007 (December 31, 2008 in the case of nonresidential real property and residential rental property).

IRS Authority to Grant Bonus Depreciation Relief

Existing law allows a first-year bonus depreciation deduction equal to thirty (30%) percent or fifty (50%) percent of the cost of qualified property. Qualified property includes certain property with a recovery period of ten years or longer, certain transportation property and certain aircraft that is not transportation property. Thirty (30%) percent bonus depreciation is allowed if the qualified property was acquired by the taxpayer or manufactured, constructed or produced by the taxpayer after September 10, 2001, and before January 1, 2005, and was placed in service by the taxpayer before January 1, 2006. Fifty (50%) percent bonus depreciation is allowed if the qualified property was acquired by the taxpayer or manufactured, constructed or produced by the taxpayer after May 5, 2003, and before January 1, 2005, and was placed in service by the taxpayer before January 1, 2006. The Act authorizes the IRS to extend the placed in service date of property eligible for the December 31, 2005 placed in service date, on a case-by-case basis, for situations where the taxpayer was unable to meet the December 31, 2005 deadline as a result of Hurricanes Katrina, Rita and/or Wilma. The IRS is not authorized to extend the deadline beyond December 31, 2006.

Increased Section 179 Expense

Currently, a taxpayer can deduct $100,000 of new investment property rather than depreciate it. This provision increases the $100,000 deduction by the lesser of $100,000 or the cost of qualified

GO Zone property. Therefore, the deduction will be increased to a maximum of $200,000. Under current law, Section 179(b)(2) reduces this deduction amount dollar for dollar for the total cost of property over $400,000. This provision increases the $400,000 limitation by the lesser of $600,000 or the cost of Section 179 GO Zone property placed in service during the taxable year. Therefore, the $400,000 limitation could be increased to $1,000,000. The provision applies to property acquired on or after August 28, 2005 (no binding contract can be in effect before August 28, 2005) and that is placed in service on or before December 31, 2007 (December 31, 2008 in the case of nonresidential real property and residential rental property).

Demolition and Cleanup Costs

Under the provision, a taxpayer may elect to treat up to fifty (50%) percent of the costs (that would be otherwise capitalized) related to site cleanup and demolition in the GO Zone as an expense. Effective for amounts paid or incurred on or after August 28, 2005 , through December 31, 2007 .

Net Operating Loss Carryback

This provision increases the carryback period for net operating losses ("NOLs") from two (2) years to five (5) years for NOLs related to the GO Zone. The NOL is limited to the aggregate amount of the following deductions:

1. Qualified GO Zone casualty losses;

2. Certain moving expenses;

3. Temporary housing expenses for employees working in GO Zone;

4. Depreciation deductions for qualified GO Zone property for the taxable year the property is placed in service; and

5. Repair expenses in the GO Zone.

Rehabilitation Tax Credit

This provision increases the tax credit for qualified rehabilitation expenditures with respect to certified historic structures from twenty (20%) percent to twenty-six (26%) and with respect to non-historic structures from ten (10%) percent to thirteen (13%) percent. To qualify as a certified historic structure, the building must be listed in the National Register of Historic Places and, after rehabilitation, be used for commercial or residential rental purposes. Non-historic structures must have been built prior to 1936 and be used solely for commercial purposes, not residential rental purposes. The tax credit is not available for the rehabilitation of a private owner-occupied residence. The certified historic structures and non-historic structures must be located in the GO Zone. This provision applies to qualified expenditures incurred on or after August 28, 2005 , and before January 1, 2009 , for taxable years ending on or after August 28, 2005 .

New Market Tax Credits

Current law provides a new markets tax credit for a qualified investment in a qualified community development entity ("CDE") equal to five (5%) percent in the year of investment and the following two years and equal to six (6%) percent for the following four years. CDEs are any domestic corporation or partnership whose primary mission is serving or providing investment capital for low-income communities or a low-income person; that maintains accountability to residents of low-income communities by their representation on any governing board of the CDE or any advisory board to the CDE; and that is certified by the Secretary as being a qualified CDE. The maximum amount of qualified investments is capped at $2 billion per year for calendar year 2005 and at $3.5 billion per year for calendar years 2006 and 2007. The Act provides for an additional allocation of new markets tax credits of $300 million for 2005 and 2006, and an additional $400 million for 2007, to be allocated among CDEs only if a significant mission of the CDE is the recovery and redevelopment of the GO Zone.

<u>Environmental Remediation Costs</u>

This provision extends the deduction under Section 198 through December 31, 2007 , for expenditures incurred to cleanup qualified contaminated sites located in the GO Zone. Further, this provision treats petroleum products as hazardous substances for purposes of the deduction under Section 198, as opposed to prior law. This provision applies to expenditures paid or incurred on or after August 28, 2005 , and before December 31, 2007 .

<u>Timber Property</u>

Increases the deduction limit for reforestation costs from $10,000 to $20,000 for taxpayers owning less than 500 acres of qualified timber in the GO Zone, Rita Zone and/or Wilma Zone. Provision also allows losses to be carried back for five (5) years, rather than (2) years as previous law allowed.

INDIVIDUAL AND BUSINESS RELIEF

<u>Employer-Provided Housing and Employer Tax Credit</u>

Allows qualified employees to exclude from gross income up to $600 per month for lodging provided by a qualified employer located in the GO Zone. Also provides a credit to the qualified employer equal to thirty (30%) percent of the amount which is excludable from the gross income of the qualified employee. The amount taken as a credit is not deductible by the qualified employer. This provision applies to lodging provided beginning on the first day of the first month beginning after the date of enactment and ending on the date which is six (6) months after that date.

INDIVIDUAL RELIEF

<u>Hope Scholarship and Lifetime Learning Credit</u>

This provision doubles the Hope Credit to $3,000. This provision also doubles the Lifetime Learning Credit percentage from 20% to 40% of the first $10,000 in qualified tuition and related expenses, for a maximum Lifetime Learning Credit of $4,000 for students attending undergraduate or graduate institutions in the GO Zone. Applies to tax years 2005 and 2006. The same income phase out provisions still applies.

STATE AND LOCAL GOVERNMENT BENEFITS

Additional Tax-Exempt Bond Authority

Provides Louisiana , Mississippi , and Alabama the authority to issue a special class of private activity bonds, called GO Zone Bonds, outside of state volume caps. Bond authority is approximately $7.9 billion for Louisiana, $4.8 billion for Mississippi, and $2.1 billion for Alabama.

Advance Refunding of Bonds

This provision permits an additional advance refunding of certain governmental, qualified 501(c)(3) and certain exempt facility bonds issued by the States of Alabama, Louisiana or Mississippi, or any political subdivision thereof, prior to January 1, 2011. The provision enables bond issuers to restructure eligible debt by either refinancing at a lower rate or spreading interest payments over a longer period of time.

Low Income Housing Credit

This provision increases the area median gross income standard with the national nonmetropolitan median gross standard in relation to the income targeting rules of the low-income housing credit. Further, the provision provides that States within the GO Zone receive an additional credit cap for calendar years 2006, 2007 and 2008 equal to $18.00 times the number of such State's residents within the GO Zone. Also, all GO Zones will be treated as development areas eligible for enhanced credits, which allows investors to calculate credits for a project on an amount equal to one-hundred-thirty (130%) percent of new construction or rehabilitation expenditures.

HURRICANE RITA AND WILMA BENEFITS

This legislation extends relief to Hurricane Rita and Wilma victims that were previously enacted for Hurricane Katrina victims in the *Katrina Emergency Tax Relief Act of 2005*. The following provisions were extended to Hurricane Rita and Wilma victims:

- Tax-favored Withdrawals from Retirement Plans;
- Employee Retention Credit;
- Temporary Suspension of Limitations on Charitable Contributions;
- Suspension on Certain Limitations on Personal Casualty Losses;
- Required Exercise of IRS Administrative Authority;
- Special Look-Back Rule for Determining Earned Income Credit and Refundable Child Credit;
- Secretarial Authority to Make Adjustments Regarding Taxpayer and Dependency Status; and

• Special Rules for Mortgage Revenue Bonds.

UNFAVORABLE TAXPAYER PROVISION

<u>Interest Suspension</u>

This provision eliminates the suspension of interest on tax deficiencies resulting from certain tax shelters accruing before October 3, 2004, as previously provided in the *American Jobs Creation Act of 2004* (P.L. 108-357). Accordingly, this provision completely eliminates the interest suspension on certain tax shelters.