



## THE GULF OPPORTUNITY ZONE ACT OF 2005 OFFERS TAX BENEFITS IN FIVE STATES

### OVERVIEW

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The Gulf Opportunity Zone Act of 2005 (the “Act”) provides significant economic incentives and benefits for individuals and businesses in specified areas of the five states affected by Hurricanes Katrina, Rita and Wilma. The Act, an amendment to the Internal Revenue Code of 1986, was designed to assist individuals and businesses in the affected areas of Louisiana, Mississippi, Alabama, Florida and Texas. Among the provisions of the Act that may help businesses in the affected areas are:

- tax-exempt bond financing,
- bonus depreciation for businesses,
- increased tax benefits for real estate developers,
- special incentives for small timber producers, and
- partial tax credits for certain hurricane-related payroll losses.

Based on the pathways of the three hurricanes, the Act defines three different hurricane zones, some of which overlap. An understanding of these three different GO zones is important because most of the Act’s tax benefits are available only within the zone affected by Hurricane Katrina, while other benefits are available within all three zones. Below is a description of the three “GO” zones:

The **Gulf Opportunity (“GO”) Zone** is the area affected by Hurricane Katrina. This area, the centerpiece of the new law, consists of 31 parishes in south Louisiana, 47 counties in south and central Mississippi, and 10 counties in southwest Alabama that were determined by the President to warrant federal disaster relief as a result of Hurricane Katrina.

The **Rita GO Zone** consists of specified Texas counties and Louisiana parishes within the Hurricane Rita disaster area that were determined by the President to warrant federal disaster relief.

The **Wilma GO Zone** is those Florida counties within the Hurricane Wilma disaster area that were determined by the President to warrant federal disaster relief.

For a complete list of counties and parishes in each of the three GO zones, see pages 2 - 3 of IRS publication 4492, available at [www.irs.gov/pub/irs-pdf/p4492.pdf](http://www.irs.gov/pub/irs-pdf/p4492.pdf).

### **GULF OPPORTUNITY ZONE BONDS (GOZBs)**

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The Act creates a new class of tax-exempt industrial revenue bond called “Gulf Opportunity Zone Bonds,” which can be issued on behalf of businesses in the GO Zone by state or local governments or by certain governmental agencies. GOZBs can be issued through the end of 2010 to finance just about any kind of nonresidential real property or residential rental property in the specified parishes and counties within Louisiana, Mississippi, and Alabama.

Unlike the existing industrial revenue bond program, GOZB projects are not limited to manufacturing facilities and are not subject to the \$10 million capital expenditure limitation.

In most cases, the proceeds of GOZBs must be used for new buildings or other immovable property; however, the acquisition of existing buildings may qualify for GOZB financing if significant renovation (at least 50% of the acquisition cost) is needed. GOZBs cannot be used for movable fixtures and equipment.

If all requirements can be met, the interest on GOZBs is exempt from state and federal income taxes and is not a preference item for federal Alternative Minimum Tax purposes, both of which features will lower borrowing costs considerably. However, GOZBs do not include any form of state or federal guaranty or funding - they are strictly issued on the basis of the credit of the business and/or project being funded, although letters of credit or other credit enhancement devices may be employed to enhance the marketing of the bonds. Also, GOZBs must be designated as such by the state in which they are issued.

Examples of business property that could use GOZBs include: apartment buildings, office buildings, warehouse and distribution facilities, hotels and tourism-related facilities, manufacturing facilities, health care facilities, retail facilities and shopping centers.

### **GENERAL TAX BENEFITS**

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The Act provides for higher earlier deductions that could lead to more rapid recovery of investment in new businesses and expansion of existing business in the specified areas of Louisiana, Mississippi, and Alabama within the GO Zone. Businesses may take an additional depreciation deduction in the first year equal to 50% of the cost of depreciable property acquired and placed into service in the GO Zone after August 28, 2005 and before December 31, 2007. Property produced, constructed or manufactured by or for the business qualifies.

In lieu of depreciating the cost of tangible personal property, businesses may find it more beneficial to expense the cost of newly acquired equipment. The maximum deductible amount has been raised to \$200,000, and the maximum phase-out amount to \$1,000,000.

Businesses and investors are permitted a deduction for 50% of any qualified clean-up cost paid or incurred on or after August 28, 2005, and before January 1, 2008 for the removal of debris from, or the demolition of structures on, real property located in the GO Zone to the extent that the amount would otherwise be capitalized.

The costs of certain environmental remediation by businesses and investors on brown fields located in the GO Zone that would otherwise be capitalized are now deductible.

### **TAX CREDITS FOR REAL ESTATE DEVELOPERS**

In addition to the foregoing general business benefits, real estate developers may benefit from increased tax credits. The Act has increased from 20% to 26%, and from 10% to 13%, respectively, the federal tax credit allowed with respect to any certified historic structure or qualified rehabilitated building located in the specified counties/parishes of the tri-state GO Zone, provided the qualified rehabilitation expenditures with respect to such buildings or structures are incurred on or after August 28, 2005, and before January 1, 2009.

Low-income thresholds with respect to the low-income housing tax credit have been eased.

There is an additional allocation of the new markets tax credit in an amount equal to \$300,000,000 for 2005 and 2006, and \$400,000,000 for 2007, to be allocated among qualified community development entities to make qualified low-income community investments within the GO Zone.

### **TAX BENEFITS FOR SMALL TIMBER PRODUCERS**

The Act's timber-related tax benefits apply in all three of the hurricane zones, meaning that timber owners in the specified counties of Texas and Florida can benefit along with those in the specified counties or parishes of Louisiana, Mississippi and Alabama. However, the Act's timber-related tax benefits are limited to certain small timber producers; publicly traded corporations, real estate investment trusts, and small timber producers owning more than 500 acres of qualified timber during 2005 are not eligible to take advantage of this change in the law.

One change in the tax law raises to \$20,000 the prior \$10,000 limitation on reforestation expense deductions for qualified timberland owners affected by Hurricanes Katrina, Rita and Wilma in the designated zones. The expenses must have been incurred on or after that date of the

applicable hurricane (August 28, 2005 for Katrina; September 23, 2005 for Rita and October 23, 2005 for Wilma) and prior to January 1, 2008.

Under the Act, if an individual owning 400 acres of qualified timberland incurred reforestation expenses of \$15,000 in 2004, that individual could only deduct \$10,000 that year due to the \$10,000 ceiling in 2004 and would have to amortize the remaining \$5,000 under Section 194(a). However, if that same individual owning 400 acres of qualified timberland incurred \$15,000 of reforestation expense in 2006 on properties, some portion of which is located in the GO Zone, the entire \$15,000 can be deducted in that year due to the increase in the ceiling to \$20,000.

Another change in the tax law increased the existing Net Operating Loss Carryback period from two or three years (depending upon the type of the loss) to five years for certain timber losses that occur in the applicable areas after the date of the applicable hurricane, and before January 1, 2007. Again, this tax benefit is not available to publicly traded corporations, real estate investment trusts and small timber producers owning more than 500 acres of qualified timber during 2005. The same time limitations also apply. For example, if a an individual owning 400 acres of qualified timberland had a Net Operating (Casualty) Loss in 2004, the taxpayer could carry the loss back for two years. However, if that same individual owning 400 acres of qualified timberland has a Net Operating (Casualty) Loss in 2005 or 2006 attributable solely one (or more) of the designated hurricanes during the applicable time periods on property in the Katrina, Rita or Wilma Opportunity Zones, the taxpayer could carry the loss back for five years.

### **TAX CREDIT FOR CERTAIN PAYROLL LOSSES**

The Act grants employers in all three GO zones a tax credit for payroll losses attributable to wages paid to employees for certain workdays lost in 2005 due to Katrina, Wilma or Rita. The tax credit is capped at 40% of “qualified wages” of up to \$6,000 per employee. To be eligible for the credit, an employer must have been conducting an active trade or business in one of the GO zones at the time of the subject hurricane for that zone and such business must have been rendered “inoperable” by damages from such hurricane.

The Act does not define “inoperable” but the term might apply to a facility that employees could not enter because building security was not allowing occupants to return, or to a facility that was shutdown due to lack of utilities or because most personnel had evacuated. The tax credit applies only to wages paid to an employee after the subject hurricane came ashore in the affected GO zone and incurred after the employee’s principal place of business became “inoperable” and before “significant operations” resumed at such place of business. The Act generously includes within the definition of “qualified wages” not only those days when the employee performed no services, but also those days when the employee worked at his or her principal place of business or elsewhere prior to the time that “significant operations” were resumed at his or her principal place of business.

## QUESTIONS?

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### **BONDS:**

For more information about GOZB provisions, please contact O. Ray Cornelius in our New Orleans office at (504) 585-0258 or by e-mail at [ray.cornelius@arlaw.com](mailto:ray.cornelius@arlaw.com); or contact David M. Wolf in our New Orleans office at (504) 585-0117 or by e-mail at [david.wolf@arlaw.com](mailto:david.wolf@arlaw.com).

### **GENERAL TAX:**

For more information about tax benefits associated with the Act, please contact John F. Lyle in our Mobile office at (251) 650-0857 or by e-mail at [john.lyle@arlaw.com](mailto:john.lyle@arlaw.com); or contact Richard D. Holton in our Nashville office at (615) 259-1003 or by e-mail at [rick.holton@arlaw.com](mailto:rick.holton@arlaw.com).

### **REAL ESTATE DEVELOPERS:**

For more information about tax credits for real estate developers, please contact John F. Lyle in our Mobile office at (251) 650-0857 or by e-mail at [john.lyle@arlaw.com](mailto:john.lyle@arlaw.com).

### **TIMBER:**

For more information about timber-related provisions associated with the Act, please contact Powell G. Ogletree, Jr. in our Jackson office at (601) 292-0740 or by e-mail at [gee.ogletree@arlaw.com](mailto:gee.ogletree@arlaw.com).

### **PAYROLL:**

For more information about the tax credit for payroll losses, please contact JoAnne Ray in our Houston office at (713) 308-0149 or by e-mail at [joanne.ray@arlaw.com](mailto:joanne.ray@arlaw.com).

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