Client Alert Bulletin

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GULF OPPORTUNITY ZONE ACT OF 2005

The centerpiece of the hurricane relief contained in the Gulf Opportunity Zone Act of 2005 signed by President Bush on December 21, 2005, is a package of tax incentives designed to help revitalize and rebuild the areas hardest hit by Hurricane Katrina. The Act provides these tax benefits in the area designated as the Gulf Opportunity Zone (or GO Zone), which is comprised of those areas in the Hurricane Katrina disaster area that have been designated by the President to warrant individual or individual and public assistance under the Stafford Act because of Hurricane Katrina. The federal tax benefits available to businesses in the GO Zone include 50% bonus first-year depreciation, a nearly doubled Code Sec. 179 expensing allowance, partial expensing of demolition and cleanup costs, a 5-year-NOL carryback, and increased rehabilitation tax credits.

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49 Mississippi counties are included in the GO Zone. They are: Adams, Amite, Attala, Claiborne, Choctaw, Clarke, Copiah, Covington, Forrest, Franklin, George, Greene, Hancock, Harrison, Hinds, Holmes, Humphreys, Jackson, Jasper, Jefferson, Jefferson Davis, Jones, Kemper, Lamar, Lauderdale, Lawrence, Leake, Lincoln, Lowndes, Madison, Marion, Neshoba, Newton, Noxubee, Oktibbeha, Pearl River, Perry, Pike, Rankin, Scott, Simpson, Smith, Stone, Walthall, Warren, Wayne, Wilkinson, Winston and Yazoo.

Some key provisions of the Act are:

Capital Cost Recovery

Bonus 50% first-year depreciation allowance. The Act provides a 50% bonus first-year depreciation allowance to help businesses rebuild in the GO Zone. Businesses get the bonus writeoff for the cost of most new property investments made in the GO Zone, including purchased computer software, leasehold improvements, certain commercial and residential real estate, machinery, and equipment. All depreciation deductions (including bonus depreciation) for property qualifying for the bonus first-year writeoff are exempt from the AMT. The 50% bonus depreciation allowance applies to property acquired after Aug. 27, 2005, and placed in service before Jan. 1, 2008 (before Jan. 1, 2009, for real property). In addition, the IRS is granted authority to extend the Dec. 31, 2005, bonus depreciation deadline for placing long-lived property in service in certain circumstances in the GO Zone, Rita Zone or Wilma Zone for up to one year.

Increase in expensing for small businesses. Under current law, businesses may elect to expense (deduct currently) up to $100,000 ($105,000 for 2005, as adjusted for inflation) of the cost of machinery and equipment (and some types of software) bought for use in business. The Act increases this amount to $200,000 ($205,000 for 2005, as adjusted for inflation) and also increases the level of investment at which benefits phase out from $400,000 ($420,000 for 2005, as adjusted for inflation) to $1 million of qualifying purchases ($1,020,000 for 2005, as adjusted for inflation), thus allowing more businesses to use this tax benefit in rebuilding. There's no change to the rule limiting expensing to taxable income from the taxpayer's active trades or businesses. The changes apply to expensing-eligible property placed in service in the GO Zone after Aug. 27, 2005, through 2007.

Who's eligible for bonus depreciation and boosted expensing. The provisions relating to additional first-year depreciation and increased expensing (as well as the five-year carryback of net operating losses attributable to casualty losses, depreciation, or amortization, covered below) don't apply to any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises. The provisions also do not apply to any property used directly in connection with gambling, animal racing, or the on-site viewing of such racing, or to buildings or portions of buildings dedicated to such activities (unless the portion so dedicated is less than 100 square feet).

Partial expensing for demolition and cleanup costs. Under current law, a deduction is not allowed to the owner or lessee of a building for any loss on demolition of the building, or for any of the demolition expenses. The loss or expenses must be capitalized and added to the basis of the land. Under the Act, 50% of otherwise capitalized costs of demolition and site cleanup are deductible by businesses in the GO Zone, effective for amounts paid or incurred after Aug. 27, 2005, through 2007.

Expensing to promote cleanup of Brownfields. The Act extends the deductibility of costs of cleaning up Brownfields (polluted areas as specially defined) in the GO Zone for two years and allows expensing for the cleanup of petroleum products in the GO Zone, effective for expenditures paid or incurred after Aug. 27, 2005, and before Jan. 1, 2008.

Boosted expensing for timber growers. In general, taxpayers may only deduct $10,000 of reforestation costs, with the election to amortize the balance over 84 months. The Act raises the expensing limit to $20,000, effective for expenditures incurred before Jan. 1, 2008. The provision applies for qualified timber property located in the GO Zone, the Rita GO Zone, or the Wilma GO Zone, but does not apply to publicly traded corporations, real estate investment trusts, or taxpayers owning more than 500 acres of timber during the tax year.

NOL Changes

Net operating loss carryback for qualified GO Zone loss. The Act extends the net operating loss carryback period from 2 to 5 years for net operating losses attributable to (i) depreciation deductions for GO Zone property and deductions for certain repair expenses resulting from Hurricane Katrina; (ii) business casualty losses in the GO Zone caused by Hurricane Katrina; and (iii) moving expenses and temporary housing expenses for employees working in the GO Zone. The 5-year carryback applies for losses paid or incurred after Aug. 27, 2005, and before Jan. 1, 2008; however, an irrevocable election not to apply the five-year carryback may be made for any tax year.

Five-year carryback for small timber producers. The Act also approves a 5-year (instead of a 2-year) NOL carryback for small (under 500 acres) timber producers. They must have timber property in the GO Zone, Rita GO Zone or Wilma GO Zone, and the longer carryback applies only to a specified portion of the producer's tax year, which begins on or after Aug. 28, 2005 (Katrina), Sept. 23, 2005 (Rita GO Zone), or Oct. 23, 2005 (Wilma GO Zone), and before Jan. 1, 2007. The taxpayer can't be a publicly traded corporation or a real estate investment trust.

Tax Credit Changes

Increase in rehabilitation credit for GO Zone projects. The Act increases the 10% credit for rehabilitation of a qualified building to 13% (and the 20% credit for the rehabilitation of certified historic structures to 26%) for buildings and structures in the GO Zone for expenditures after Aug. 27, 2005, through 2008.

Employee retention credit broadened. The Katrina Emergency Tax Relief Act of 2005 (KETRA) provided a 40% tax credit for wages paid up to $6,000 if paid after Aug. 28, 2005, and before Jan. 1, 2006, by employers located in the Hurricane Katrina core disaster area (defined the same way as the GO Zone) who continue to pay their employees while their business is inoperable. The Act modifies the tax credit so that the provision applies to the Katrina, Rita (reference date: Sept. 23, 2005), and Wilma (reference date: Oct. 23, 2005) Zones without regard to the size of the employer.

New markets tax credit. A new markets tax credit (NMTC) allows businesses investing in low-income communities lacking access to capital to take a 39% tax credit over seven years for investments in qualified community development entities (CDEs). The Act allows an additional $300 million in 2005 and 2006, and an additional $400 million in 2007 for NMTC authority for CDEs operating in the GO Zone.

Additional low-income housing credits. The Act allows States to allocate volumes of additional housing credit amounts in years 2006 to 2008 of $18 per person in the GO Zone, as measured by 2004 population data. Additionally, the GO Zone will be treated as a difficult development area, allowing investors to calculate credits for a project on an amount equal to 130% of new construction or rehabilitation expenditures.

This Client Alert Bulletin is not intended to cover the entire Act and provides general information only. It does not constitute legal advice applicable to any particular situation. If you have any questions concerning the Act, please contact one of the following YoungWilliams attorneys:

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