

1. *Benefits to Employers for Hiring or Retaining Certain Employees*

Code section 51 gives a credit to employers who hire individuals from certain target groups such as veterans or individuals receiving public assistance. A credit also applies to retaining these individuals beyond the first year of employment. The Gulf Opportunity Zone Act expands the hiring credit to include all individuals and businesses affected by Hurricane Katrina, and it expands the retention credit to all individuals and businesses affected by Hurricanes Katrina and Rita. Employers providing housing to employees are also eligible for a housing credit.

2. *Bonus First-Year Depreciation for “Gulf Opportunity Zone Property”*

The law allows an additional income tax deduction of 50% of a qualified property’s depreciable basis during the first year it is placed in service. Calculate this additional allowance after section 179 deductions (election to expense certain depreciable business assets) and before the regular depreciation schedule.

3. *Increase in Expensing Under Code Section 179*

The change increases the section 179 expense deduction allowed for tangible personal property placed in service in the Gulf Opportunity Zone.

4. *Expensing for Certain Demolition and Clean-Up Costs*

Taxpayers in the Gulf Opportunity Zone may deduct 50 percent of clean-up costs instead of capitalizing them.

5. *Extension of Expensing for Environmental Remediation Costs*

Extends the expense deduction under Section 198 through December 31, 2007, and defines petroleum products as hazardous substances.

6. *Increase in Rehabilitation Income Tax Credit*

Increases the income tax credit allowed for rehabilitation of qualified historic structures and rehabilitated buildings under code section 47.

7. *Extension of the Net Operating Loss Carryback Period*

The provision extends the net operating loss (NOL) carryback period from 2 years to 5 years for certain amounts related to Hurricane Katrina or the Gulf Opportunity Zone. It also suspends the 90% limit on the Alternative Tax Net Operating Loss Deductions under section 56(d)(1) for qualified Gulf Opportunity Zone losses, which allows a taxpayer to apply those NOL carrybacks to offset up to 100 percent of the alternative minimum taxable income.

8. *Authorization of Gulf Opportunity Zone Bonds*

The provision authorizes the issuance of \$ 7.9 billion of qualified private activity bonds to finance the construction and rehabilitation of residential and nonresidential property located in the Gulf Opportunity Zone.

9. *Tax Benefits Not Available with Respect to Certain Property*

Excludes from the bonus depreciation, increased expensing under code section 179, the five-year carryback for net operation losses, and all bond provisions any property used in connection with any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, liquor store gambling or animal racing facility.

DEFINITIONS

1. “Hurricane Katrina Disaster Area”

It is the area for which the President declared a major disaster, because of Hurricane Katrina. The Hurricane Katrina disaster area covers parts of Alabama, Florida, Louisiana, and Mississippi.

2. Gulf Opportunity Zone (“GO Zone” or “Core Disaster Area”)

The portion of the Hurricane Katrina Disaster Area determined by FEMA to be eligible for either individual only or both individual and public assistance from the Federal Government. It covers the parishes of Acadia, Ascension, Assumption, Calcasieu, Cameron, East Baton Rouge, East Feliciana, Iberia, Iberville, Jefferson, Jefferson Davis, Lafayette, Lafourche, Livingston, Orleans, Plaquemines, Pointe Coupee, St. Bernard, St. Charles, St. Helena, St. James, St. John the Baptist, St. Martin, St. Mary, St. Tammany, Tangipahoa, Terrebonne, Vermilion, Washington, West Baton Rouge, and West Feliciana.

3. “Hurricane Rita Disaster Area”

The area for which a major disaster was declared by the President before October 6, 2005 under the Stafford Act because of Hurricane Rita.

4. Hurricane Rita GO Zone

The portion of the Hurricane Rita disaster area determined by the President to warrant individual or individual and public assistance (Level 1 assistance) from the Federal Government under the Stafford Act by reason of Hurricane Rita. It covers the parishes of Acadia, Allen, Ascension, Cameron, Calcasieu, Beauregard, Evangeline, Iberia, Jefferson, Jefferson Davis, Lafayette, Lafourche, Livingston, Plaquemines, Sabine, St. Landry, St. Martin, St. Mary, St. Tammany, Terrebonne, Vermilion, Vernon, and West Baton Rouge.

ANALYSIS

1. Benefits to Employers for Hiring or Retaining Certain Employees

a. Summary

Code section 51 gives a credit to employers who hire individuals from certain target groups such as veterans or individuals receiving public assistance. A credit also applies to retaining these individuals beyond the first year of employment. The Gulf Opportunity Zone Act expands the hiring credit to include all individuals and businesses affected by Hurricane Katrina, and it expands the retention credit to all individuals and businesses affected by Hurricanes Katrina and Rita. Employers providing lodging to employees are also eligible for a housing credit.

b. Benefits for Hiring Hurricane Katrina Employees.

i. Effects

1. Income tax credit of 40% of the first \$6,000 qualified first-year wages for employment of more than 400 hours.
2. Income tax credit of 25% of qualified first-year wages for employment of less than 400 hours but more than 120 hours.
3. The code section 51(c)(4) hiring deadline of December 31, 2005, for other target groups does not apply to wages paid or incurred to any Hurricane Katrina employee.
4. The code section 51(i)(2) rehiring ban is waived, thus, the income tax credit can apply if an employer rehires a former employee who was not employed by the employer on August 28, 2005.
5. **Note:** This provision applies only to Hurricane Katrina—not Hurricane Rita.

ii. Requirements

1. New employee must work for 120 hours or more in the first year of employment. So, the credit can be taken only in the year when 120 hours have been worked.
2. *Individuals residing in the GO Zone*
 - a. Principal place of abode must have been in the core disaster area on August 28, 2005.
 - b. Hired during the two-year period for the position beginning on or after August 28, 2005.
 - c. Principal place of employment is in the core disaster area.
3. *Individuals displaced from the GO Zone*
 - a. Principal place of abode of the employee must have been in the GO Zone on August 28, 2005.
 - b. Displaced from the principal place of abode by Hurricane Katrina.
 - c. Hired on August 28, 2005 through December 31, 2005 without regard to the principal place of employment.
4. Individuals must provide “reasonable evidence” the employee is a Hurricane Katrina employee such as drivers’ licenses, utility bills, voter registration cards and public benefits identification cards (a “revocation rule” will apply).

iii. Examples

1. On July 1, 2007, T hires W, whose principal place of abode on August 28, 2005, was the core disaster area, for a position the principal place of

employment of which is in the core disaster area. Subject to the dollar amount and percentage limits discussed above, the Work Opportunity Tax Credit is available for qualified wages paid or incurred for services performed at any time during the one-year period beginning on July 1, 2007 and ending on June 30, 2008 (even though this period ends after August 27, 2007).

2. On January 12, 2006, X provides to T reasonable evidence that, on August 28, 2005, X's principal place of abode was in the core disaster area. On January 16, 2006, X begins work for T in a principal place of employment within the core disaster area. On February 27, 2006, T discovers that X's principal place of abode on August 28, 2005, was not in the core disaster area. Wages paid by T to X after February 27, 2006 will not qualify for the income tax credit.

c. Benefits for Retaining Hurricane Katrina or Hurricane Rita Employees

i. Effects

The new law provides an employee Income tax credit of 40% of the first \$6,000 of qualified wages paid by an eligible employer to an eligible employee.

ii. Requirements

1. Eligible Employers

- a. Conducted an active trade or business on August 28, 2005, in the GO Zone; or, on September 23, 2005 in the Rita GO Zone.
- b. The trade or business was inoperable on any day after August 28, 2005, and before January 1, 2006, as a result of damage sustained by reason of Hurricane Katrina; or, on any day after September 23, 2005, and before January 1, 2006, as a result of damage sustained because of Hurricane Rita.
- c. All businesses are eligible regardless of the average number of employees.

2. Eligible Employees

- a. Have a principal place of employment in the GO Zone on August 28, 2005, with an eligible employer; or, on September 23, 2005, in the Rita GO Zone.
- b. Is/May not already be eligible for the same credit under the section 51 target groups during that period.

3. Qualified Wages

- a. Section 51(c)(1) (without regard to section 3306(b)(2)(B)) wages paid or incurred any day after August 28, 2005, or after September 23, 2005, and before January 1, 2006, but within the period
 - i. Beginning on the date on which the trade or business first became inoperable at the principal place of employment of the employee immediately before Hurricane Katrina or Hurricane Rita.
 - ii. Ending on the date on which such trade or business has resumed significant operations at such principal place of employment.

- b. No restrictions on hours of services performed, on the place of employment after the hurricane, or on performing services at original place of employment before significant operations resume.
- c. This income tax credit is added to the general business credit under section 38(b); thus, the employee retention credit cannot be carried back to a tax year ending on or before the effective date of the specific credit (the transitional rule in section 39(d)). It is not, however, a qualified business credit under section 196(c).
- d. Eligible employers must reduce the deduction for wages paid to an eligible employee by the amount of the employee retention credit generated by qualified wages paid to that employee (section 280C(a)).
- e. Rules similar to sections 51(i)(1) and 52 apply.

iii. Examples

- 1. Employer X has two eligible employees (A and B) to whom X pays qualified wages of \$4,000 and \$7,000 respectively. X is entitled to a total credit of \$4,000; \$1,600 for the wages paid to A ($\$4,000 \times 40\%$) and \$2,400 for \$6,000 of the wages paid to B ($\$6,000 \times 40\%$).
- 2. Employer Y has a single employee who is paid a total of \$40,000 in the tax year, of which \$6,000 is qualified wages. Since Y is entitled to an employee retention credit of \$2,400 ($\$6,000 \times 40\%$), Y's deduction for wages is reduced to \$37,600.

d. Special Employee Housing Credit

- i. GO Zone Employers who provide lodging to an employee may receive a "Hurricane Katrina housing credit" equal to 30 percent of any amount which is excludable from the gross income of a qualified employee for any month during the tax year.
- ii. An employer must reduce its deduction for wages paid to a qualified employee by the amount of the income tax credit generated by the value of income-excluded lodging provided to that employee.
- iii. Employees must have had a principal residence in the GO Zone and must perform substantially all employment services in the GO Zone for the employer that furnishes lodging to that individual.
- iv. Lodging must be furnished beginning January 1, 2006, and ending on June 30, 2006.

v. Example

- 1. A qualified employer provides \$600 worth of lodging per month to qualified employees in January 2006 through June 2006. For each employee for whom the lodging is provided, a Hurricane Katrina housing tax credit of \$180 per month is available to the employer (30% of \$600), but the employer's otherwise deductible expenses for providing the lodging is reduced by the same \$180.

2. Bonus First-Year Depreciation for “Gulf Opportunity Zone Property”

a. Summary

The law allows an additional income tax deduction of 50% of a qualified property’s depreciable basis during the first year it is placed in service. Calculate this additional allowance after section 179 deductions (election to expense certain depreciable business assets) and before the regular depreciation schedule.

b. Property Requirements—“GO Zone Property”

- i. Must be one of the following types of property
 1. Tangible property depreciated under the modified accelerated cost recovery system (MACRS) with a recovery period of 20 years or less (section 168).
 2. Water utility property (section 168(e)(5)).
 3. Computer software (purchasable by public, nonexclusive license, not substantially modified) (see section 167(f)(1)(B)).
 4. Qualified leasehold improvement property (certain improvements to buildings made more than three years after the building is placed in service and that are made under a lease).
 5. Nonresidential real property or residential rental property (buildings and structural components of buildings).
- ii. Substantially all of the use of the property must be in the GO Zone and in the **active** conduct of the trade or business in the GO Zone.
 1. The requirement of an “active” trade or business to qualify for the bonus depreciation appears to preclude passive rental activities from qualifying. It is our understanding that the Treasury is developing guidance on this particular issue.
- iii. Must be placed in service after August 27th, 2005, and before 2008 (or 2009 for non-residential real property and residential rental property).
 1. Used property can be qualified as GO Zone property if it has not previously been used within the GO Zone. For example, a used compressor or other piece of equipment brought in the GO Zone will qualify.
 2. Additional capital expenditures incurred by the taxpayer after August 27th, 2005, to recondition or rebuild the taxpayer’s property meet the original test if the original use of the property in the GO Zone began with the taxpayer.
- iv. The property must be acquired by purchase (section 179(d)).
- v. Rules similar to the Alternative Minimum Tax deduction under section 168(k)(2)(G) apply; thus, the bonus depreciation is allowed for both regular tax and AMT purposes.
- vi. **Recapture** may apply the year after claiming the special allowance if the property ceases to be GO Zone property (see rules under section 179(d)(10)).

c. Excluded Property

- i. Property not used in a trade or business.
- ii. Property for which a written binding contract for the acquisition was in effect before August 28, 2005 (unless it was only for a component of the property).
- iii. Property required to be depreciated using the Alternative Depreciation System (ADS) (section 168(k)(2)(D)(i)).

- iv. Property any portion of which is financed with the proceeds of a tax-exempt obligation under section 103.
- v. Property for which the taxpayer is claiming a commercial revitalization deduction.
- vi. Property in the same class for which the taxpayer elected not to claim the special GO Zone depreciation allowance (“election-out”).

d. ***Special Provisions for Long-Production-Period Property and Aircraft***

- i. The required placement-in-service date for bonus depreciation under section 168(k)(2)(A)(iv) for long-production period property and aircraft may be extended by the IRS for up to one year if the property is located and manufactured in the GO Zone or the Rita GO Zone.
- ii. The extension must be claimed by a taxpayer affected by Hurricanes Katrina or Rita.

e. ***Examples***

- i. On November 1, 2005, T, a calendar year taxpayer, acquires and places in service “qualified GO Zone property” that is 5-year MACRS property (in this case, computers and other qualified technological equipment), and that costs \$1 million. Assume that T does not make an election to forgo bonus depreciation (an “election-out”). T’s bonus depreciation deduction for 2005 is \$500,000 ($\$1,000,000 \times 50\%$). Then, assuming that T applies the 200% declining balance method (switching to the straight-line method when that method yields larger deductions), the half-year convention, and the percentages provided by the optional depreciation tables, T’s remaining depreciation deductions are as follows:

- 1. for 2005, \$100,000 (20% of \$500,000);
- 2. for 2006, \$160,000 (32% of \$500,000);
- 3. for 2007, \$96,000 (19.20% of \$500,000);
- 4. for 2008, \$57,600 (11.52% of \$500,000);
- 5. for 2009, \$57,600 (11.52% of \$500,000);
- 6. for 2010, \$28,800 (5.76% of \$500,000).

- ii. Assume in the previous example T permanently moves on June 1, 2006, all the computers and other qualified technological equipment to one of its offices located outside the GO Zone. The property would fail the substantially-all-use requirement and would no longer be qualified GO Zone property. Accordingly, 2006 is a recapture year for T. Had T made an “election-out” with respect to 5-year MACRS property, T would have been entitled to deduct as depreciation, with respect to what would have been the 50% bonus depreciation “portion” of the property, a total of \$260,000 in 2005 and 2006 (\$100,000 in 2005 and \$160,000 in 2006).

Thus, in 2006, T, in addition to claiming \$160,000 of depreciation for the property (as shown in the previous example), must include in ordinary income \$240,000 (the \$500,000 of bonus depreciation that was allowed to T in 2005 minus \$260,000). In later years, the property is depreciated as if T had made the election-out; i.e., T is allowed depreciation deductions of \$192,000 for the property in 2007, \$115,200 in 2008, \$115,200 in 2009 and \$57,600 in 2010.

- iii. On November 1, 2005, W, a calendar-year taxpayer, purchases and places in service qualified GO Zone property that costs \$350,000. Assume
 - 1. That the property is section 179 property,

2. That after applying all the rules that can limit W's maximum allowable section 179 expensing deduction for 2005, W can elect a section 179 expensing deduction of up to \$205,000 (\$105,000 under the regular rules, and \$100,000 under the special allowance for qualified GO Zone property).
3. That W does in fact make a \$205,000 expensing election under section 179 for the property, and
4. That W does not elect out of bonus depreciation ("election-out").

For the qualified GO Zone property, W is allowed, for 2005, a 50% bonus depreciation deduction of \$72,500 (50% of \$145,000, which is the \$350,000 original cost minus \$205,000). Then, assuming that W applies the 200% declining balance method (switching to the straight-line method when that method yields larger deductions), the half-year convention, and the percentages provided by the optional depreciation tables; the other depreciation deductions allowed for the property are as follows:

1. for 2005, \$14,500 (20% of \$72,500);
2. for 2006, \$23,200 (32% of \$72,500);
3. for 2007, \$13,920 (19.20% of \$72,500);
4. for 2008, \$8,352 (11.52% of \$72,500);
5. for 2009, \$8,352 (11.52% of \$72,500);
6. for 2010, \$4,176 (5.76% of \$72,500).

- iv. **Original Use Requirement Example:** In 2007, J, a calendar year taxpayer, incurs \$5,000 in capital expenditures to recondition a machine that, in 2006, had, for a purchase price of \$20,000, been acquired by J, from K, who had previously used the machine in the GO Zone. Assuming that J is the first person, after the machine is reconditioned, to use the machine in the GO Zone, the \$5,000 in capital expenditures satisfies the original use requirement.
- v. On November 1, 2005, X, a calendar year taxpayer, buys a newly manufactured machine from manufacturer M, and begins to use the machine in the active conduct of X's business in the GO Zone. On January 10, 2006, X sells the machine to Y, which is a company in the equipment leasing business and is a calendar-year taxpayer. Also, on January 10, 2006, X leases the machine back from Y under a lease, the term of which begins on January 10, 2006. X continues to use the machine in the active conduct of X's business in the GO Zone. Thus, January 10, 2006 is the date that the machine is first used under the leaseback, and, thus, first satisfies the original use requirement. Therefore, if the machine meets the other requirements for being qualified property, and if Y doesn't make an "election-out" (see below), Y is allowed 50% bonus depreciation for the machine in 2006. X is not allowed 50% bonus depreciation for the machine in either 2005 or 2006.
- vi. The facts are the same as the previous example, except that (1) X acquires the machine and begins to use it in the GO Zone on August 5, 2005, and (2) the sale and leaseback of the machine occurs on October 1, 2005. The sale and leaseback of the machine occurs within the three-month time period required under the sale-leaseback rule. However, the machine fails the requirement, under the sale-leaseback rule, that property be originally placed in service after August 27, 2005. Thus, Y is not allowed 50% bonus depreciation for the machine. With respect to X, the machine fails the requirement that the original use of the machine in the GO Zone must begin with the

taxpayer after August 27, 2005. Thus, X also is not allowed 50% bonus depreciation for the machine.

- vii. Lessor F places Property P in service in the GO Zone on August 1, 2006. The lessee of Property P is E. On September 1, 2006, Lessor F sells Property P to G. On October 1, 2006, G sells Property P to H. E continues to be the lessee of Property P, and continues to use it in the GO Zone, from August 1, 2006 through October 1, 2006. H is the original user of Property P, and is eligible to claim 50% bonus depreciation for the property.
- viii. Lessor B places Property Q in service in the GO Zone on June 1, 2006 and Property R in service in the GO Zone on April 15, 2007. Properties Q and R are subject to the same lease. The lessee of Properties Q and R is N. On July 1, 2007, Lessor B sells Properties Q and R to C. N continues to be the lessee of Properties Q and R, and continues to use them in the GO Zone, from June 1, 2006 through July 1, 2007. C is the original user of Properties Q and R, and is eligible to claim 50% bonus depreciation for the properties.
- ix. R, a person related, within the meaning of section 267(b), to taxpayer Z, entered into a written binding contract to buy machinery on August 1, 2005. On September 15, 2005, before the delivery of the machinery to R, R transferred to Z the rights of R under the contract. Z cannot treat the machinery as qualified GO Zone property.
- x. R, a person related, within the meaning of section 267(b), to Taxpayer Z, began construction on December 1, 2004, of an electric generator for R's use. On September 15, 2005, before completing construction of the generator, R transfers to Z the partially completed generator. Z is not allowed to treat the generator as qualified GO property and, thus, is not allowed 50 percent bonus depreciation for either any amount it pays to R for the generator or for any of Z's costs of completing the generator.

3. Increase in Expensing Under Code Section 179

a. Summary

The change increases the section 179 deduction allowed for property placed in service in the Gulf Opportunity Zone.

b. Effects

- i. Increases the section 179 deduction for property acquired after August 27th, 2005, by the lesser of
 - 1. \$100,000, or
 - 2. The cost of qualified section 179 GO Zone property placed in service during the year.
- ii. Increases the dollar amount in effect under section 179(b)(2) (the \$400,000 beginning-of-phase-out level indexed for inflation) by the lesser of
 - 1. \$600,000, or
 - 2. The cost of qualified section 179 GO Zone property placed in service during the year.

- iii. **Recapture:** Rules similar to the rules under section 179(d)(10) apply with respect to any qualified section 179 GO Zone property that ceases to be qualified section 179 GO Zone property or property predominantly used in a trade or business.

c. Requirements

- i. Qualified section 179 property that is qualified GO Zone property as defined under “Bonus First Year Depreciation” *supra*.
- ii. **Excludes** residential real property or residential rental property.
- iii. The taxpayer must choose between the GO Zone provision election and the empowerment zone/renewal community elections (sections 1397A and 1400J).

d. Examples

- i. T's cost of section 179 property that is qualified section 179 GO Zone property placed in service during a tax year is \$800,000, and, in that year, T acquires no other section 179 property. The dollar limit (calculated without regard to phase-out) on the amount that can be expensed (i.e., deducted) under section 179 is increased from \$100,000 to \$200,000 (i.e., increased by the lesser of \$100,000 and \$800,000, which is the cost of the qualified section 179 GO Zone property placed in service during the tax year).

The \$400,000 beginning-of-phase-out level is increased by \$600,000 to \$1 million (i.e., is increased by the lesser of \$600,000 and \$800,000, which is the cost of the qualified section 179 GO Zone property placed in service during the tax year). T's cost of section 179 property placed in service is \$800,000 which is less than the beginning-of-phase-out level, which is \$1 million (\$400,000 plus \$600,000). Thus, there is no reduction in the \$200,000 dollar limit, and, subject to the taxable income limitation, T can elect to expense up to \$200,000 of section 179 property.

This example excludes consideration of the calendar year at issue and any resultant inflation indexing.

- ii. In this example, the taxpayer has placed \$200,000 of qualified section 179 GO Zone property into service. The number used is \$225,000, in order to avoid confusion with the \$200,000 dollar limit.

T's cost of section 179 property that is qualified section 179 GO Zone property placed in service during a tax year is \$225,000, and T's cost of other section 179 property placed in service during that year is \$450,000. Under Code Sec. 1400N(e), the dollar limit (calculated without regard to phase-out) on the amount that can be expensed (i.e., deducted) under Code Sec. 179 is increased from \$100,000 to \$200,000 (i.e., increased by the lesser of \$100,000 and \$225,000, which is the cost of the qualified section 179 GO Zone property placed in service during the tax year).

The \$400,000 beginning-of-phase-out level is increased by \$225,000 to \$625,000 (i.e., is increased by the lesser of \$600,000 and \$225,000, which is the cost of the qualified section 179 GO Zone property placed in service during the tax year). T's cost of section 179 property placed in service is \$675,000 (\$225,000 plus \$450,000). Thus, the \$200,000 dollar limit must be reduced by \$50,000, which is the excess of \$675,000 over \$625,000. Thus, the dollar limit is reduced to \$150,000, and, subject to the taxable income limitation (see above), T can elect to expense up to \$150,000 of section 179 property.

This example excludes consideration of the calendar year at issue and any resultant inflation indexing.

- iii. The facts are the same as the previous illustration, except that the tax year at issue is calendar year 2006 and the actual amounts of the dollar limit and the beginning-of-phase-out level, as adjusted for inflation, for tax years beginning in 2006 are taken into account.

Thus, the dollar limit is \$108,000 and the beginning-of-phase-out level is \$430,000. Under the GO Zone Act, the dollar limit (calculated without regard to phase-out) on the amount that can be expensed (i.e., deducted) under Code Sec. 179 is increased from \$108,000 to \$208,000 (i.e., increased by the lesser of \$100,000 and \$225,000, which is the cost of the qualified section 179 GO Zone property placed in service during the tax year).

The \$430,000 beginning-of-phase-out level is increased by \$225,000 to \$655,000 (i.e., is increased by the lesser of \$600,000 and \$225,000, which is the cost of the qualified section 179 GO Zone property placed in service during the tax year). T's cost of section 179 property placed in service is \$675,000 (\$225,000 plus \$450,000). Thus, the \$208,000 dollar limit must be reduced by \$20,000, which is the excess of \$675,000 over \$655,000. Thus, the dollar limit is reduced to \$188,000, and, subject to the taxable income limitation, T can elect to expense up to \$188,000 of section 179 property.

- iv. **Recapture:** On September 1, 2006, X, a calendar year taxpayer, places into service computers and other qualified technological equipment (the "property") that are 5-year MACRS property, that cost \$178,000 and that are qualified section 179 GO Zone Property. The property is the only section 179 property that X places in service in 2006 and X makes a section 179 election for the entire cost of the property.

The resulting \$178,000 expensing deduction is \$70,000 more than the \$108,000 of expensing that X would have been allowed (see the previous illustration) for 2006 had the property been section 179 property, but not qualified section 179 GO Zone property. On June 1, 2007, X moves a portion of the property, that cost \$50,000, to an office outside of the GO Zone, and, thus, that \$50,000 portion fails the substantially-all-use test for qualified GO Zone property, which, in turn, means that the property is no longer qualified section 179 GO Zone property.

Accordingly, 2007 is a recapture year for X. Assuming that X made no depreciation elections for 2006 and that, therefore, T would have depreciated the property by applying the 200% declining balance method (switching to the straight-line method when that method yields larger deductions, the half-year convention, and the percentages provided by the optional depreciation tables, the consequences of the recapture are determined as follows:

Had X not elected to expense the \$50,000 portion, X, with respect to the \$50,000 would have been entitled to deduct as depreciation a total of \$38,000 in 2006 and 2007—i.e., \$25,000 of bonus depreciation and \$5,000 of "regular" depreciation in 2006 and \$8,000 of "regular" depreciation in 2007.

X must, therefore, include in ordinary income \$12,000 (\$50,000 minus \$38,000) in 2007.

In 2008 and thereafter, the property is depreciated as if the election to expense the additional \$50,000 had not been made; i.e, T is allowed depreciation deductions as follows:

1. for 2008, \$4,800 (19.20% of \$25,000);
2. for 2009, \$2,880 (11.52% of \$25,000);

3. for 2010, \$2,880 (11.52% of \$25,000);
4. for 2011, \$1,440 (5.76% of \$25,000).

4. Expensing for Certain Demolition and Clean-Up Costs

a. Summary

Taxpayers in the Gulf Opportunity Zone may deduct 50 percent of clean-up costs instead of capitalizing them.

b. Effects

The taxpayer can elect to deduct 50 percent of any qualified GO Zone clean-up costs for the tax year in which the costs are paid or incurred.

c. Requirements

Must be paid or incurred after August 27, 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 that is:

1. Held by the taxpayer for use in a trade or business or for the production of income, or;
2. Inventory or other property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business.

d. Examples

- i. X, an accrual-method manufacturer, owned a factory in the GO Zone that was totally destroyed by Hurricane Katrina. Any expenses of demolition of the factory, or the removal of debris that are incurred after August 27, 2005, and before January 1, 2008 (and chargeable to capital account) are generally eligible for the 50% expensing election.
- ii. The facts are the same in the previous example except there was no hurricane damage, and X simply made a business decision to demolish the factory on May 1, 2006, and demolition was completed on May 15, 2006. Under the wording of the statute, the results would presumably be the same.
- iii. Y, an accrual-method builder and seller of houses, owned 500 houses in the GO Zone that (1) at the time of Hurricane Katrina, were either completed (and being held for sale) or under construction (to be held for sale upon completion), and (2) were totally destroyed or partially damaged by Hurricane Katrina. Any expenses of demolition of the houses, or the removal of debris, incurred after August 27, 2005, and before January 1, 2008, (and chargeable to capital account) are eligible for the 50% expensing election.

5. Extension of Expensing for Environmental Remediation Costs

a. Summary

Extends the deduction under Section 198 through December 31, 2007, and defines petroleum products as hazardous substances.

b. *Effects*

Taxpayer may take a section 198 deduction for expenditures incurred to cleanup qualified contaminated sites in the GO Zone until December 31, 2007. It also defines petroleum products as a hazardous substance.

c. *Requirements*

- i. Expenses must be paid or incurred on or after August 27, 2005 and before January 1, 2008.
- ii. Must be in connection with a qualified contaminated site located in the GO Zone.
- iii. For the revised definition of petroleum products, the “national priorities exception” and “CERCLA section 104 exception” (Code section 198 (d) (2)) still apply.

d. *Examples*

- i. X, a cash-method taxpayer, pays, after Dec. 31, 2005, but before Jan. 1, 2008, qualified environmental remediation expenditures in connection with a qualified contaminated site located in the GO Zone. X is allowed to make the expensing election for the expenditures.
- ii. The facts are the same as the previous illustration, except that X is an accrual-method taxpayer and accrues the expenditures after Dec. 31, 2005, but before Jan. 1, 2008. The result is the same.
- iii. There is a release of crude oil, crude oil condensates, or natural gasoline on property held for use in a trade or business in the GO Zone. The property is now a contaminated site unless it is on the national priorities list or under the CERCLA section 104 exception.

6. *Increase in Rehabilitation Income Tax Credit*

a. *Summary*

Increases the income tax credit allowed for rehabilitation of qualified historic structures and qualified rehabilitated buildings under code section 47.

b. *Effects*

The section 47 income tax credit for certified historic structures increases from 20% to 26% and the credit for qualified rehabilitated buildings increases from 10% to 13%.

c. *Requirements*

- i. Must be paid or incurred during the period beginning on August 28, 2005, and ending on December 31, 2008.
- ii. Must be located in the GO Zone.
- iii. **Certified Historic Structure:** any building listed in the National Register or that is located in a registered historic district and has been certified by the Secretary of the Interior to the Treasury Secretary as being of historic significance to the district.
- iv. **Qualified Rehabilitated Building:** a building that was first placed in service before 1936.

7. Extension of the Net Operating Loss Carryback Period

a. *Summary*

The provision extends the net operating loss (NOL) carryback period from 2 years to 5 years for certain amounts related to Hurricane Katrina or the GO Zone. It also suspends the 90% limit on the Alternative Tax Net Operating Loss Deductions under section 56(d)(1) for qualified GO Zone losses, which allows a taxpayer to apply those NOL carrybacks to offset up to 100 percent of the alternative minimum taxable income.

b. *Effects*

- i. The extension of the carryback period applies by changing the period from 2 years to 5 years.
- ii. Taxpayer may also use the tentative (or “quick”) carryback procedures to expedite the recovery of the refund attributable to the five-year carryback of the loss.
- iii. Rules similar to section 172(i)(2) (separate NOL treatment for “farming losses”) apply to any portion of a loss subject to the five-year carryback period for Qualified GO Zone (QGZ) losses. Thus, this provision provides for a separately treated NOL taken into account after the remaining portion of the NOL for the year.
- iv. Allows a QGZ loss to take to 100 percent deduction as an alternative tax net operating loss under code section 56(d) instead of current 90 percent limitation.
- v. The extended five-year carryback period also applies for the alternative tax net operating loss deduction (ATNOLD) in computing alternative minimum taxable income.
- vi. Special Effects (*additional rules apply*)
 1. Public utility property losses caused by Hurricane Katrina may, at taxpayer’s election, be carried back 10 years instead of two years.
 2. Taxpayers may elect to deduct GO Zone public utility property losses from Hurricane Katrina in the fifth tax year before the year of loss.
 3. A NOL incurred by small timber producers before January 1, 2007, attributable to certain qualified timber property in the GO Zone or Rita GO Zone are allowed a 5-year carryback.

c. *Requirements*

- i. **A Qualified GO Zone (QGZ) loss is the lesser of**
 1. **The excess of**
 - a. The **Net Operating Loss (NOL)** for such taxable year
 - b. The **Specified Liability Loss (SLL)** for such taxable year to which a 10-year carryback applies under section 172(b)(1)(C), or
 2. **The aggregate amount** of the following deductions used to compute the net operating loss for such taxable year:
 - a. **GO Zone casualty losses** with respect to the sale or conversion of a trade or business property (any uncompensated section 1231 loss)
 - i. Must be allowed as a deduction under section 165 for the taxable year.

- ii. Must be by reason of Hurricane Katrina.
 - iii. Must be from the sale, exchange, or involuntary conversion of property used in a trade or business, or of capital assets held for more than one year in connection with either a trade or business or a transaction entered into for profit.
 - iv. Includes only the amount not compensated by insurance or otherwise.
 - v. May not apply Section 165(i) General Disaster Losses to these qualified GO Zone casualty losses.
 - vi. Property must be located in the GO Zone
 - vii. Reduce amount of casualty loss for gains on involuntary conversions.
- b. **GO Zone employee moving expenses** paid by an employer for employees living in the GO Zone.
- i. The individual's principal place of abode must have been located in the GO Zone before August 28, 2005.
 - ii. The individual must have been unable to remain in that abode as a result of Hurricane Katrina.
 - iii. The individual's principal place of employment with the taxpayer after the expense must be located in the GO Zone and the individual must be employed in the GO Zone.
 - iv. Section 217 (b) defines a "moving expense," except the former residence and the new residence may be the same.
 - v. A taxpayer who pays the moving expense of a prospective employee never employed with the employer and later employs the individual in the GO Zone will be able to use this provision.
- c. **Employee temporary housing expenses** paid by an employer in the GO Zone for employees displaced by Hurricane Katrina. Temporary housing may be outside the GO Zone, but the employee's principal place of employment with the taxpayer must be in the GO Zone.
- d. **GO Zone property depreciation deductions** (or amortization in lieu thereof) for the taxable year in which the property is placed in service. This includes income tax deductions allowable for any "qualified GO Zone property" for the tax year the property is placed in service (*see "qualified GO Zone property" under bonus depreciation supra*).
- e. **Deductions for repairs** resulting from Hurricane Katrina for property located in the GO Zone. This includes expenses for the removal of debris, mold, and other contaminants.
- ii. The taxpayer must pay or incur the losses after August 27, 2005, and before January 1, 2008.

- iii. The taxpayer may irrevocably elect not to apply the five-year carryback with respect to any taxable year. This is not an election to forgo other carryback periods, but this may be done under section 172(b)(3).
- iv. Use of this provision precludes the taxpayer from also claiming the loss as having occurred in the immediately preceding tax year (section 165(i) early deduction election). If the taxpayer has a large amount of taxable income for the first year, but little or no taxable income for the earlier years, the taxpayer should elect out of the five-year carryback to preserve its right to the section 165(i) election.
- v. The portion claimed under this provision must be excluded from a section 172(F) claim (individual net operating losses attributable to casualties and disasters, and farm and small business net operating losses attributable to presidential-declared disasters).

d. *Examples*

- i. Taxpayer has a \$400,000 NOL for its tax year ending Dec. 31, 2005. Assume that \$150,000 of that NOL is a qualified GO Zone loss eligible for the five-year NOL carryback period provided by the GO Zone Act. For tax years ending Dec. 31, 2000 through Dec. 31, 2002, taxpayer had taxable income of \$50,000 for each tax year. Because taxpayer can carry \$150,000 of the \$400,000 NOL back five years, taxpayer can use it to offset taxable income for the 2000, 2001, and 2002 tax years. Under pre-GO Zone Act law, taxpayer could only carry the 2005 NOL back two years, to 2003 and 2004, and so couldn't offset the \$150,000 taxable income for 2000, 2001, and 2002.
- ii. In the previous example, the \$250,000 portion of taxpayer's 2005 NOL that doesn't qualify for the special five-year carryback period for QGZ losses (\$400,000 total NOL arising in 2005 minus \$150,000 amount eligible for five-year carryback) can be carried back two years, under the normal carryback rules (unless another special carryback period applies), to 2003 and 2004.
- iii. Taxpayer has \$150,000 taxable income in each tax year for tax years 2000 through 2004, and a \$500,000 NOL for the 2005 tax year. Assume that \$200,000 of the NOL is a QGZ loss. Taxpayer is treated as having two separate NOLs: (1) a \$200,000 NOL attributable to the QGZ loss, and (2) a \$300,000 "regular" NOL for the remainder. Taxpayer may carry the \$200,000 QGZ NOL back five years to 2000, but not until the "regular" \$300,000 NOL (which, under the normal carryback rules, can be carried back only two years to 2003) is absorbed, first against the \$150,000 taxable income for 2003, and the balance (\$150,000) against the \$150,000 taxable income for 2004. The \$200,000 QGZ NOL can offset the \$150,000 taxable income for 2000, and \$50,000 (\$200,000 – \$150,000 used in 2000) of the \$150,000 taxable income for 2001.

8. Authorization of Gulf Opportunity Zone Bonds

a. *Summary*

The provision authorizes the issuance of \$ 7.9 billion of qualified private activity bonds to finance the construction and rehabilitation of residential and nonresidential property located in the Gulf Opportunity Zone.

b. *Requirements*

- i. **Exempt facility bonds:** 95% or more of the proceeds are used for qualified projects in the GO Zone. (*The act also includes a provision for **qualified mortgage bonds**, which this analysis excludes.*)
- ii. Must be issued by the State of Louisiana or any political subdivision thereof after being approved by the Governor, or if required by state law, the Bond Commission.
- iii. Bonds must be issued after December 21, 2005 and before January 1, 2011 for purposes of this provision.
- iv. Must be for the following “qualified project costs”
 1. Qualified residential rental projects (as defined for exempt facility bond purposes in section 142(d)) located in the GO Zone).
 2. The cost of acquisition, construction, reconstruction and renovation of:
 - a. Nonresidential real property (including fixed improvements associated with that property) located in the GO Zone;
 - b. Public Utility Property (for purposes of MACRS as defined in section 168(i)(10)) located in the GO Zone.

c. *Limitations*

- i. The aggregate face amount of the bonds shall not exceed the product of \$2,500 multiplied by the portion of the State population in the GO Zone (\$7.9 billion for Louisiana).
- ii. Bonds shall not be issued for movable fixtures and equipment.
 1. “Movable fixtures and equipment” excludes components that are assembled to construct an industrial plant, consumer appliances installed in owner-occupied residences, and residential rental property financed with the proceeds of the GO Zone Bonds.

d. *Special Rules*

- i. Qualified Residential Rental Projects changes under code section 141(d)1.
 1. Must be occupied by individuals whose income is 60 percent or less of area median gross income under the “20-50 test” or 70 percent or less under the “40-60 test.” (The usual requirement is 50 percent and 60 percent respectively).
- ii. Code section 146 aggregate annual state private activity volume caps shall not apply.
- iii. Increase to 50 percent from 15 percent the allowable portion financed with the net proceeds of the issue for existing properties under code section 147 (d)(2) (amounts for rehabilitation).
- iv. The exception from rebate for certain proceeds to be used to finance construction expenditures shall apply (code section 148(f)(4)(C)).
- v. Tax-exempt interest rules on private activity bonds (Section 57(a)(5)) shall not apply.

- vi. Advance refunding of certain tax-exempt bonds outstanding on August 28, 2005, shall be allowed for up to \$4.5 billion in Louisiana. The provision allows one advance refunding after December 21, 2005 and before January 1, 2011.
 - 1. The advance refunding authority only applies to bonds that will not be advance refunded under Code restrictions in effect on August 28, 2005.
 - 2. The advance refunding bond is the only other outstanding bond with respect to the refunded bond, so that at no time after the advance refunding authorized under the 2005 GO Zone Act occurs may there be more than two sets of bonds outstanding.
 - 3. The requirements of section 148 (arbitrage) must be met with respect to all bonds issued under the 2005 GO Zone Act.
- vii. The special arbitrage expenditure rules for certain construction bond proceeds apply to available construction proceeds of the qualified GO Zone Bonds issued to finance qualified project costs, treating the bonds as a construction issue.
- viii. Interest on GO Zone Bonds is not a preference item for purposes of the alternative minimum tax (AMT) preference for private activity bond interest.
- ix. This provision does not apply to the portion of an issue which, if issued as a separate issue, would be treated as a qualified bond or as a bond that is not a private activity bond if the issuer elects to so treat that portion.

e. ***Examples***

- i. If a building is purchased for \$750,000, tax-exempt bond financing is available if at least \$375,000 (50% of \$750,000) is spent for rehabilitation of the building.

9. ***Tax Benefits Not Available with Respect to Certain Property***

Excludes from the bonus depreciation, increased expensing under code section 179, the five-year carryback for net operation losses, and the bond provisions any property used in connection with any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, liquor store gambling or animal racing facility.

Information and Examples Taken From the Following Publication:

RIA, Complete Analysis of the Gulf Opportunity Zone and Katrina Emergency Tax Relief Acts of 2005 (2006).

Some examples and explanations in this material are taken from the book, RIA'S COMPLETE ANALYSIS OF THE GULF OPPORTUNITY ZONE AND KATRINA EMERGENCY TAX RELIEF ACTS OF 2005 (Thompson 2006). Those desiring more in-depth treatment of the topics addressed in this material are encouraged to consult this resource.