

TAX SERVICES

GULF OPPORTUNITY ZONE ACT OF 2005



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**BUSINESS AND
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On December 21, President Bush signed the Gulf Opportunity Zone Act of 2005, legislation designed to help businesses reestablish in the areas affected by Hurricane Katrina. A summary of some of the more relevant provisions follows. For brevity, we have necessarily omitted various details. Verify that a provision does apply to you before taking any action. If you have any questions, call us.

GULF OPPORTUNITY ZONE - The legislation creates a Gulf Opportunity Zone ("GO Zone") which is composed of the parishes or counties that warrant individual or individual and public assistance from the Federal government under the President's Katrina disaster declaration. Certain provisions of the new act only apply to taxpayers in the Gulf Opportunity Zone and thus do not apply to taxpayers living in the Hurricane Rita or Hurricane Wilma disaster areas.

BONUS DEPRECIATION - Taxpayers placing qualified Gulf Opportunity Zone property in service can deduct 50% of the cost of the property in the first year, in addition to normal depreciation on the remaining 50% of cost. (The 50% bonus depreciation previously available to all U.S. taxpayers is no longer available).

The term "qualified Gulf Opportunity Zone property" means property

- which is purchased software, qualified leasehold improvements, other property with a recovery (depreciable) period of twenty years or less or which is nonresidential real property or residential rental property,
- substantially all of the use of which is

in the Gulf Opportunity Zone and is in the active conduct of a trade or business,

- the original use of which in the Gulf Opportunity Zone commences with the taxpayer on or after August 28, 2005, and
- in the case of the Katrina GO Zone, which is purchased by the taxpayer on or after August 28, 2005 and on or before December 31, 2007 (December 31, 2008, in the case of nonresidential real property and residential rental property).

Note that, while original use of the property in the GO Zone must originate with the taxpayer, this does not mean the property must be new. It simply means that the property has not been used by any other taxpayer in the GO Zone.

The bonus depreciation is also deductible for alternative minimum tax purposes. Special depreciation recapture rules apply if the property is sold or moved out of the GO Zone.

EXPENSING OF FIXED ASSETS - The Internal Revenue Code allows taxpayers to expense up to \$105,000 (\$108,000 in 2006) of the cost of qualifying depreciable ("section 179") property. This ability to expense the cost of section 179 property phases out as a taxpayer's purchase of such assets in the year exceeds \$420,000 (\$430,000 in 2006). The new legislation increases the amount of the cost that can be expensed by \$100,000 and the phase-out floor by \$600,000 for qualifying Katrina property. Qualifying Katrina property is section 179 property that

GULF OPPORTUNITY ZONE ACT (CONT'D)

otherwise meets the definition of qualifying Gulf Opportunity Zone property, as defined above, placed in service on or after August 28, 2005 and on or before December 31, 2007 (real property does not qualify as section 179 property).

The increased expensing option does not apply to automobiles, including those weighing over 6,000 pounds.

EXCLUDED PROPERTY - The new provisions for 50% bonus depreciation, for increased expensing of fixed assets, and for the extended net operating loss (see below) do not apply to any property used in connection with 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, or any gambling or animal racing property.

DEMOLITION AND CLEAN-UP COSTS - Under the Internal Revenue Code, a taxpayer cannot deduct the cost of demolishing a building. Instead, this cost is capitalized as part of the (nondepreciable) land. Taxpayers are also required to capitalize clean-up costs in certain circumstances. The new legislation allows taxpayers to expense 50% of such costs paid or incurred after August 28, 2005 and before January 1, 2008, if the property is located in the Gulf Opportunity Zone and is either property held for use in a trade or business, for the production of income, or as

inventory. This new provision thus does not apply to personal-use property, such as your residence.

REHABILITATION TAX CREDIT -

The legislation increases the tax credit allowed in the case of qualified rehabilitation expenditures paid or incurred during the period beginning on August 28, 2005, and ending on December 31, 2008, with respect to any qualified rehabilitated building or certified historic structure located in the Gulf Opportunity Zone. The rehabilitation credit for a qualified rehabilitated building has been increased from 10% to 13% and the rehabilitation credit for a certified historic structure has been increased from 20% to 26%.

TIMBER PROPERTY - The legislation includes two benefits for small timber producers.

The legislation doubles, for certain taxpayers, the present-law expensing limit for reforestation expenditures paid or incurred by such taxpayers (i) during the period after on or after August 28, 2005 and before January 1, 2008, with respect to qualified timber property any portion of which is located in the Gulf Opportunity Zone, (ii) during the period on or after September 23, 2005, and before January 1, 2008, with respect to qualified timber property any portion of which is located in the Rita Zone and no portion of which is located in the Gulf Opportunity Zone, and (iii) during the period on or after October 23, 2005, and before January 1, 2008, with respect to qualified timber property any portion of which is located in the Wilma Zone. The amount by which the ex-

pensing limit is increased, however, is limited to the amount of reforestation expenditures paid or incurred during the relevant portion of the taxable year.

In addition, income and loss attributable to qualified timber property is attributed to a farming business for purposes of the special rules governing net operating losses from farming businesses. This rule applies to qualified timber property located in the Gulf Opportunity Zone or the Rita GO Zone. See the legislation for more details.

NET OPERATING LOSSES - Generally, taxpayers can carry back a net operating loss two years and then carry it forward twenty years. The legislation provides for a carryback period of five years to the extent the net operating loss includes the following specific components:

- The amount of a taxpayer's casualty loss deduction attributed to property used in a trade or business or to capital assets held for more than one year in a trade or business or a transaction entered into for profit. The property must be located in the Gulf Opportunity Zone and the loss must be attributable to Hurricane Katrina. The loss must be reduced by any gain recognized by the taxpayer from an involuntary conversion of property by reason of Katrina.
- Any deduction for moving expenses paid or incurred after August 27, 2005, and before January 1, 2008, and allowable under this section to any taxpayer

GULF OPPORTUNITY ZONE ACT (CONT'D)

in connection with the employment of any individual whose principal place of abode was located in the Gulf Opportunity Zone before August 28, 2005, who was unable to remain in such abode as the result of Hurricane Katrina, and whose principal place of employment with the taxpayer after such expense is located in the Gulf Opportunity Zone. The term "moving expenses" has the same meaning as in the Internal Revenue Code provision covering normal moving expenses, except that the taxpayer's former residence and new residence may be the same residence if the initial vacating of the residence was the result of Hurricane Katrina.

- Any deduction for expenses paid or incurred after August 27, 2005 and before January 1, 2008 to temporarily house any employee of the taxpayer whose principal place of employment is in the Gulf Opportunity Zone. It is not necessary that the temporary housing be located in the GO Zone.
- Any deduction for depreciation (or amortization in lieu of depreciation) allowable with respect to any qualified Gulf Opportunity Zone property (see the definition above) for the taxable year such property is placed in service.
- Any deduction allowable for repair expenses (including expenses for removal of debris and mold remediation) paid or incurred after August 27, 2005, and before January 1, 2008,

with respect to any damage attributable to Hurricane Katrina and in connection with property which is located in the Gulf Opportunity Zone.

In addition to the five year carryback period, the general rule that limits a net operating loss to 90% of alternative minimum taxable income for alternative minimum tax purposes will not apply.

**SEE OUR SUMMARY OF THE
KATRINA EMERGENCY TAX
RELIEF ACT AS WELL AS
OTHER IMPORTANT
HURRICANE RELATED
INFORMATION ON OUR WEB
SITE:
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EDUCATION CREDITS - The legislation increases the amounts of the Hope and Lifetime Learning Credits available to students attending an eligible education institution in the Gulf Opportunity Zone. The expanded credits are available in 2005 and 2006.

Under this provision, the Hope credit is increased to 100% of the first \$2,000 and 50% of the next \$2,000 in qualified tuition and related expenses, for a maximum credit of \$3,000 per student (compared to a \$1,500 maximum credit for students attending class outside the GO Zone). The Lifetime Learning credit rate has been increased from 20% to 40%. Finally, the definition of qualified education expenses subject to the credits

has been expanded to include room and board expenses for students attending on at least a half-time basis.

The income levels at which these credits phase out has not been changed.

HOUSING RELIEF - Subject to certain exceptions, employers must include in taxable wages on their employees' Forms W-2 the value of employer-provided housing. Many employers in the disaster areas are currently providing temporary housing to employees who have lost their residences.

The legislation states that qualified employers can exclude from taxable wages the value of such housing up to \$600 per month. The exclusion does not apply for Social Security, Medicare and unemployment taxes.

In addition, employers may claim a credit of 30% of the value of the lodging excluded under this provision. The amount of the credit cannot be deducted by the employer.

An employee qualifies for this exclusion if he or she is an individual who had a principal residence in the Gulf Opportunity Zone on August 28, 2005 and who performs substantially all his or her employment services in the Gulf Opportunity Zone for the qualified employer which furnishes the lodging.

A qualified employer is any employer with a trade or business located in the Gulf Opportunity Zone.

This exclusion and credit only applies to housing provided from January, 2006 through June, 2006.

GULF OPPORTUNITY ZONE ACT (CONT'D)

EMPLOYEE RETENTION CREDIT -

The legislation makes the employee retention credit provided by the Katrina Emergency Tax Relief Act available to all employers, retroactively repealing previous legislation that had limited the credit to employers averaging 200 employees or less.

TAX RELIEF FOR HURRICANE RITA AND WILMA VICTIMS -

The legislation extends many of the provisions of the Katrina Emergency Relief Tax Act to taxpayers living in the Hurricane Rita and Hurricane Wilma disaster areas. However, the effective dates are different, determined by the dates these two storms struck the mainland. These provisions include

- Tax-favored withdrawals from pension plans and other pension provisions
- Employee retention credit
- Temporary suspension of limitations on charitable contributions for corporations contributing to Rita and Wilma relief efforts.
- Elimination of the 10% of adjusted gross income and \$100 floors for personal casualty losses caused by Rita and Wilma.

Required notice if this communication includes tax advice: This written advice is not intended or written to be used, and it cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer.

TED STACEY joined the Firm in 1978 after spending two years with a national CPA firm. He was admitted to the membership in 1985. Ted holds a Bachelor's degree in business administration from Loyola University and a Master's in Accounting from the University of New Orleans.

As Director of Tax Services, Ted specializes in tax research, partnership, corporations and limited liability companies. He is the Contributing Editor of *Review and Outlook*, the Firm's newsletter and *eBulletin*, its electronic news brief. An active member of the Society of Louisiana CPAs and recipient of its 2002 Distinguished Service Award, Ted is also a member the American Institute of CPAs and the New Orleans Estate Planning Council. A recent President of the UNO International Alumni Association, he serves on the Executive Committee of the UNO Business Council. He is also a member and Past President of the Archdiocese of New Orleans School Board.

A distinguished speaker, he is often requested to discuss tax issues on New Orleans radio and television and has addressed numerous local, state and national conferences.



KEN FRANZ joined the Firm following graduation from the University of New Orleans in 1985 and was admitted to the membership in May 2000.

As a Tax Director, Ken handles a variety of tax matters and planning for individuals and businesses. He has specialized experience in the area of law firm administration and oil and gas taxation.

Ken is a member of the Board of Directors of the Greater New Orleans Sports Foundation. He is a member of the Society of Louisiana CPAs, the American Institute of Certified Public Accountants, the Elmwood Business Association and Riverside Country Club. Ken also participates in various other community activities sponsored by the Firm and serves as captain of the Firm's Legal Team Committee.