

# Legislative Briefing

## Katrina Update

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**Selected Provisions of  
The Katrina Emergency  
Tax Relief Act of 2005  
And  
The Gulf Opportunity  
Zone Act of 2005**

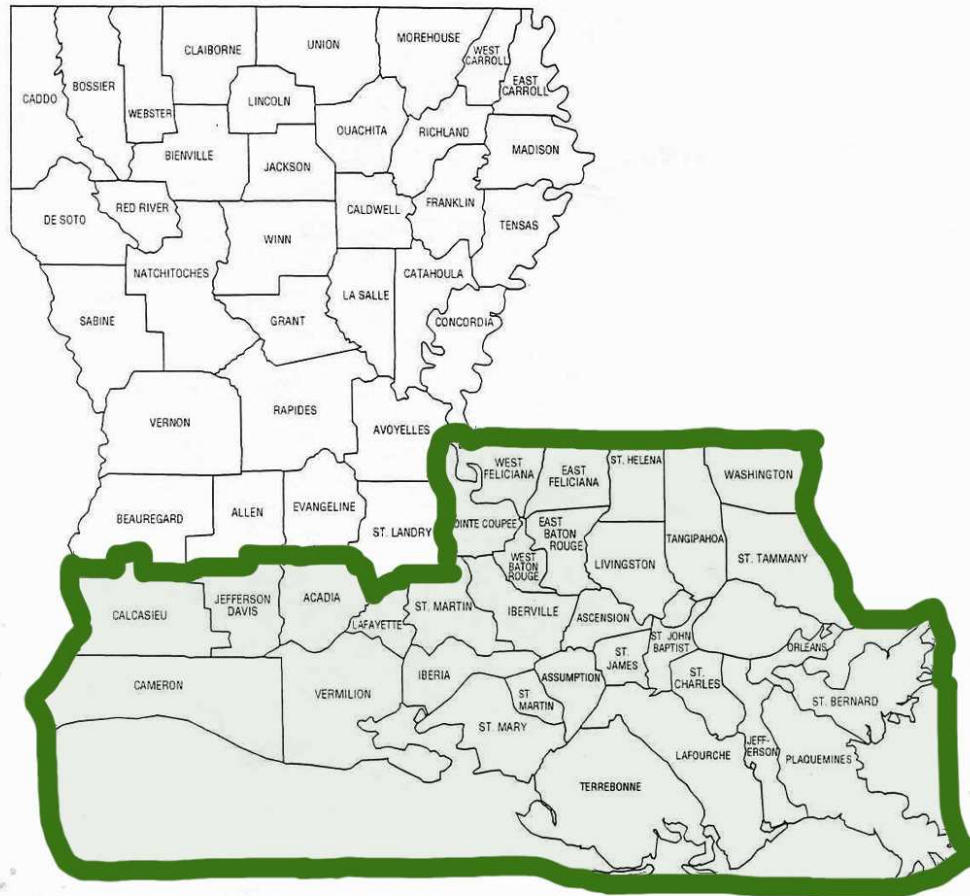
**Alex P. Trostorff**  
January 23, 2006

# Hurricane Katrina Disaster Area—Core Disaster Area

- All of Louisiana is within the “Hurricane Katrina Disaster Area”
- Louisiana “Core Disaster” and “Gulf Opportunity Zone” (GO Zone) areas are:
  - Acadia
  - Ascension
  - Assumption
  - Calcasieu
  - Cameron
  - East Baton Rouge
  - East Feliciana
  - Iberia
  - Iberville
  - Jefferson
  - Jefferson Davis
  - Lafayette
  - Lafourche
  - Livingston
  - Orleans
  - Plaquemines
  - Point Coupée
  - St. Bernard
  - St. Charles
  - St. Helena
  - St. James
  - St. John
  - St. Martin
  - St. Mary
  - St. Tammany
  - Tangipahoa
  - Terrebonne
  - Vermilion
  - Washington
  - West Baton Rouge
  - West Feliciana



# Katrina Map



- Gulf Opportunity Zone—Gulf Opportunity Zone Act
- Core Disaster Area--KETRA



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# Filing & Payment Deadlines Extensions

## ■ Federal Tax Returns

- ❑ Taxpayers affected by Hurricane Katrina now have until Feb. 28, 2006 to file tax returns, pay taxes and perform other time-sensitive acts.
- ❑ For taxpayers located in the core disaster areas, the tax relief is automatic.
- ❑ Taxpayers in the Hurricane Katrina Disaster Area need to identify themselves to the IRS.



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# Personal Casualty Losses

\$100 limitation per casualty and casualty loss allowed only to the extent it exceeds 10% of adjusted gross income will not apply.

## ■ Computing the Amount of Your Loss

- ❑ Determine the decrease in the fair market value (less any insurance or other reimbursement) of your property.
- ❑ Compare decrease in FMV with adjusted basis.
- ❑ Smaller of these two amounts is deductible.
- ❑ But IRS may limit the decrease in value to the extent it is attributable “short term” psychological impact of a storm.



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# Personal Casualty Losses

- When Can You Deduct the Casualty Loss?
  - 2005
  - 2004
  - 2002, 2003, 2004 if NOL
  - 2000, 2001, 2002, 2003, 2004 if GO Zone NOL



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# 50% Bonus Depreciation

- Additional first year depreciation 50% of adjusted basis of GO Zone property that is placed in service before 2008 (before 2009, for nonresidential real property and residential rental property)
- Applies for both regular tax and alternative minimum tax



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# 50% Bonus Depreciation

- Qualified GO Zone property is property that meets four requirements.
  - ❑ Eligible property
  - ❑ Substantially all use of the property must be used in an active trade or business in the GO Zone
  - ❑ Original use of the property must begin in the GO Zone on or after August 28, 2005
  - ❑ Acquired by “purchase” and no written binding contract for the acquisition was in effect before August 28, 2005



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# 50% Bonus Depreciation

- Eligible property includes:
  - MACRS with recovery of 20 years or less
  - certain computer software
  - certain water utility property
  - MACRS qualified leasehold property
  - non-residential real property
  - and residential rental property



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# 50% Bonus Depreciation

- Qualified Leasehold Property
  - Improvements made pursuant to a lease made by the lessor or lessee and
  - The area improved on is occupied exclusively by lessee and
  - The improvement is placed in service more than 3 years after building placed in service.
- Does not include:
  - An enlargement of the building.
  - Elevator or escalators
  - Structural component benefiting common area
  - Internal structural framework of the building.



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# 50% Bonus Depreciation

- Not applicable to:
  - Property depreciated under alternative depreciation system
  - Tax-exempt bond finance property; or
  - Qualified revitalization buildings
- Recapture rules apply



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# EXAMPLES

## 1. Substantially All Requirement.

- On December 10, 2006, A, in the trucking business purchases ten trucks. The “home” terminal is in the GO Zone but the trucks regularly service areas outside the GO Zone. Does the property qualify for the 50% bonus depreciation?

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# EXAMPLES

## 2. Active Trade or Business.

- B begins construction of a Rally's hamburger stand in the GO Zone on December 10, 2005 which is completed on January 30, 2006. B enters into triple net lease with Mr. Rally. Does the property qualify for 50% bonus depreciation?

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# EXAMPLES

## 3. Original Use.

- On December 10, 2005, C purchases used construction equipment which had been used exclusively in North Carolina. Upon purchase, the equipment is brought to the GO Zone for use in a trade or business. Does the equipment qualify for bonus depreciation?

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# EXAMPLES

## 4. Original Use.

- On December 10, 2005, D purchases a flooded duplex in New Orleans for \$150,000. D restores the property at a cost of \$200,000 and puts it out for lease on December 10, 2006. What part, if any, of the \$350,000 qualifies for the bonus depreciation?

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# EXAMPLES

## 5. Conversion to Business or Income Producing Property.

- E, an evacuee from New Orleans, buys a newly constructed house in Baton Rouge for personal use on December 10, 2005. On March 10, 2006, E moves back to New Orleans and puts the property out for lease. Does the property qualify for bonus depreciation? What if E sells the house to F on March 10, 2006 who then holds it out for lease?

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# EXAMPLES

## 6. Sale-Leaseback.

- On December 10, 2005, F, in the waste hauling business, purchases a fleet of garbage trucks to be used in the GO Zone. F determines that it cannot use the tax benefits attributable to the trucks. Within 3 months of the placed in service date January 20, 2006, F enters into a sale-leaseback with GECC. Does GECC get the bonus depreciation and in what year?

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# EXAMPLES

## 7. Acquired by Purchase.

- On December 10, 2005 G buys construction equipment previously exclusively used in North Carolina by H, a related corporation. G's first use of the equipment is in the GO Zone. Does the 50% bonus depreciation apply?

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# EXAMPLES

## 8. Acquired By Purchase.

- On December 10, 2005, H completes a like kind exchange and receives replacement property not previously used in the GO Zone. Does the replacement property qualify for the 50% bonus depreciation? What about an involuntary conversion situation?

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# EXAMPLES

## 9. Binding Contract.

- On July 5, 2005, I enters into a contract to purchase equipment. The contract is enforceable under local law and has a liquidated damage clause of 4%. The equipment is placed in service in the GO Zone on December 10, 2005. Does the property qualify for bonus depreciation? What if the liquidated damages clause is 10%? What if no liquidated damage clause but seller must refund amounts paid?

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# EXAMPLES

## 10. Binding Contract – Supply Agreements.

- On July 5, 2005, J, a corporation, entered into a written agreement with a manufacturer to purchase 20 new lamps for \$100 each within the next two years. Although the agreement specifies the number of lamps to be purchased, the agreement does not specify the design of the lamps to be purchased. Is the agreement a binding contract?

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# EXAMPLES

## 11. Components.

- On July 5, 2005, K entered into a written binding contract to acquire a new turbine. The new turbine is to be a component part of a new electric generation power plant in the GO Zone that is being constructed on L's behalf. Construction began on December 10, 2005 and is completed on December 10, 2007. Does the component qualify for bonus depreciation? Does the power plant qualify for bonus depreciation?

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# EXAMPLES

## 12. Components.

- What if in the prior example the construction began on July 5, 2005 and the turbine was acquired on December 10, 2005? Is bonus depreciation available with respect to the power plant? The turbine?

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# EXAMPLES

## 13. Construction Projects.

- On July 5, 2005 L starts work on a plant in the GO Zone by clearing a site, test drilling to determine soil condition and excavating to change the contour of the land. On December 10, 2005, taxpayer begins excavation for footings, driving foundation pilings in the ground and pouring concrete. The plant is placed in service on December 10, 2007. Does the plant qualify for bonus depreciation? What if L had a binding contract with a construction company as of June 30, 2005 and the foregoing activity is conducted by the contractor? What if the excavation etc. took place on August 5, 2005? What if the cost of such activities is 9% of the total cost of the project (excluding cost of land and preliminary activities)?

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# EXAMPLES

## 14. Condominiums.

- The construction of a new condominium in the GO Zone begins on December 10, 2005 and is placed in service on December 10, 2007. Is the developer eligible for the bonus depreciation? Is the first purchaser of a unit eligible for the bonus depreciation? What if a building is purchased on December 10, 2005 and converted into a condominium and completed on December 10, 2007?

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# Section 179 Expensing

- Increase in expensing under §179
  - §179 deduction increased to \$200,000 for GO Zone property.
  - Increases the maximum amount of eligible property acquired to \$1,000,000 (currently \$400,000) without triggering a reduction in deduction.



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# Employment Relief – Tax Credits

- Employers Entitled to Credit up to 40% of Wages with a Maximum \$6000
- Work Opportunity Tax Credit
  - Individual who on August 28, 2005, not then an employee, had a principal place of abode in the core disaster area and who is hired during the two-year period beginning on that date for a position the principal place of employment of which is located in the core disaster area.
  - Individual who on August 28, 2005, not then an employee, had a principal place of abode in the core disaster area, who is displaced from such abode by reason of Hurricane Katrina, and who is hired during the period beginning on such date and ending on December 31, 2005 without regard to place of employment.
  - Hours worked first year
    - Minimum of 120 hours
    - 25% wages 400 hours or less
    - 40% wages more than 400 hours



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# Employment Relief – Tax Credits

## ■ Employee Retention Credit

- Employer which conducted an active trade or business on August 28, 2005, in a core disaster area, and which is inoperable, as a result of Hurricane Katrina.
- An employee whose principal place of employment on August 28, 2005, with such eligible employment was in a core disaster area.
- Wages paid on any day after August 28, 2005, and before January 1, 2006, which occurs after trade or business first became inoperable and ends on date when resumed significant operations.
- "Wages" without regard to whether employee performs services; performed services at different place of employment; performed services at such principal place of employment before significant operations resumed.



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# Extension of Replacement Period

- Five-year replacement period if substantially all of the use of the replacement property is in the Hurricane Katrina disaster area. Both personal residences and business property.



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# NOL—GO Zone Losses

- Five-year carryback period for net operating losses (NOLs) to the extent of certain specified amounts related to the GO Zone.
- Five-year carryback or "eligible NOL" is limited to:
  - ❑ qualified GO Zone casualty losses;
  - ❑ certain moving expenses;
  - ❑ certain temporary housing expenses;
  - ❑ depreciation deductions with respect to qualified GO Zone property; and
  - ❑ deductions for certain Hurricane Katrina repair expenses.



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# Tax Benefits—Ineligible Property

- Provisions relating to bonus first-year depreciation, increased expensing under §179, five-year carryback of (NOLs) do not apply with respect to certain property:
  - ❑ Private or commercial golf course
  - ❑ Country clubs
  - ❑ Massage parlors
  - ❑ Hot tub facilities
  - ❑ Suntan facilities
  - ❑ Liquor stores
  - ❑ Casinos
  - ❑ Animal racing properties



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# Retirement Funds

- 10% penalty on early distributions does not apply to qualified Hurricane Katrina distributions of up to \$100,000. Hurricane Katrina distribution: made on or after August 25, 2005, and before January 1, 2007. Individual whose principal place of abode on August 28, 2005, is located in the Hurricane Katrina disaster area sustained an economic loss.
  - Included in gross income ratably over the three-taxable year period.
  - During the three-year period contributions to retirement plan reduces tax liability.



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# Retirement Funds

- Loans from Qualified Plans for Relief Relating to Hurricane Katrina
  - Increases the limitations on the amount excluded from income for loans to \$100,000 or 100% of the individual's account balance. Applies individual whose principal place of abode on August 28, 2005, is located in the Hurricane Katrina disaster area and who has sustained an economic loss.



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# Expensing—Demolition, Clean-up Costs

- Taxpayer may elect to treat 50% of any qualified GO Zone clean-up costs as deductible expense.
  - GO Zone clean-up costs are: amounts paid before 2008, for debris removal from, or demolition of structures on, real property located in the GO Zone.
  - Does not apply to non-business or non-investment property.
  - Amounts paid taken into account only if such amount would otherwise be capitalized.



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# Low-Income Housing

- The Act provides an increase in the housing credit dollar amount for low-income housing purposes in the GO Zone.
- For 2006, 2007, and 2008, the State housing credit ceiling of each state located in the GO Zone is increased.



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# Increase In Rehabilitation Credit

- The Act provides an increase in the rehabilitation credit in the GO Zone.
- During the period beginning on August 28, 2005, and ending on December 31, 2008, for any qualified rehabilitated building or certified historic structure, the 10% rehabilitation credit is 13% and the 20% rehabilitation credit is 26%.



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# Special Rules—Small Timber Producers

- Double expensing allowances for timber producers that hold 500 or fewer acres of qualified timber property throughout the taxable year for reforestation costs incurred before 2008.
- Extends to five years the carryback period for net operating losses incurred by certain businesses and small timber producers in the GO Zone.
- Does not apply to taxpayers that are publicly-traded corporations or REITs.



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# Housing Exemption

- Use their principal residence to provide housing free of charge to evacuees.
  - At least 60 consecutive days.
  - The evacuee's principal place of abode must have been in the Hurricane Katrina disaster area as of August 28, 2005.
- A special \$500 deduction for each evacuee capped at \$2,000.



# Legislative Briefing

# Katrina Update

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**Fred L. Chevalier**  
January 23, 2006

# HR 4440 Analysis

- Gulf Opportunity Zone or GO Zone = Hurricane Katrina ONLY –
  - for individual and individual or public assistance
- GO Zone – Individual and Individual and Public =
  - Acadia
  - Ascension
  - Assumption
  - Cameron
  - Calcasieu
  - East Baton Rouge
  - East Feliciana
  - Iberia
  - Iberville
  - Jefferson
  - Jefferson Davis
  - Lafayette
  - Lafourche
  - Livingston
  - Orleans
  - Plaquemines
  - Point Coupée
  - St. Bernard
  - St. Charles
  - St. Helena
  - St. James
  - St. John
  - St. Martin
  - St. Mary
  - St. Tammany
  - Tangipahoa
  - Terrebonne
  - Vermilion
  - Washington
  - West Baton Rouge
  - West Feliciana



# Tax-Exempt Bonds

- Sec. 1440N. Gulf Opportunity Zone Bond
  - \$2500 per capita in GO Zone (\$7.9B for LA)
  - 95%+ for "qualified project costs" acquisition, construction, reconstruction and renovation of:
  - qualified mortgage bonds, but:
    - GO Zone = all targeted area = \$249,861 (1) / \$319,856 (2) Orleans
    - 140% or less of medium area family income = limit
    - \$150,000 for "qualified home improvement loan"
    - Do not have to be first-time homebuyer (HR 3768)



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# Tax-Exempt Bonds

- ❑ qualified residential rental project under 142(d) (except use 20-60 and 40-70)
- ❑ public utility property under 168(i)(10)
- ❑ nonresidential real property (fixed improvements, structural components also, or building improvements if chargeable to capital account) (i.e., pre 1986):
  - types of projects allowable:
    - ❑ Stores
    - ❑ Warehouses
    - ❑ Manufacturers
    - ❑ Office Buildings
    - ❑ Bank Branches
    - ❑ Hotels, motels
    - ❑ Restaurants
    - ❑ Medical office or treatment facility
    - ❑ Other miscellaneous commercial facilities



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# Tax-Exempt Bonds

- General:
  - bonds issued by states of Louisiana, Alabama, Mississippi or "any political subdivision thereof"
    - Louisiana Community Development Authority
    - Louisiana Public Facilities Authority
    - Local on-behalf-of
    - Industrial Development Boards
  - designated by state bond commission
  - issue before 1/1/11
  - no revolving funds (except under 143)
  - 146 re volume cap superseded
  - AMT does not apply
  - separate issue treatment - can separate GO Zone bonds from existing qualified bonds



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# Tax-Exempt Bonds

- Restrictions:
  - Can not use 50% Bonus depreciation and tax exempt bonds
  - no golf course, country club, massage parlor, hot tub, suntan, racetrack or other gambling, or off premises alcohol
  - No moveable equipment
  - 50% rehab for acquisition of existing property
  - designated by state bond commission
  - issue before 1/1/11



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# Advance Refundings

- 1 new advance refunding if:
  - Governor designates
  - was outstanding on August 28, 2005 and is bond of Louisiana/Alabama/Mississippi or political subdivision thereof
  - Port/Airport
  - Governmental
  - 501c3's
  - \$4.5B limit Louisiana (AL=\$2.25B; MS=\$1.125B)
  - must have used 1 advance refunding already
  - only outstanding bond is adv. ref. bond vis-à-vis refunded bonds
  - meet §148 arbitrage rules requirements
  - can not refund prohibited list



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# Tax Credit Bonds

(credit included in gross income)

- Issued by state of Louisiana, Alabama and Mississippi
  - 95%+ used to:
    - pay principal, interest, premium on bonds of state or political subdivision
    - make a loan to potential subdivision to pay principal, interest, premium on qualified bonds (O/S 8/28/05)
  - Governor designates
  - General Obligation of state
  - Matures NX 2 years
  - Issue before 1/1/07



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# Tax Credit Bonds

(credit included in gross income)

- ❑ Secretary of Treasury sets credit rate = no discount or interest due
- ❑ Must have state match of principal amount
- ❑ Must use on 50/50 basis to make payments or loans over 1-year period
- ❑ LA           200mm
- ❑ AL           50 mm
- ❑ MS           100 mm
- ❑ Arbitrage rules apply
- ❑ No 144(c)(6)(B) facilities
- ❑ No Private Activity Bonds allowed
- ❑ No refunded or refunding bonds



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# New Markets Tax Credit

- Qualified equity investments in CDE's gets a credit on federal income tax:

- Year

- 1 (year of investment)

- 2

- 3

- 4

- 5

- 6

- 7

- Fed

- 5% of investment

- 5

- 5

- 6

- 6

- 6

- 6



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# New Markets Tax Credit

- What is a CDE?
  - corporation or partnership
    - mission to provide investment \$ for low-income communities or persons
    - residents of low-income communities on board
    - certified by Secretary of Treasury
- Can transfer investment, but
  - Recapture if CDE loses its status in the 7-year period or investment is redeemed



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# New Markets Tax Credit

- What is a qualified "equity investment?"
  - stock (not unqualified preferred stock) in corp. or capital interest in partnership acquired directly from CDE for cash
  - can be a subsequent purchaser
  - substantially all of the investment \$ must be used to make qualified low-income community investments
    - Qualified Low-Income Community Investments:
      - capital or equity investments in, loans to qualified active low-income community businesses
      - financial counseling therein
      - purchase a loan from another CDE
      - equity investment or loan to another CDE



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# New Markets Tax Credit

- Low Income Community
  - population census tract with either
    - poverty rate of 20% or
    - median family income  $N \times 80\%$  of greater of metropolitan area median family income (non-metropolitan =  $N \times 80\%$  of statewide median family income)
  - special rules on high migration (85) "high migration" = lost at least 10% people over 20 years
- Targeted Populations - special rule of Section to designate certain areas even if not Low Income Community - Possible use for full GO Zone? Takes CDE action and Treasury approval.



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# New Markets Tax Credit

- HR 4440 - Add:
  - \$300mm 05/06; \$400mm 07 for qualified CDE's for Gulf Opportunity Zone only
    - CDE must have "significant mission" = the recovery and redevelopment of GO Zone. Can carry over GO Zone \$ separately

