Order Code RS22344
Updated February 14, 2006

CRS Report for Congress

Received through the CRS Web

The Gulf Opportunity Zone Act of 2005

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Summary

The Gulf Opportunity Zone Act of 2005 (H.R. 4440) was signed into law on December 22, 2005 (P.L. 109-135). The act provides tax benefits to assist in the recovery from Hurricanes Katrina, Rita, and Wilma. Some of its provisions expand several sections of the Katrina Emergency Tax Relief Act (KETRA, P.L. 109-73)[1] to apply to victims of Hurricanes Rita and Wilma. This report summarizes the act's provisions dealing with hurricane relief.

The Gulf Opportunity Zone Act of 2005 (H.R. 4440) provides tax relief to businesses and individuals affected by Hurricanes Katrina, Rita, and Wilma.[2] The House passed the act on December 7, 2005, by a vote of 415 to 4. The Senate passed an amended version by unanimous consent on December 16, 2005, and the House agreed to the Senate Amendment later that day. President Bush signed the bill into law, P.L. 109-135, on December 22, 2005.

The act's provisions distinguish between the "Hurricane Katrina disaster area," which is the presidentially-declared disaster area, and the "Gulf Opportunity Zone" (GO Zone), which is the portion of the Hurricane Katrina disaster area determined by President Bush to warrant individual or individual and public assistance under the Stafford Act. The same distinction is made between the "Hurricane Rita disaster area" and the "Rita GO Zone," and the "Hurricane Wilma disaster area" and the "Wilma GO Zone."

Tax-exempt Bonds. The act allows Alabama, Louisiana, and Mississippi to issue tax-exempt GO Zone bonds between the date of the section's enactment and January 1, 2011. The bonds must be issued either to (1) use at least 95% of the proceeds for the cost of qualified GO Zone residential rental projects or the acquisition, construction,

[1] For more information on P.L. 109-73, see CRS Report RS22269, *Katrina Emergency Tax Relief Act of 2005*, by Erika Lunder.

[2] Title III of the act contains several tax provisions not dealing with hurricane relief, Title IV includes technical corrections to previous legislation, and Title V designates any part of the act that has an effect on receipts, budget authority, or outlays to be an emergency requirement pursuant to section 402 of H.Con.Res. 95. These provisions are not discussed in this report.

reconstruction and renovation of GO Zone nonresidential real property or public utility property or (2) finance below-market rate mortgages for low and moderate-income homebuyers under IRC § 142, with modifications. The maximum amount of bonds that each state may issue is $2,500 multiplied by the portion of the state's population in the GO Zone as determined prior to August 28, 2005. None of the bond issue's proceeds may be used to finance private and commercial golf courses, country clubs, massage parlors, hot tub and suntan facilities, racetracks and other gambling facilities and stores with the principal business of selling alcoholic beverages for consumption off premises.

The act allows one additional advance refunding of qualifying bonds that were issued by those states and were outstanding on August 28, 2005. Additionally, while bonds issued to advance refund private activity bonds are generally not tax-exempt, the act allows one advance refunding for bonds used to finance airports, docks, and wharves. The refundings must occur between the date of the act's enactment and January 1, 2011, and each state is capped in the amount of bonds it may refund. The refunding provisions do not apply if any of the bond issue's proceeds are used to provide property that does not qualify for GO Zone bond financing, as discussed above.

The act creates a special rule for applying IRC § 142(d), which allows residential rental projects for low-income tenants to qualify for tax-exempt bond financing. The act allows project operators who rent to individuals displaced by Hurricane Katrina to rely on those individuals' representations that their income is under the income limits so long as the tenancy begins within six months of the displacement.

Low-income Housing Tax Credit. The low-income housing tax credit in IRC § 42 allows owners of qualified residential rental property to claim a credit for ten years that is a percentage of the costs of constructing, rehabilitating, or acquiring the building that is attributable to low-income units. Owners may claim a credit based on 130% of the project's costs if the housing is in a low-income or difficult development area. Owners must be allocated the credit by a state. Each state is limited in the amount of credits it may allocate to the greater of $2,000,000 or $1.75 times the state's population (both are adjusted for inflation and are currently $2,125,000 and $1.85), with adjustments.

For 2006, 2007, and 2008, the act increases the credits available to Alabama, Louisiana, and Mississippi for use in the GO Zone by up to $18.00 multiplied by the portion of the state's population in the GO Zone prior to August 28, 2005. It also increases the credits available to Florida and Texas in 2006 by $3,500,000 for each state. For 2006, 2007, and 2008, the act treats the GO Zone, Rita GO Zone and Wilma Go Zone as difficult development areas and uses an alternate test for determining whether certain GO Zone projects qualify as low-income housing.

Depreciation. The act increases the depreciation deduction otherwise allowed under IRC § 167 for qualified GO Zone property. The increase equals 50% of the taxpayer's adjusted basis in the property and is claimed the year the property is placed in service. Among other requirements, the property's original use in the GO Zone must commence with the taxpayer after August 27, 2005, and the property must be placed in service prior to January 1, 2008 (January 1, 2009, for nonresidential real and residential rental property). Qualified property does not include (1) property used in connection with private and commercial golf courses, country clubs, massage parlors, hot tub and suntan facilities, racetracks and other gambling facilities, and stores whose principal business is selling alcoholic beverages for consumption off premises or (2) gambling and animal property, which is the equipment, furniture, software and other property used directly in connection with gambling, the racing of animals, or the on-site viewing of such activity, and any portion of at least 100 square feet of real property dedicated to those activities.

Net Operating Losses. Under IRC § 172, net operating losses (NOL) may generally be carried back for two years. The act allows GO Zone NOL to be carried back for five years. The GO Zone loss is the lesser of (a) the year's NOL with adjustment or (b) the deductions used in computing the year's NOL for GO Zone casualty losses, employment-related moving expenses due to Hurricane Katrina, temporarily housing employees, depreciation of GO Zone property, and hurricane-related repair expenses. Property that is disqualified under the depreciation provision discussed above does not qualify as GO Zone property or its loss as a GO Zone casualty loss.

Expensing. In general, capital expenditures must be added to the property's basis rather than being expensed (i.e., deducted in the current year). IRC § 179 provides an exception so that a business may expense the costs of certain property in the year it is placed in service. The total cost of the property that the business elects to treat as section 179 property cannot exceed $100,000. Additionally, for every dollar that the total cost of all property that the business places in service in the year exceeds $400,000, the maximum deduction is decreased by one dollar. Both limitations are adjusted for inflation, and are $105,000 and $450,000 in 2005. IRC § 198 contains another exception to the rule against expensing capital expenditures. It allows taxpayers to expense environmental remediation costs from the abatement or control of hazardous substances at a qualified contaminated site. It does not apply to costs paid after December 31, 2005.

The act increases the $100,000 limitation in IRC § 179 by up to $100,000 and the $400,000 limitation by up to $600,000 for qualified GO Zone property. Qualified property does not include the property that is disqualified from the depreciation and NOL provisions discussed above. The act amends IRC § 198 for sites in the GO Zone by extending the current deadline to December 31, 2007, and treating petroleum products as a hazardous substance. It also allows taxpayers to expense 50% of qualified clean-up costs paid or incurred between August 27, 2005, and January 1, 2008, for the removal of debris or the demolition of structures on business real property in the GO Zone.

Rehabilitation Credit. Under IRC § 47, taxpayers may claim a credit equal to 10% of the qualifying expenditures to rehabilitate a qualified building or 20% of such expenditures for a certified historic structure. The act increases these amounts to 13% and 26% for building and structures in the GO Zone for expenditures between August 27, 2005, and January 1, 2009.

Small Timber Producers. The act creates two special rules for timber producers with less than 501 acres of timber property. Under IRC § 194, taxpayers may expense up to $10,000 of qualifying reforestation expenditures. The act increases that limit by up to $10,000 for expenditures made for qualified timber property in the GO Zone, Rita GO Zone, or Wilma GO Zone. Under IRC § 172, the general rule is that taxpayers may carry net operating losses back for two years. The act increases this to five years for certain losses attributable to timber property in any of the three zones.

Public Utility Losses. Under IRC § 172, certain net operating losses, called specified liability losses, may be carried back for 10 years. The act treats GO Zone public utility casualty losses as such a loss. Under IRC § 165(i), certain disaster losses may be deducted in the year prior to the disaster. The act allows GO Zone public utility disaster losses to be deducted in the fifth taxable year preceding the disaster.

Gulf Tax Credit Bonds. The act allows holders of gulf tax credit bonds to claim a credit based on the credit rate on the date the bonds were sold and their outstanding face amount. The bonds may be issued by Alabama, Louisiana, and Mississippi to pay the principal, interest, or premiums on qualified governmental bonds or to make loans to political subdivisions to make such payments. Qualified bonds do not include those used to finance private and commercial golf courses, country clubs, massage parlors, hot tub and suntan facilities, racetracks and other gambling facilities, and stores with the principal business of selling alcoholic beverages for consumption off premises. The gulf tax credit bonds must be issued between December 31, 2005, and January 1, 2007, and may not have a maturity date beyond two years. Each state is capped in the amount of bonds it may issue.

New Markets Tax Credit. The new markets tax credit in IRC § 45D is capped at $2 billion for 2005 and $3.5 billion for 2006 and 2007. The act increases the cap by $300,000,000 for 2005 and 2006 and by $400,000,000 for 2007, and allocates these amounts to entities making low-income community investments in the GO Zone.

Education Credits. Under IRC § 25A, individuals with eligible tuition and related expenses may claim the Hope Scholarship or Lifetime Learning credit. The maximum Hope credit is 100% of the first $1,000 of eligible expenses and 50% of the next $1,000 of eligible expenses. The maximum Lifetime Learning credit is 20% of up to $10,000 of eligible expenses. For individuals attending school in the GO Zone for 2005 and 2006, the act allows any qualified higher education expenses to qualify for the credits, doubles the $1,000 limitations in the Hope credit to $2,000, and increases the 20% limitation in the Lifetime Learning credit to 40%.

Housing Relief. The act excludes the value of certain employer-provided housing, limited to $600 per month, from the employee's income and allows the employer to claim a credit equal to 30% of that amount. The employee must have had a principal residence in the GO Zone on August 28, 2005, and perform substantially all employment services for that employer in the GO Zone. The employer must have a trade or business in the GO Zone and the lodging must be provided during the first six months after the act's enactment.

Bonus depreciation. IRC § 168(k) provides a bonus depreciation deduction that is similar to the act's depreciation provision discussed above in that it allows taxpayers to claim an increased depreciation deduction during the year qualifying property is placed in service. Certain types of property must be placed in service prior to January 1, 2006. The act grants the Treasury Secretary the authority to suspend this deadline, on a case-by-case basis, by up to one year for taxpayers affected by the hurricanes.

Gulf Coast Recovery Bonds. The act states it is the sense of Congress that the Treasury Secretary designate at least one series of bonds as Gulf Coast Recovery Bonds.

Modifications to Certain KETRA Provisions

The act repeals several provisions that were enacted in KETRA to assist individuals affected by Hurricane Katrina and then reenacts them to also apply to individuals affected by Hurricanes Rita and Wilma.

Retirement Plan Distributions. For certain post-hurricane retirement plan distributions, the act waives the 10% penalty tax in IRC § 72(t) that would otherwise apply on early withdrawals. The recipient must have had a principal place of abode in the Hurricane Katrina disaster area on August 28, 2005, the Hurricane Rita disaster area on September 23, 2005, or the Hurricane Wilma disaster area on October 23, 2005, and sustained an economic loss due to a hurricane. The distributions must be made before January 1, 2007, and the most that may be withdrawn without penalty is $100,000. Funds may be re-contributed to a qualified plan over a three-year period and receive tax-free rollover treatment. Additionally, with respect to the taxable portion of the distribution, the individual may include one third of such amount in his or her income for three years rather than the entire amount in the year of distribution.

The act increases the amount that these individuals may borrow from their plans without immediate tax consequences. Under IRC § 72(p), the maximum amount that may be borrowed without being treated as a taxable distribution is the lesser of (a) $50,000, reduced by certain outstanding loans or (b) the greater of $10,000 or 50% of the present value of the employee's nonforfeitable accrued benefits. For loans made during the applicable period, the act increases this to the lesser of (1) $100,000, reduced by certain outstanding loans, or (2) the greater of $10,000 or 100% of the present value of the employee's nonforfeitable accrued benefits. The applicable period is between September 23, 2005, and January 1, 2007, for Katrina individuals and between the date of enactment and January 1, 2007, for Rita and Wilma individuals. The act also extends loan repayment due dates by one year if the original date falls between a certain date and January 1, 2007. The date is August 25, 2005, for Katrina individuals, September 23, 2005, for Rita individuals, and October 23, 2005, for Wilma individuals.

The act also allows individuals to re-contribute without tax consequences distributions that were made to purchase or construct a principal residence in one of the disaster areas but were not used because of the hurricanes. The distribution must have been received after February 28, 2005, and before either August 29, 2005 (Katrina), September 24, 2005 (Rita), or October 24, 2005 (Wilma). The contributions must be made after August 24, 2005 (Katrina), September 22, 2005 (Rita), or October 22, 2005 (Wilma), and before March 1, 2006.

Retention Credit. The act includes a retention credit for hurricane-damaged businesses that continue to pay their employees' wages, regardless of whether they perform services. Eligible employers are those with an active business in the GO Zone on August 28, 2005, the Rita GO Zone on September 23, 2005, or the Wilma GO Zone on October 23, 2005, and whose business was rendered inoperable due to hurricane damage for any day prior to January 1, 2006. Eligible employees are those whose principal place of employment at the time of the hurricane was with the eligible employer in the appropriate zone. The credit equals 40% of the employee's first $6,000 in wages paid between the date the business became inoperable and the date it resumes significant operations there, but no later than December 31, 2005.

Limits on Charitable Deductions. Under IRC § 170, individuals may not claim a charitable deduction that exceeds 50% of their contribution base (adjusted gross income with adjustment) and corporations may not claim a deduction that exceeds 10% of their taxable income with adjustment. The act suspends the 50% and 10% limitations for cash contributions made between August 27, 2005, and January 1, 2006. For individuals, the deduction may not exceed the amount that the contribution base exceeds other charitable contributions. For corporations, the deduction is only allowed for contributions used for hurricane relief efforts and may not exceed the amount that taxable income exceeds other contributions. The act also suspends the overall limitation on itemized deductions.

Casualty Losses. Under IRC § 165, taxpayers may deduct unreimbursed losses of property not connected to a trade or business when the losses are from a casualty, such as a hurricane. In addition to losses from the actual damage caused by the casualty, a taxpayer in a presidentially-declared disaster area has a casualty loss if ordered, within 120 days of the area's designation, by the state to demolish or relocate his or her home. The loss is the lesser of (1) the decrease in the property's fair market value due to the casualty or (2) the taxpayer's adjusted basis in the property. The deduction may only be claimed to the extent that the loss exceeds $100 plus the sum of 10% of the taxpayer's adjusted gross income and any taxable gains from property involuntarily converted due to the casualty. The act waives the $100 and 10% floors for casualty losses from Hurricanes Katrina, Rita, and Wilma.

Extension of Tax-related Deadlines. KETRA instructed the Treasury Secretary to extend certain tax-related deadlines for Hurricane Katrina victims until February 28, 2006.[3] The act extends this relief to victims of Hurricanes Rita and Wilma.

Credit Computations. The act allows hurricane victims to use last year's earned income for computing the child tax credit [IRC § 24] and the earned income tax credit [IRC § 32] instead of this year's income. Eligible individuals are those whose principal place of abode was (a) in the GO Zone, Rita GO Zone, or Wilma Go Zone or (b) in one of the disaster areas and who were displaced by the hurricanes.

Authority to Make Adjustments. The act allows the Treasury Secretary to make adjustments in the application of the tax laws for 2005 and 2006 so that taxpayers do not lose deductions or credits or have a change of filing status due to temporary relocations from the hurricanes.

Mortgage Revenue Bonds. Under IRC § 143, tax-exempt mortgage revenue bonds finance below-market rate mortgages for low and moderate-income homebuyers who have not owned a home for the past three years. The act removes the three-year requirement if the home was in the GO Zone, Rita GO Zone, or Wilma Go Zone and financing was provided before January 1, 2011. It also increases the limitation on qualified home improvement loans from $15,000 to $150,000 for loans to repair damage to homes in the zones.

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[3] The Treasury Secretary had extended the deadlines until January 2, 2006. News Release IR-2005-96; CRS Report RS22261, *Hurricane Katrina: The Response by the Internal Revenue Service,* by Erika Lunder.