Draft – 5/16/06

Gulf Opportunity Zone Program
Suggested Changes

1. Economic Development in Highest Impact Parishes

The Gulf Opportunity Zone legislation now allows parishes less impacted by the storms to have the same benefits as those most impacted. The most impacted areas have housing, infrastructure, and workforce issues that make doing business much more difficult. If the goal is to drive investments into the most impacted areas, priority needs to be given to these areas.

Recommendation: Extend benefits for an additional two years for the 4-5 most damaged Louisiana parishes and 2-4 most damaged Mississippi counties.

2. Bonus Depreciation – Substantially All Use

Another requirement that must be met in order to qualify for the Bonus Depreciation, is that "substantially all of the use" of the property must be used in the GO Zone. Many operators of vessels with base of operations within the GO Zone are uncertain whether otherwise qualifying vessels are eligible for the Bonus Depreciation in that vessels, by their very nature cannot generally be "used" in the GO Zone even if their base of operations is within such area.

Recommendation: Clarification is needed that otherwise qualifying vessels which have their base of operations in the GO Zone should qualify for the Bonus Depreciation.

3. Bonus Depreciation – Real Estate Placed In Service Date

In order to qualify for the 50% Bonus Depreciation for GO Zone property nonresidential real property and residential rental property must be placed in service on or before December 31, 2008. This relative short time period is an impediment to investment in the devastated areas in that many projects cannot be completed within such time period. This is especially true with respect to large projects. However, projects of all sizes have problems such as a shortage of workers as well as the fact that FEMA has not as of yet delineated the floodplain as to where building can commence.

Recommendation*:* For projects in which construction has begun by December 31, 2008, the placed in service date deadline should be extended to December 31, 2010 (with the exception of the first recommendation about a further extension for the most impacted parishes).

4. Economic Development -- Benefits for Small Businesses

Small businesses currently get little benefit from the Gulf Opportunity Zone act.

Recommendation: A change that would help small businesses would be to have small issue bonds of $3,000,000 or less be bank qualified under Section 265(b)(3) of the Internal Revenue Code. This small change would allow banks to buy small amounts of bonds directly that would not have to be underwritten to other types of investors. The cost of selling these small bonds to the public in an underwritten offering is prohibitive except to the extent possibly of a pooling transaction. Currently the smallest amount of bonds that are able to be financed through a public offering is about $2,500,000 or the costs are prohibitive. All private activity bonds were bank eligible at one time and we used to easily justify bond issues as low as $250,000.

5. <u>Section 143(K) Home Improvement Loans</u>

Congress was good enough to increase the Sect. 143(k)Home Improvement Loans from $15,000 to $150,000 for the GO Zone. Unfortunately the Home Improvement provisions do not allow refinancing of a first mortgage loan. While the Sect. 143 Qualified Rehabilitation Loan provides for refinancing a first mortgage loan, it can only do so for a 20 year-old home or older home. While New Orleans is an old city there are subdivisions and homes of less than 20 years of age throughout the GO Zone.

Recommendation: In order to provide more flexible and effective home renovation financing for our evacuee homeowners, it would be good if Congress would waive the 20 year rule provision of the Qualified Rehabilitation Loan for all Sect 143 loans in the GO Zone and/or allow for refinancing in connection with the Home Improvement Section of the Code for homes in the GO Zone. [see IRC 143 (k)]

6. <u>Worker Retention Credit</u>

The Act provides for an employee retention tax credit. Similar to the "substantially all use" issue, many businesses in the GO Zone have employees working in the offshore area while their main office was inoperable during the storm.

Recommendation: Clarification may be necessary to make clear that these offshore employees qualify for the employee retention credit.

7. <u>Bonus Depreciation – Active Trade or Business Requirement</u>

Another requirement that must be met in order to qualify for the Bonus Depreciation, is that the property must be used "in the active conduct of a trade or business by the taxpayer" in the GO Zone.

Some potential investors may be deemed to be unable to meet this requirement in that they normally enter into "triple net leases" (i.e., where the lessee pays all expenses with respect to the leased property, such as maintenance, taxes, insurance, etc.). In other areas of the tax law, triple net leases have been determined not to constitute an active trade or business.

Recommendation: In order to induce such investors to help rebuild the affected areas, the active trade or business requirement should be deleted or, alternatively, there should be clarification that property subject to triple net leases qualify for the Bonus Depreciation.

8. <u>Bonus Depreciation – Passive Loss Rules</u>

Deductions from a "passive trade or business activity", including depreciation deductions, generally may not be deducted from other income for the tax year to the extent that the deductions exceed income from all such passive activities. For example, investments by individuals in leased real estate are generally treated as passive investments absent the individual spending a substantial amount of time with respect to the investment. Furthermore, an individual who holds a limited partnership interest or an interest in a limited liability company ("LLC") may be subject to the passive loss rules and therefore not derive the intended benefit of investing in GO Zone property.

Recommendation: Therefore, an exception to the passive loss rules should apply to investments in GO Zone property.

9. <u>Low-Income Housing Tax Credits – Calendar Year Requirements</u>

The GO Zone Act increases the State's credit ceiling by $18.00 per capita for calendar years 2006, 2007 and 2008 in the Gulf Opportunity Zone. If the increased allocations are not made in each calendar year, the State loses the additional credits. FEMA has yet to publish the revised flood elevations in many areas of the GO Zones. Many affordable housing developers are at risk that the new flood elevations in the flood plain may require site changes or additional design and construction costs in connection with their developments that were not anticipated in applications for Gulf Opportunity Amount Tax Credits in calendar year 2006.

Recommendation: Allow the state to apply for an extension for one calendar year if Low Income Housing Tax Credits go unused.

10. <u>Low-Income Housing Credits – Placed in Service Date</u>

The GO Zone Act also permits property placed in service in the GO Zone or the Rita Zone during calendar year 2006, 2007 and 2008 to be treated as property located in difficult distressed areas. This treatment permits a thirty percent (30%) increase in qualified basis for purposes of computing the amount of credits a project may qualify for in determining the credit amount needed for feasibility and viability purposes. The general rule for properties receiving a credit allocation from a calendar year is that such properties must be placed in service by not later that the second calendar year following the year from which the credit allocation was received. Properties receiving an allocation of the 2007 and 2008 Gulf Opportunity Amount Tax Credits are at risk of losing the thirty percent (30%) if the property is not placed in service by the end of 2008. In the case of credits allocated in 2008, this requirement may be extraordinarily difficult.

Recommendation: Restore the normal two year placed in service rule for the GO Zone Low Income Housing Tax Credits.

11. <u>Low-Income Housing Credits – National Nonmetropolitan Median Income Limits in Nonmetropolitan Areas</u>

This GO Zone Act permits properties placed in service in non-metropolitan areas of the GO Zone to use "national non-metropolitan median gross income" for purposes of determining maximum rents and income limits. Developers receiving Credits in calendar year 2007 or 2008 are at risk of being underwritten with higher rents that cannot be sustained if such a property is not placed in service by the 2008 placed in service date.

Recommendation: Restore the normal two (2) year placed in service rule at least for the 2008 Gulf Opportunity Amount Tax Credits for projects in non-metropolitan areas of the GO Zone.

12. <u>Low-Income Housing Tax Credits – Ten Year Rule For Existing Properties</u>

Section 42(d)(2)(B) permits a building's acquisition cost to be included in eligible basis for tax credit purposes if there is a period of at least ten years between the date of its acquisition by the taxpayer and the date the building was last placed in service. Exceptions to this ten-year rule are permitted for certain federally assisted buildings. Hurricanes Katrina and Rita destroyed thousands of buildings and tens of thousands of units in the GO Zone. Many buildings in the GO Zone that can be redeveloped as affordable housing developments with low income housing credits have existing debt and uninsured losses that require substantial investments in the very short term to be placed back into commerce.

Recommendation: In order to stimulate rehabilitation of existing property, existing buildings in the GO Zone should be treated as federally assisted buildings.

13. <u>Housing – Neighborhood Development</u>

Currently, if you are attempting to finance something to be sold, you cannot qualify under the general private activity bond rules. If this were permitted, based on my interviews with developers, the subdivisions would come about more quickly.

Recommendation: Developers should be able to finance infrastructure and utilities in a subdivision they intend to sell lots or houses in with Go Zone bonds. Allow developers to finance the construction of houses that are to be resold, which is not currently permitted under the private activity bond rules.

14. <u>Improvements Needed Within Louisiana -- Allocation/Designation Process</u>

Applicants for GO Zone bond allocations have reported that the process is less streamlined in Louisiana than in other Gulf States in the GO Zone. As it was created, the process is different for Louisiana, and is perhaps more cumbersome and confusing than necessary. The process should be modified so that the process is established in a similar way for all Gulf States, with the Governor making recommendations to the State Bond Commission. Current Louisiana state law provides that no tax-exempt bonds can be issued unless the State Bond Commission approves them.

Recommendation: Change the allocation process to be the same for all Gulf States in the GO Zone as relates to GO Zone bond allocations for projects. This will speed the process, while still retaining oversight by the Bond Commission.

15. "<u>Presidentially Declared Disaster Area" – Include Offshore Louisiana</u>

Current law provides special rules in Internal Revenue Code Section 1033 for casualty losses that are incurred in "Presidentially declared disaster" areas. Taxpayers in "Presidentially declared disaster" areas can reinvest insurance proceeds in a broader range of assets without incurring a tax gain. Certain parishes in Louisiana are "Presidentially declared disaster" areas. All of the damage done off the coast of Louisiana is *not* in a "Presidentially declared disaster" area. Thus, the replacement of damaged oil and gas platforms offshore do not currently qualify for the favorable provisions under Section 1033.

Recommendation: Areas off the coast of Louisiana (up to 9 miles) be included as a "Presidentially declared disaster" area.

16. <u>Authority to Designate "Targeted Populations" within the Gulf Opportunity Zone</u>

The assistance of the U.S. Treasury Department is required to designate "targeted populations" as low-income communities for the application of the new markets tax credit in the recently-established Gulf Opportunity Zone.

The Joint Committee on Taxation, in its technical explanation of the revenue provisions for the Gulf Opportunity Zone Act of 2005, stated the following:

> The Secretary [of the Treasury] has the authority to designate 'targeted populations' as low-income communities for purposes of the new markets tax credit. For this purpose, a "targeted population" is defined by reference to section 103(20) of the Riegle Community Development and Regulatory Improvement Act of 1994 (12 U.S.C. 4702(20)) to mean individuals, or an identifiable group of individuals, including an Indian tribe, who (A) are low-income persons; or (B) otherwise lack adequate

> access to loans or equity investments. …. Under such Act, a targeted population is not required to be within any census tract. In addition, a population census tract with a population of less than 2,000 is treated as a low-income community for purposes of the credit if such tract is within an empowerment zone, the designation of which is in effect under section 1391, and is contiguous to one or more low-income communities.

There are many good reasons to designate some or all of the GO Zone as a "targeted population" for low-income community purposes, including:

- Since 80% of Orleans Parish was mostly destroyed and now is largely abandoned, one can confidently conclude that most of the census tracts are severely impoverished.
- The Greater New Orleans unemployment rate has increased from around 6% before the catastrophic Katrina disaster to around 18%. The national unemployment rate is 4.7% and falling rapidly.
- The Region lacks adequate access to loans or equity investments. In fact, the lack of financial capital is extreme. The factors contributing to this severe problem are:
    - The financial professionals that have left the State.
    - The physical damage to financial institutions.
    - The extremely high cost of insurance and the lack of insurance.
    - The undeterminable risk factor associated with investing in an unprecedented environment.

Recommendation: The Treasury Department should designate most, if not all, of the Gulf Opportunity Zone as a region eligible for the application of "targeted populations" as low-income communities for purposes of the New Markets Tax Credit.