



2-Year Extension Makes Revelay’s Resort Condominiums in Biloxi “Go Zone Qualified” For Significant Tax Savings

Consult Your Tax Attorney or CPA on Your Eligibility

Highlights:

1. The Gulf Opportunity Zone Act (“Go Zone”) provides tax incentives that encourage the rapid rebuilding of hurricane affected areas in Mississippi, Louisiana and Alabama.
2. In December 2006, the Go Zone incentives were extended by Congress and the President through December 31, 2010 for five counties in Mississippi. Revelay is scheduled to be completed in 2009, comfortably ahead of the deadline.
3. Go Zone incentives include first year 50% bonus depreciation – in the case of Revelay, that deduction may be reflected in the 2009 tax return filed in early 2010. To illustrate the potential impact, the first year 50% bonus depreciation write-off on a \$329,900 purchase may be as much as \$164,950.
4. In the event of an assignment of the purchase contract prior to the closing in 2009 (a resale or “flip” from the original buyer to the Assignee), the Assignee may be able to take advantage of Go Zone tax savings since the Assignee is considered the original user of the property.
5. Revelay is the most fundamentally sound preconstruction opportunity in Biloxi, independent of Go Zone considerations. Revelay is co-located right next door to the Mississippi Coast Coliseum & Convention Center. Go Zone tax incentives make Revelay that much more compelling for condominium buyers who can take advantage of the incentives put in place by the Federal Government and recently extended for 2 years in the case of Biloxi.

Each taxpayer’s circumstances are unique and he or she should consult with a highly qualified Tax Attorney and/or CPA to learn more about the Gulf Opportunity Zone Act’s provisions and the applicability to the taxpayer’s situation. The Sterling Companies, the developer of Revelay, is not qualified to determine a buyer’s eligibility for the various Go Zone tax incentives.



Go Zone FAQ – February 2007

THIS FAQ IS BASED ON THE DEVELOPER'S DISCUSSIONS WITH SEVERAL TAX ATTORNEYS AND CERTIFIED PUBLIC ACCOUNTANTS OPERATING IN SEVERAL DIFFERENT STATES AND CANNOT BE RELIED UPON TO DETERMINE AN INDIVIDUAL TAXPAYER'S ELIGIBILITY FOR GO ZONE TAX INCENTIVES ON A CONDOMINIUM PURCHASE IN BILOXI, MISSISSIPPI. CONSULT YOUR TAX ATTORNEY OR CPA TO DETERMINE YOUR ELIGIBILITY FOR GO ZONE TAX INCENTIVES.

What action by the Federal Government has created Go Zone tax incentives?

The Gulf Opportunity Zone Act, signed into law by President Bush on December 21, 2005, established bond provisions and tax incentives, including 50% bonus depreciation, to encourage the rapid rebuilding of hurricane affected counties and parishes in Mississippi, Louisiana and Alabama.

In December 2006, Congress passed and the President signed the Tax Relief and Health Care Act of 2006, which extends for two years the deadline for benefiting from the bonus depreciation under the Gulf Opportunity Zone Act – the deadline for placing a property into service has been extended to December 31, 2010.

The 2-year extension impacts certain highly damaged areas in Mississippi and Louisiana. Those areas are five counties in Mississippi (Hancock, Harrison, Jackson, Pearl River and Stone) and seven parishes in Louisiana.

How does a property become Go Zone Qualified?

It must be new construction acquired by the buyer after August 27, 2005 and placed into service prior to December 31, 2010.

Can the buyer take the first year 50% bonus depreciation in the year of the purchase?

In the case of a qualifying property and qualifying owner-taxpayer where the closing takes places in 2009 and the condo is made available for rental guest purposes (placed into service) before the end

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of 2009, the 50% bonus depreciation can be taken on the 2009 tax return filed in early 2010. In addition, the buyer can prorate regular annual depreciation based on a 27.5 year life from the closing date through December 31, 2009 to generate an even larger net operating loss for tax purposes for the first year.

What are the property owner's options for applying portions of the net operating loss to prior year tax returns or future year tax returns?

The qualifying property owner can use either the 5-year carry back provision or the 2-year carry back provision associated with the Go Zone program. In the case of the 5-year option, the tax return for 2004 becomes relevant for tax planning purposes for Go Zone property purchased and placed into service in 2009; in the case of the 2-year option, the tax return for 2007 becomes relevant. Alternatively, the net operating loss can be carried forward for up to 20 years.

How can the buyer avoid the IRS' passive activity limitations if the buyer wants to use the 50% bonus depreciation to offset ordinary income (non-passive income) such as wages, interest, dividends, trade or business income, etc.?

If, for example, the buyer is a real estate professional (Realtor) who is generating commission income on real estate transactions, the purchase of the qualifying Go Zone property is considered non-passive. Alternatively, the non-working spouse can qualify as a tax real estate professional if that individual materially participates in the real estate activity and meets these two tests:

1. More than 750 hours during the year is spent in a real estate trade or business such as the management of several income properties.
2. More than half of the total hours devoted to non-leisure activities must have been devoted to real estate activities.

If the household has two or more rental properties, it is also advisable to take what is known as the unitary election which treats all of those properties as a single activity. Using that approach, the household can meet the 750 hours test and the more-than-50% test just once each year for the bundle of properties as a whole.

How significant could the tax savings be for a qualifying tax real estate professional?

In addition to taking the normal deductions associated with rental property (interest on the mortgage loan, real estate taxes and depreciation), the qualifying property owner can take first year 50% bonus depreciation as an additional deduction to create a substantial net operating loss on paper. To illustrate the impact, the first year bonus depreciation line item would be \$164,950 on a \$329,900 purchase. Assuming the property owner has substantial ordinary income, a marginal Federal income tax rate of 28% and a marginal State income tax rate of 6% (34% combined), the tax savings could equate to almost 20% of the property's purchase price.

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When the qualifying Go Zone property is sold, is the buyer subject to normal recapture rules?

Yes, regular IRS rules on the recapture of depreciation will apply upon the sale of the Go Zone property, however, the buyer should work with a financial planner and tax advisor to implement a cost segregation study for the property. For example, a portion of the sales price may be treated as an intangible asset (the value of existing rent rolls, the goodwill associated with the property, etc.) The objective is to minimize the portion of the gain subject to ordinary income tax rates and maximize the portion of the gain that will receive more favorable IRC1231 long term capital gain treatment. This amounts to a very promising tax planning opportunity for the buyer and his advisors per IRC1060.

How would the Go Zone tax incentives apply to a household that does not include a tax real estate professional and has passive income (for example, the husband is a doctor and the wife is a full-time advertising executive and they own other rental property)?

They may be able to use the first year 50% bonus depreciation to generate a significant net operating loss on the 2009 tax return for the property and, possibly, for their portfolio of rental properties as a whole. Passive losses generated from Go Zone bonus depreciation can be used to offset passive income. When the property is sold (the passive activity is disposed of), any suspended losses are deductible in the year of the disposition and the losses are deducted against ordinary income. The gain on the sale would likely be taxed at lower capital gain rates unless there was some depreciation to recapture as a result of bonus depreciation.

How would the Go Zone tax incentives apply to a real estate investor who is in the business of buying, managing and selling income properties?

As noted above in the example of the doctor and advertising executive, the net operating loss on the Go Zone property (a passive loss) can be used to offset passive income.

How would a \$10,000 furniture/resort package be viewed for Go Zone purposes if reflected in the purchase price of the condominium and installed by the developer as part of the closing process?

For depreciation purposes, the value of the furniture/resort package would be isolated and depreciated based on a 5-year life rather than on a 27.5-year life. The net result is a bigger overall deduction in the first few years of ownership than would otherwise be the case.

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