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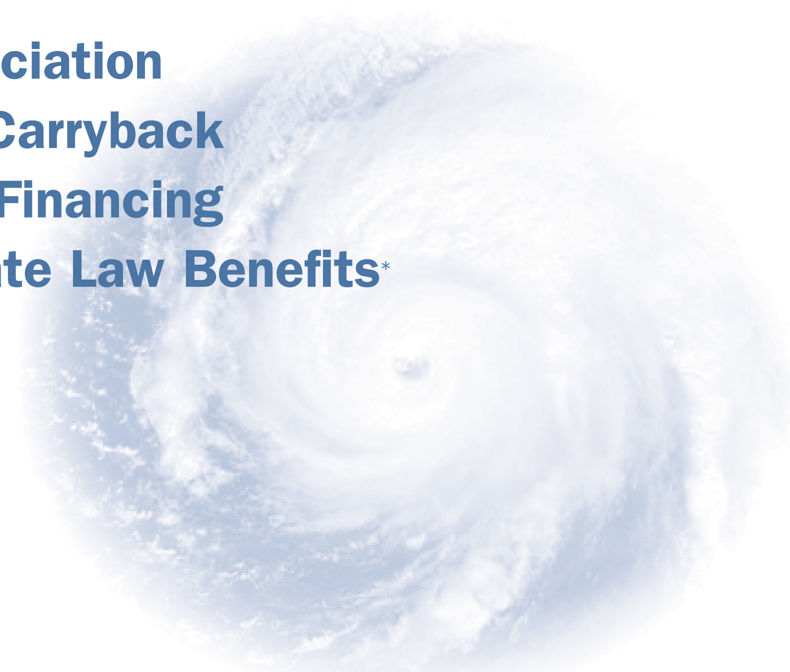
The Gulf Opportunity Zone Act of 2005: Benefits Available to Businesses

- **Bonus Depreciation**
- **5-Year NOL Carryback**
- **Tax-Exempt Financing**
- **Selected State Law Benefits***



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** The selected state law benefits discussed are independent of, and in addition to, benefits available under the Gulf Opportunity Zone Act of 2005.*

Executive Summary:

The Gulf Opportunity Zone Act of 2005, signed into law by President Bush on December 21, 2005, contains significant economic incentives to rebuild the Gulf Coast, as well as to attract new investments to the affected areas. Modeled after the Liberty Zone incentives created after the 9-11 disaster, these incentives are intended to stimulate private investment within the Gulf Opportunity Zone (GO Zone) within the window of time provided.

These economic incentives are so significant that any business considering an investment in any new, replacement or expanded operations, buildings or equipment within the GO Zone should consider how to employ these incentives to the fullest extent possible.

The most significant incentives in the GO Zone Act include:

- **50% Bonus Depreciation**
- **5-Year NOL Carryback**
- **Tax-exempt Financing**
- **GO Zone incentives coupled with state incentives**
- **100% First-Year Equipment Expense Deduction for Small Businesses**
- **Special Incentives for Employers**
- **Expensing of Demolition and Cleanup Charges**

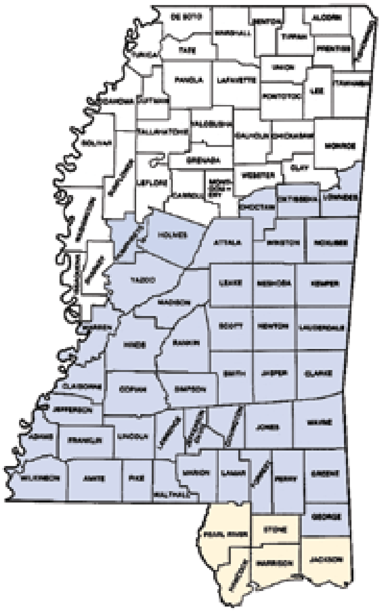
The process of successfully developing a plan to optimize use of the incentives for a particular taxpayer or a specific project includes identifying and understanding the following factors:

1. what is available from all sources (federal, state and local);
2. the existing status of the taxpayer and the nature of the potential project; and
3. the short-term and long-term business objectives of the taxpayer.

Because of the time-sensitive nature of the major federal incentives, it is critical that taxpayers begin the planning process as soon as possible.

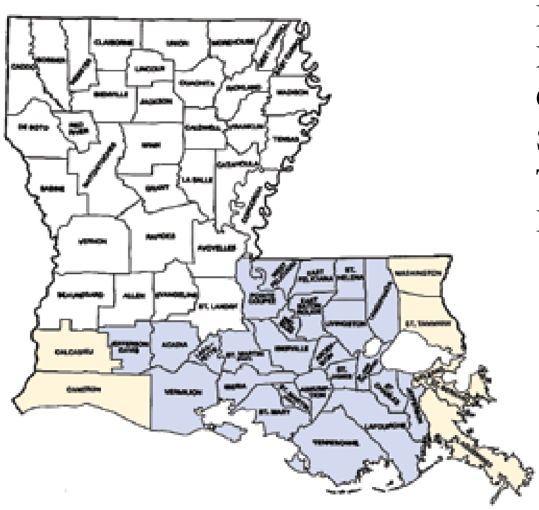
The Gulf Opportunity Zone (or GO Zone)

The legislation created the Gulf Opportunity Zone in the following counties of Mississippi and Alabama and in the following parishes of Louisiana (indicated by the shaded areas:



Mississippi: Adams, Amite, Attala, Claiborne, Choctaw, Clarke, Copiah, Covington, Forrest, Franklin, George, Greene, Hancock, Harrison, Hinds, Holmes, Humphreys, Jackson, Jasper, Jefferson, Jefferson Davis, Jones, Kemper, Lamar, Lauderdale, Lawrence, Leake, Lincoln, Lowndes, Madison, Marion, Neshoba, Newton, Noxubee, Oktibbeha, Pearl River, Perry, Pike, Rankin, Scott, Simpson, Smith, Stone, Walthall, Warren, Wayne, Wilkinson, Winston, and Yazoo Counties.

Alabama: Baldwin, Choctaw, Clarke, Greene, Hale, Marengo, Mobile, Pickens, Sumter, Tuscaloosa, and Washington Counties.



Louisiana: Acadia, Ascension, Assumption, Calcasieu, Cameron, East Baton Rouge, East Feliciana, Iberia, Iberville, Jefferson, Jefferson Davis, Lafayette, Lafourche, Livingston, Orleans, Plaquemines, Pointe Coupee, St. Bernard, St. Charles, St. Helena, St. James, St. John the Baptist, St. Martin, St. Mary, St. Tammany, Tangipahoa, Terrebonne, Vermilion, Washington, West Baton Rouge, and West Feliciana Parishes.

Part of "Specified GO Zone Extension Property"

50% Bonus Depreciation

The GO Zone Act allows for a significant acceleration of the normal depreciation deduction by allowing a **bonus depreciation deduction in the first year Qualified GO Zone Property is placed in service equal to 50% of its cost, in addition to the normal depreciation deduction for the balance of such costs.**

- **Available to businesses of all sizes.**
- **Applicable to investments in equipment, non-residential real property or residential rental property substantially all of which is used both in the active conduct of trade or business and in the GO Zone.**
- **Original use of the property in the GO Zone must commence with the business on or after August 28, 2005 (the day before Hurricane Katrina made landfall).**
- **Available for both costs incurred on new projects and rehabilitation costs.**
- **Costs incurred for replacement, renovation or rehabilitation of existing property are treated as separate property for purposes of the GO Zone Act.**
- **Original placed in service requirements for all Qualified GO Zone Property except "Specified GO Zone Extension Property"**

    > Personal property – on or before December 31, 2007.

    > Real property – on or before December 31, 2008.

- **Extended placed in service requirements for "Specified GO Zone Extension Property"**

    > Specified GO Zone Extension Property is property, substantially all of the use of which is in one or more "specified portions of the GO Zone" and which is:

    1. *nonresidential real property or residential rental property* that is placed in service before Jan. 1, 2011 (only costs incurred before Jan. 1, 2010 are eligible for 50% bonus depreciation); or

    2. in the case of a taxpayer who places a building described in (1) above in service before Jan. 1, 2011, *personal property* if substantially all of the use of that property is in the building and the property is placed in service not later than 90 days after the building is placed in service.

    > "Specified portions of the GO Zone" include Hancock, Harrison, Jackson, Pearl River and Stone Counties in Mississippi and Calcasieu, Cameron, Orleans, Plaquemines, St. Bernard, St. Tammany and Washington Parishes in Louisiana.

- **Opt-outs of bonus depreciation allowance are permitted by asset class.**

- **If any portion of property is financed with tax-exempt bonds, that entire property is ineligible for bonus depreciation.**

- **Gaming property is excluded, but ancillary facilities and related equipment may qualify. Also excluded is property used in connection with any private or commercial golf course, country club, or liquor store.**

- **CAUTION:**
  > The business is subject to recapture provisions if the property ceases to be Qualified GO Zone Property.

  > Use of the deductions afforded by bonus depreciation remains subject to the normal limitations found in the "at-risk" and "passive activity" rules.

- **IRS Guidance related to the 50% Bonus Depreciation**

  > Notice 2006-77 provides guidance for the following provisions related to 50% Bonus Depreciation

  - Substantially all requirement
  - Active conduct of a trade or business requirement
  - Opt-out of bonus depreciation
  - Property excluded from bonus depreciation
  - Recapture provisions

Bonus Depreciation Examples:

A. Non-residential Real Property (Recovery Period: 39 Years)

Hotels, Office Buildings, Stores, Warehouses, Manufacturing Plant Buildings

Assumptions: Basis of $10,000,000; Placed in service in June 2006

	Allowance With Bonus Depreciation	Allowance Without Bonus Depreciation
Year #1	**$ 5,069,550**	**$ 139,100**
Year #2	**$ 128,200**	**$ 256,400**

B. Residential Rental Property (Recovery Period: 27.5 Years)

Apartment Complexes

Assumptions: Basis of $2,500,000; Placed in service in June 2006

	Allowance With Bonus Depreciation	Allowance Without Bonus Depreciation
Year #1	$ 1,274,625	$ 49,250
Year #2	$ 45,450	$ 90,900

C. 15-Year MACRS Property (150% Double Declining Balance Method)

Restaurants, Parking Lots, Sidewalks, Fences, Roads and Bridges, Pipelines

Assumptions: Basis of $1,000,000; Placed in service in June 2006

	Allowance With Bonus Depreciation	Allowance Without Bonus Depreciation
Year #1	$ 525,500	$ 50,000
Year #2	$ 43,750	$ 95,000

D. 7-Year MACRS Property (150% Double Declining Balance Method)

Manufacturing Equipment, Office Furniture and Fixtures, Agricultural Equipment, Oil & Gas Drilling and Production Equipment

Assumptions: Basis of $1,000,000; Placed in service in June 2006

	Allowance With Bonus Depreciation	Allowance Without Bonus Depreciation
Year #1	$ 553,550	$ 107,100
Year #2	$ 95,650	$ 191,300

E. 5-Year MACRS Property (150% DDB Method)
Automobiles, Trailers, Construction Equipment, Restaurant Fixtures

Assumptions: Basis of $100,000; Placed in Service in June 2006

	Allowance With Bonus Depreciation	Allowance Without Bonus Depreciation
Year #1	$ 57,500	$ 15,000
Year #2	$ 12,750	$ 25,500
Year #3	$ 8,925	$ 17,850

F. 3-Year Straight Line Property
Computer Software

Assumptions: Basis of $100,000; Placed in Service in July 2006

	Allowance With Bonus Depreciation	Allowance Without Bonus Depreciation
Year #1	$ 58,333	$ 16,667
Year #2	$ 16,667	$ 33,333
Year #3	$ 16,667	$ 33,333

5-Year NOL Carryback

Recognizing that the deductions generated by the 50% bonus depreciation may exceed current year income, Congress expanded the opportunity for businesses in the GO Zone to carry back their net operating losses.

- **Time period for NOL carryback extended from 2 years to 5 years.**
- **Businesses may carry forward NOLs for up to 20 years.**
- **Qualifying losses may be used to offset up to 100% of income subject to the Alternative Minimum Tax.**
- **Qualifying losses include:**

  > Depreciation deductions with respect to qualified Zone property.

  > In-Zone casualty losses.

  > Moving expenses.

  > Temporary housing expenses.

  > Repair expenses resulting from Katrina.

- **The NOL provisions may enable a client to convert operating losses into refunds for taxes previously paid.**

Note: Decisions regarding NOL Carrybacks are complicated by the varying tax rates for individual taxpayers. You will want to consult your tax advisor prior to pursuing this option.

Tax-Exempt, Private-Activity "GO Zone Bonds"

Tax-exempt, private-activity bonds have now been authorized to finance development of a wide array of commercial projects which locate within the GO Zone on or after August 28, 2005. **Mississippi may issue in excess of $4.9 Billion in tax-exempt "GO Zone Bonds," while Louisiana may issue nearly $7.9 Billion, and Alabama may issue in excess of $2.1 Billion.**

- **Bonds are available to most business sectors (gaming and certain other activities are excluded).**
- **Bond proceeds may be used to fund construction and renovation of nonresidential real property and certain residential rental property (moveable fixtures and equipment are excluded).**
- **For new acquisitions of existing property to qualify, rehabilitation improvements must be made to the property in an amount not less than 50% of the purchase price financed with GO Zone Bonds.**
- **A project must choose between bonus depreciation and tax-exempt bonds on project costs that otherwise would qualify for both incentives.**
- **Bonds must be issued on or before December 31, 2010.**
- **Under current federal tax law, borrowers may use bond proceeds to reimburse for costs previously incurred by the borrower for only 60 days prior to initial approval by the governmental authority issuing the bonds.***

Considerations For Tax-Exempt GO Zone Bond Financing:

- **Estimated savings of 150–200 basis points in lower cost of funds per annum.**
- **Tax-exempt bonds are typically amortized over 10-20 years.**
- **Interest on tax-exempt private activity bonds is generally priced at a weekly floating rate.**
- **The tax-exempt bonds are backed by a letter of credit issued by a "rated" financial institution or other approved credit enhancement.**
- **$3 Million is generally the minimum project size to justify the increased costs of stand-alone, tax-exempt financing.**

It is critical that the borrower request this initial approval from the governmental authority and that the project be induced as soon as possible, especially since the approving agency meets only one day each month. To facilitate the project, we will handle the inducement of the project at no cost to the borrower.

Private Activity GO Zone Bond Allocation Policies for Mississippi:

- **Projects of $20 Million or less.**

  > Processed on a first-come, first-served basis.

  > Approvals based on a limited review of the type of business seeking the allocation.

- **Projects in excess of $20 Million.**

  > Reviewed on a case-by-case basis.

  > Factors determining allocation will be location of project, number of jobs created, payroll, total investment of the project, and type of business.

- **Projects in excess of $50 Million may require a cost/benefit analysis from an acceptable entity.**

- **Limits on percentage of total project funding.**

  > Projects over $200 Million may be limited to 50% of the total project financing.

  > Allocation prorated at 50% for projects between $100 Million and $200 Million.

- **Maximum allocations for any project.**

  > For the six southernmost counties, $250 Million for any single project.

  > For all other counties in the Mississippi GO Zone, $100 Million per project.

- **Confirmation of Issuance must be received within 120 days of the Notice of GO Zone Bond Allocation.**

- **Governor may amend or waive any requirement if necessary to promote the public purpose of the GO Zone Act.**

Tax-Exempt “GO Zone Bonds” Savings Illustrations

Project 1: **Assumptions:**

- $10 Million financed
- 20-year term
- 200 basis points savings
- 5% rate for tax-exempt and 7% taxable rate

Total Savings: $2,768,237

Project 2: **Assumptions:**

- $10 Million financed
- 20-year term
- 175 basis points savings
- 5.25% rate for tax-exempt and 7% taxable rate

Total Savings: $2,434,913

Project 3: **Assumptions:**

- $10 Million financed
- 20-year term
- 150 basis points savings
- 5.5% rate for tax-exempt and 7% taxable rate

Total Savings: $2,097,878

Industrial Development Revenue Bond Program – Taxable Bonds (IRBs)

MBFC may issue a taxable IRB for commercial businesses approved by MBFC for a term not to exceed 30 years. As security for the IRB, MBFC may require a letter of credit from a qualifying bank or other collateral.

- **MBFC is authorized to issue taxable industrial development revenue bonds and loan the proceeds thereof to eligible companies.**
- **Any eligible commercial business approved by MBFC is an eligible business.**
- **Bond proceeds may be used for land, buildings, machinery and equipment, and other expenses necessary for or incidental to the project.**
- **Interest on a taxable IRB may be priced at a variable interest rate or fixed interest rate.**
- **Bonds are backed by an irrevocable, direct-pay letter of credit issued by an approved bank or other credit enhancement or collateral acceptable to MBFC.**
- **$3 million is generally the minimum project size to justify the increased costs of an IRB (typical costs of issuance are 2-3% of the amount of the bond issue; additional annual fees are approximately 1.5% for bank letter of credit fees, trustee fees, etc.)**
- **There is no maximum statutory amount for a taxable IRB.**

Use of Tax-Exempt, Private Activity GO Zone Bonds Permits Use of Additional State-Law Incentives:

- **If properly structured, projects financed with tax-exempt GO Zone Bonds or taxable IRBs can be exempt from the sales and use tax (generally 7%) and, with proper planning, a portion of the contractor's tax (3½% on component materials and on design services) can be avoided.**
- **Projects financed with GO Zone Bonds are also eligible to obtain ad valorem tax exemptions, subject to the discretion of the local governing body where the project is located.**
- **Companies utilizing tax-exempt GO Zone Bonds may also be eligible for RED Program Mississippi income tax credits.**

Examples of Savings on Sales and Use and Contractor's Tax:

Hotel

Assumptions:

- **Total Construction Cost — $12 Million**
- **Allocation of total construction costs:**

  33.3% ($4,000,000)—labor
  33.3% ($4,000,000)— component materials
  33.3% ($4,000,000)— furniture, fixtures and equipment

Projected savings on each component:

- **Labor: (0% x $4,000,000) — $0**
- **Component Materials: (3½% x $4,000,000) — $140,000**
- **FFE: (7% x $4,000,000) — $280,000**

Total Savings on Hotel Project: $420,000

Office Building

Assumptions:

- **Total Construction Cost — $10 Million**
- **Allocation of total construction costs:**

  40% ($4,000,000)—labor
  40% ($4,000,000)— component materials
  20% ($2,000,000)— furniture, fixtures and equipment

Projected savings on each component:

- **Labor: (0% x $4,000,000) — $0**
- **Component Materials: (3½% x $4,000,000) — $140,000**
- **FFE: (7% x $2,000,000) — $140,000**

Total Savings on Office Building Project: $280,000

Warehouse

Assumptions:

- **Total Construction Cost — $10 Million**
- **Allocation of total construction costs:**

  45% ($4,500,000)—labor
  45% ($4,500,000)— component materials
  10% ($1,000,000)— furniture, fixtures and equipment

Projected savings on each component:

- **Labor: (0% x $4,500,000) — $0**
- **Component Materials: (3½% x $4,500,000) — $157,500**
- **FFE: (7% x $1,000,000) — $70,000**

Total Savings on Warehouse Project: $227,500

Use of 50% Bonus Depreciation and State-Law Incentives Related to Taxable State Bond Financing

Under the GO Zone Act, if any portion of property is financed with tax-exempt bonds, that entire property is ineligible for bonus depreciation.

A business which elects to take advantage of the 50% bonus depreciation offered by the GO Zone Act, however, may be able to achieve significant additional state-law incentives that are available to those using taxable state bond financing via Industrial Revenue Bonds (IRBs) issued through the Mississippi Business Finance Corporation (MBFC).

Utilizing this taxable bond financing offers a business the following benefits:

- **Projects are able to utilize both the 50% bonus depreciation and other savings set forth below.**
- **If properly structured, projects financed with taxable IRBs can be exempt from the sales and use tax (generally 7%) and, with proper planning, a portion of the contractor's tax (3½% on component materials and on design services).**
- **Companies utilizing taxable IRBs may also be eligible for RED Program Mississippi income tax credits.**
- **Projects financed through taxable IRBs also may be eligible to obtain ad valorem tax exemptions, subject to the discretion of the local governing body where the project is located.**

Other Benefits Offered by the GO Zone Act

100% Deduction for Qualifying Tangible Personal Property for Small Businesses

Under current law, small businesses are permitted to expense, rather than depreciate, up to $100,000 of investments in equipment and computer software. The GO Zone Act increases to $200,000 the amount that eligible small businesses can expense for under Section 179 for qualifying tangible personal property and computer software placed in service in the Zone. The deduction is phased out to the extent the amount of qualifying property placed in service in a year exceeds the applicable threshold. The placement in service dates are the same as those that apply to bonus depreciation.

Demolition and Cleanup Expenses May Be Expensed

Under existing law, the cost of demolition generally is added to the business owner's basis in the underlying land and cannot be recovered until the property is sold. The GO Zone Act allows businesses to expense 50% of their demolition and cleanup expenses incurred through 2007.

Special Incentives for Employers

Employee Retention Tax Credit. The Employee Retention Tax Credit was expanded to apply to all employers in the Zone, regardless of the number of employees. The credit is equal to 40% of qualifying wages up to a maximum of $6,000 (for a maximum credit of $2,400 per qualifying employee) and applies to qualifying amounts expended prior to December 31, 2005.

Qualified employees may exclude from gross income up to $600 per month for employer-provided lodging located in the Zone. In addition, employers receive a credit for 30% of the tax-free lodging benefit. This provision applies to lodging benefits provided during the 6-month period from and after enactment.

WOTC. Employers may claim the Work Opportunity Tax Credit (WOTC) if they hire a "Hurricane Katrina employee." This is an individual who, on August 28, 2005, had a principal place of abode in the "core disaster area" and (1) who is hired after August 27, 2005, and before August 28, 2007, for a job located in the core disaster area; or (2) who was displaced by Hurricane Katrina and is hired after August 27, 2005, and on or before December 31, 2005 for a job located outside the core disaster area.

For employers outside the GO Zone, the employee must have been hired after August 27, 2005, and before January 1, 2006. For employers within the GO Zone, the WOTC is extended for employees hired through August 27, 2007.

Eligible employers are allowed a credit of 40% of the first $6,000 of qualified first-year wages paid to each eligible employee.

New Markets Tax Credit Authority Increased

The New Markets Tax Credit program is a federal tax incentive program authorized by Congress in 2000 to help spur the investment of capital in businesses located in low-income communities. The NMTC program was patterned, in part, after the Low Income Housing Tax Credit program that has been in effect for many years. NMTC allocations are made through a very competitive, nationwide process. If obtained, such credits may be used either to attract equity investment (in a manner similar to low-income housing credits) or to lower a developer's cost of capital on borrowed funds.

The allowable credit is equal to 39% of qualifying investments in low-income communities. To qualify, the investment must be made by an authorized community development entity (CDE). An additional $1 Billion in NMTC authority was granted for the years 2005-2007.

Other Important Provisions of the GO Zone Act

The GO Zone Act contains a number of additional incentives and relief provisions that are important to businesses considering an investment in the GO Zone, including:

- **Increase in Qualified Rehabilitation Credit**: The credit for qualified expenditures for a historic structure was raised to 26% and for other qualified structures to 13%.

- **Reforestation Incentives for Small Timber Owners**: The cap on the deductibility of reforestation costs was doubled to $20,000 per year through 2008, and a special 5-year NOL carryback for small timber operations was authorized. To qualify, the timber owner must own less than 500 acres of timber.

- **Low-Income Housing**: The Act authorizes almost $40 Million in additional low-income tax credits for Mississippi. Additional provisions will increase the credits available to investors for new construction and rehabilitation expenditures.

- **Expensing of Qualified Environmental Cleanup Costs**: The deductibility of environmental cleanup costs incurred on qualifying sites was extended for 2 years and applies to the clean-up of petroleum products. To qualify, costs must be incurred from August 27, 2005 through December 31, 2007.

Mississippi Non-GO Zone Tax Incentives and Savings

There are many other state law incentives or other incentives that could apply in certain circumstances depending on the nature of the project and whether the business obtains tax-exempt financing either through a GO Zone Bond or through the MBFC. These include RED debt service income tax credits, income tax job credits, and local property tax exemptions.

RED Debt Service Income Tax Credits

Projects financed with bonds may also be granted credits against the State income tax under the Rural Economic Development (RED) Program. However, "RED" is a misnomer, since it is available throughout the state — not just rural areas, although it is not available to all enterprises that qualify for bond financing. Projects must be approved by MBFC for participation in the RED program.

The annual RED Credit is the amount of the debt service payments (principal and interest) made for that year under the bonds for the project. It is available for both new facilities and expansions. Unused RED Credits can be carried over for 3 years; are available for the term of the bonds (but not to exceed 25 years for a total of 28 years with carryover); are limited annually to 80% of Mississippi income tax from the project; and can be combined with other credits.

Income Tax Jobs Credits

The requirements for qualification and amount of the credit for new jobs vary with the State Tax Commission's annual county designation. All of the State's 82 counties are divided into three equal categories or tiers based on economic criteria. The minimum number of net new full-time jobs required in a single year in order to qualify for new job credits varies by category. Qualification of each project must be pre-certified as "qualified" by the State Tax Commission.

Once the minimum number of new jobs is created, the enterprise will be eligible for an annual new jobs credit for each net new full-time employee of 2.5%, 5% or 10% of the payroll for the net new jobs depending on the county. The credit can offset 50% of the business' annual State tax liability, and unused credits may be carried forward for 5 years.

Other Jobs Incentives

The "Mississippi Advantage Jobs Act" provides quarterly incentive payments from the State to a qualified business or industry for a period generally not to exceed 10 years. The amount of the incentive is directly related to jobs created as a result of an establishment locating in the State.

Exemptions from Property Taxes

All are discretionary with local taxing authorities (city and/or county governing authorities). The new enterprise/additions exemption exempts all real and tangible personal property (including raw materials and work-in-process inventories, but excluding finished goods inventories and automobiles and trucks) from ad valorem real and personal property taxation, *except* taxes for school district purposes. It covers new enterprises, additions to or expansion of an enterprise, replacements of equipment used in connection with or necessary to the operation of the enterprise, and renovations of an existing facility (at least in conjunction with an otherwise qualifying expansion of such enterprise). It is available for a maximum of 10 years, and is non-renewable but is available annually.

All real and personal property purchased with bond proceeds (whether taxable or tax-exempt) is also exempt from property taxes. However, there are no property tax advantages over the new enterprise/additions exemptions. As a general rule, even if bonds are issued, new enterprise/additions exemption should still be obtained.

There is also a free port exemption which is applicable to the portion of finished goods shipped out of Mississippi. Unlike any other type of property tax exemptions, the free port exemption can be granted to include an exemption from school taxes and for longer than a 10-year term.

A finished goods exemption is also available for all finished goods, whether shipped out of Mississippi or not, but school taxes are not subject to exemption, and the exemption cannot exceed a maximum of 10 years and is non-renewable. The free port and finished goods exemptions can be combined.

For more information on the Gulf Opportunity Zone Act of 2005, please contact:

Jackson Office:

Lucien Bourgeois
601-985-4553
lucien.bourgeois@butlersnow.com

Steve Rosenblatt
601-985-4504
steve.rosenblatt@butlersnow.com

Barry Cannada
601-985-4535
barry.cannada@butlersnow.com

Michael Russ
601-985-4597
michael.russ@butlersnow.com

John England
601-985-4563
john.england@butlersnow.com

Kim Smith
601-985-4540
kim.smith@butlersnow.com

Jet Hollingsworth
601-985-4404
jet.hollingsworth@butlersnow.com

Paul Varner
601-985-4552
paul.varner@butlersnow.com

Sai Ireland
601-985-4566
sai.ireland@butlersnow.com

Thad Varner
601-985-4518
thad.varner@butlersnow.com

Coast Office:

John Harral
228-575-3038
john.harral@butlersnow.com

Memphis Office:

Joey Dudek
901-680-7329
joey.dudek@butlersnow.com

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ATTORNEYS AT LAW

JACKSON
AmSouth Plaza, 17th Floor
210 East Capitol Street
Jackson, MS
Phone 601-948-5711
Fax 601-985-4500

GULF COAST
Whitney National Bank Building
1300 Twenty-fifth Avenue, Suite 204
Gulfport, MS
Phone 228-864-1170
Fax 228-868-1531

MEMPHIS
Crescent Center
6075 Poplar Avenue, Suite 500
Memphis, TN
Phone 901-680-7200
Fax 901-680-7201

gozonelaw.com

butlersnow.com

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