Order Code RS22344
December 6, 2005

CRS Report for Congress
Received through the CRS Web

Hurricane Tax Relief: H.R. 4440 and S. 2020

Erika Lunder
Legislative Attorney
American Law Division

Summary

H.R. 4440, the Gulf Opportunity Zone Act of 2005, and S. 2020, the Tax Relief Act of 2005, contain tax benefits to assist in the recovery from Hurricanes Katrina, Rita, and Wilma. The bills provide similar relief and both expand several provisions in the Katrina Emergency Tax Relief Act (KETRA, P.L. 109-73)[1] to apply to victims of Hurricanes Rita and Wilma. The House has not yet acted on H.R. 4440. The Senate passed S. 2020 by a vote of 64 to 33 on November 18, 2005. This report summarizes the bills' provisions dealing with hurricane relief and will be updated as events warrant.

The Gulf Opportunity Zone Act of 2005 (H.R. 4440) and the Tax Relief Act of 2005 (S. 2020) provide tax incentives to aid in the recovery from the recent hurricanes. The bills 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. Both bills would allow Alabama, Louisiana, and Mississippi to issue tax-exempt GO Zone bonds between the date of the section's enactment and January 1, 2011. The maximum amount of bonds that each state could issue would be $2,500 multiplied by the portion of the state's population in the GO Zone as determined prior to August 28, 2005. Both bills would also allow one additional advance refunding of certain bonds issued by those states if the bonds were outstanding on August 28, 2005 (H.R. 4440), or August 27, 2005 (S. 2020). The refunding would have to occur between the date of the bills' enactment and January 1, 2011 (H.R. 4440), or January 1, 2007 (S. 2020). The bills would differ in the types of bonds that would qualify, and H.R. 4440 would cap the amount of bonds each state could refund, while S. 2020 would not.

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

S. 2020 would amend IRC § 142(d), which allows residential rental projects for low-income tenants to qualify for tax-exempt bond financing. The bill would allow the project's operators who rent to individuals displaced by Hurricane Katrina to rely on their representation that their income was under the income limits if the tenancy began within six months of the displacement. H.R. 4440 does not include the provision.

Low-income Housing Tax Credit. The low-income housing tax credit in IRC § 42 allows owners of qualified residential rental property to claim as a credit for ten years 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 certain adjustments.

H.R. 4440 would increase the credits available to Alabama, Louisiana, and Mississippi by the lesser of the amount allocated by the state to GO Zone buildings or $18.00 multiplied by the portion of the state's population in the GO Zone as determined prior to August 28, 2005. H.R. 4440 would also designate the GO Zone as a difficult development area and use an alternative test for determining whether certain GO Zone projects would qualify as low-income housing. These provisions would apply for 2006, 2007, and 2008. S. 2020 would increase the credits available to these states by $5.25 (adjusted for inflation) multiplied by the portion of the state's population in the GO Zone as determined before August 28, 2005. This provision would apply for 2006, 2007, 2008, and 2009. S. 2020 would also treat the GO Zone as a difficult development area for 2006, 2007, and 2008, and increase the percentage of costs that could be claimed as the credit.

Depreciation. For qualified GO Zone property, both bills would increase for one year the depreciation deduction otherwise allowed under IRC § 167 by 50% of the taxpayer's adjusted basis in the property. Among other requirements, the property's original use in the GO Zone would have to 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).

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.

Both bills would increase 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. Both bills would amend IRC § 198 for sites in the GO Zone by extending the current deadline to December 31, 2007, and allowing petroleum products to be treated as a hazardous substance. The bills would also allow 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. H.R. 4440 would increase those amounts to 13% and 26% for building and structures in the GO Zone for expenditures between August 27, 2005, and January 1, 2009. S. 2020 does not include a similar provision.

Small Timber Producers. The bills would create two special rules for timber producers with no more than 500 acres of qualified timber property. Under IRC § 194, taxpayers may elect to expense up to $10,000 of qualifying reforestation expenditures. The bills would increase that limit by up to $10,000 for expenditures made for qualified timber property in the GO Zone, Rita GO Zone, or (S. 2020 only) Wilma GO Zone. Under IRC § 172, the general rule is that taxpayers may carry net operating losses back for two years. The bills would increase this to five years for certain losses attributable to timber property in the GO Zone, Rita GO Zone, or (S. 2020 only) Wilma GO Zone.

Public Utility Losses. Under IRC § 172, certain net operating losses, called specified liability losses, may be carried back for 10 years. Both bills would treat 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. S. 2020 would allow GO Zone public utility disaster losses to be deducted in the fifth taxable year preceding the disaster. H.R. 4440 does not include a similar provision.

Net Operating Losses. Under IRC § 172, net operating losses (NOL) may generally be carried back for two years. The bills would allow GO Zone NOL to be carried back for five years. In H.R. 4440, the loss would be the lesser of the depreciation deductions allowed for GO Zone property or the year's NOL with adjustments. In S. 2020, the loss would be the lesser of the year's NOL or the deductions for GO Zone casualty losses, employment-related moving expenses due to Hurricane Katrina, temporarily housing employees, depreciation of GO Zone property, and repair expenses.

Gulf Tax Credit Bonds. Under H.R. 4440, holders of gulf tax credit bonds could claim a credit based on the credit rate on the date the bonds were sold and their outstanding face amount. The bonds could 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. The bonds must be issued between December 31, 2005, and January 1, 2007, and could not have a maturity date beyond two years. Each state would be capped in the amount of bonds that could be issued. S. 2020 does not include a similar provision.

Casinos and Certain Other Facilities. H.R. 4440 would restrict the following facilities from qualifying for the above provisions: private or commercial golf course, country clubs, massage parlors, hot tub facilities, suntan facilities, racetracks or other facilities used for gambling, and stores whose principal business is selling alcoholic beverages for consumption off premises.

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, S. 2020 would allow any qualified higher education expenses to qualify for the credits. The bill would also double the $1,000 limitations in the Hope credit to $2,000 and increase the 20% limitation in the Lifetime Learning credit to 40%. H.R. 4440 does not include a similar provision.

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. S. 2020 would increase the cap by $300,000,000 for 2005 and 2006 and by $400,000,000 for 2007, and allocate these amounts to entities making low-income community investments in the GO Zone. There is no similar provision in H.R. 4440.

Traveling Expenses. Under IRC § 162, taxpayers may deduct traveling expenses while away from home in pursuit of a trade or business. Taxpayers are not considered to be traveling if the period away from home exceeds one year. H.R. 4440 would grant the Treasury Secretary the authority to extend the one-year period by up to one year for taxpayers who were away from home in pursuit of a trade or business by reason of a presidentially-declared disaster. S. 2020 does not include a similar provision.

Gulf Coast Recovery Bonds. H.R. 4440 would state it is the sense of Congress that the Treasury Secretary designate at least one series of bonds as Gulf Coast Recovery Bonds. S. 2020 does not include a similar provision.

Federal Guarantee of Certain Bonds. H.R. 4440 would federally guarantee 50% of the outstanding principal of certain bonds issued by Alabama, Louisiana or Mississippi prior to January 1, 2009. The state would have to demonstrate need based on such criteria as the loss of revenue base due to Hurricane Katrina. The amount of bonds would be capped at $3,000,000,000. S. 2020 does not have a similar provision.

Housing Relief. S. 2020 would exclude the value of employer-provided housing, limited to $600 per month, from the employee's income and allow 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 at least 80% of the employment services in the Hurricane Katrina disaster area. The employer must have a trade or business in the disaster area. The lodging must be provided during the first six months after the bill's enactment. H.R. 4440 does not include a similar provision.

Modifications to Certain KETRA Provisions

Both bills modify several KETRA provisions to provide relief for victims of Hurricanes Rita and Wilma. The provisions described below were enacted in KETRA to assist individuals affected by Hurricane Katrina. H.R. 4440 and S. 2020 would repeal them and enact versions that also apply to individuals affected by the other hurricanes.

Retirement Plan Distributions. For certain post-hurricane retirement plan distributions, the bills would waive 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 maximum amount that could be withdrawn without penalty is $100,000. Funds could 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 could 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 bills would increase the amount that these individuals could borrow from their retirement 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 bills would increase 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 would be between September 23, 2005, and January 1, 2007 for Katrina individuals and the date of the provision's enactment and January 1, 2007 for Rita and Wilma individuals. The bills would also extend the repayment due dates by one year if the original date fell between a certain date and January 1, 2007. The date would be August 25, 2005, for Hurricane Katrina individuals, September 23, 2005, for Hurricane Rita individuals, and October 23, 2005, for Hurricane Wilma individuals.

The bills would allow 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 hurricane. 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 would have to be made after August 25, 2005 (Katrina), September 22, 2005 (Rita), or October 22, 2005 (Wilma), and before March 1, 2006.

Retention Credit. Both bills include a retention credit for businesses damaged by a hurricane that continued to pay their employees' wages, regardless of whether the employees performed services. Eligible employers would be 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 would be those whose principal place of employment at the time of the hurricane was with the eligible employer in the Go Zone, Rita GO Zone, or Wilma GO Zone . The credit would equal 40% of the employee's first $6,000 in wages paid between the date the business became inoperable and the date it resumed significant operations there, but no later than December 31, 2005. H.R. 4440 would not allow employers with more than 200 employees to claim the credit.

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 certain adjustments) and corporations may not claim a deduction that exceeds 10% of their taxable income with certain adjustments. The bills would suspend the 50% and 10% limitations for cash contributions made between August 27, 2005, and January 1, 2006. For individuals, the deduction could not exceed the amount that the taxpayer's contribution base exceeded other charitable contributions. The bills also suspend the overall limitation on itemized deductions for individuals. For corporations, the deduction would only be allowed for contributions used for hurricane relief efforts and could not exceed the amount that the corporation's taxable income exceeded its other contributions.

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 taxpayer may only claim a deduction 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 that was involuntarily converted due to the casualty. The bills would waive 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.[2] H.R. 4440 would apply the KETRA extension to victims of Hurricanes Rita and Wilma. S. 2020 does not contain a similar provision.

Credit Computations. H.R. 4440 would allow 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 would be those whose principal place of abode was (a) in the GO Zone, Rita GO Zone, or Wilma Go Zone or (b) in the Hurricane Katrina, Rita or Wilma disaster area and who were displaced by the hurricane. S. 2020 does not include a similar provision.

Authority to Make Adjustments. H.R. 4440 would allow the Treasury Secretary to make adjustments in the application of the tax laws for 2005 and 2006 so that taxpayers would not lose deductions or credits or have a change of filing status due to temporary relocations from one of the hurricanes. S. 2020 does not have this provision.

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. S. 2020 would remove 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. S. 2020 would also increase the limitation on qualified home improvement loans from $15,000 to $150,000 for loans to repair damage to homes in the zones. H.R. 4440 does not include a similar provision.

---

[2] 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.