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Permanent Tax Relief Provisions for Disaster Victims as Presented in the Internal Revenue Code

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Abstract. Several bills introduced in the 110th Congress propose to create permanent tax relief provisions for disaster victims. The Catastrophe Savings Account Act of 2007 (H.R. 1787 and S. 927) would provide for tax-exempt catastrophe savings accounts (CSAs) and would allow tax-free distributions from these accounts to pay expenses resulting from presidentially declared disasters. The Hurricane and Tornado Mitigation Investment Act of 2007 (S. 930 and H.R. 913) and the Homeowners Insurance and Mitigation Assistance Act of 2008 (H.R. 6762) would allow individual and business taxpayers a tax credit for 25% of their qualified hurricane and tornado mitigation property expenditures up to $5,000 for any taxable year.

Permanent Tax Relief Provisions for Disaster Victims as Presented in the Internal Revenue Code

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Summary

When natural or man-made disasters occur, there are several tax relief provisions that apply to affected taxpayers. This report focuses on permanent tax relief laws that are intended to benefit victims of both presidentially and non-presidentially declared disasters such as hurricanes, floods, earthquakes, tornadoes, droughts, wildfires, wars, and terrorist attacks. The selected laws are summarized in table format and are arranged by different categories, including “losses,” “gains exempted from income,” and “postponements.” For each law summarized, the table contains the corresponding Internal Revenue Code (IRC) section citation and a brief description of the provision. The descriptions are combinations of verbatim and summarized IRC text.

Several bills introduced in the 110th Congress propose to create permanent tax relief provisions for disaster victims. The Catastrophe Savings Account Act of 2007 (H.R. 1787 and S. 927) would provide for tax-exempt catastrophe savings accounts (CSAs) and would allow tax-free distributions from these accounts to pay expenses resulting from presidentially declared disasters. The Hurricane and Tornado Mitigation Investment Act of 2007 (S. 930 and H.R. 913) and the Homeowners Insurance and Mitigation Assistance Act of 2008 (H.R. 6762) would allow individual and business taxpayers a tax credit for 25% of their qualified hurricane and tornado mitigation property expenditures up to $5,000 for any taxable year.

The Fair Disaster Tax Relief Act of 2008 (H.R. 6640), introduced on July 29, 2008, includes several permanent provisions that would enhance the recovery of expenses incurred as a result of presidentially declared disasters. In regard to calculating the deductions for losses, this bill waives the 10% adjusted gross income rule and raises the deductible to $500. The bill also allows for deduction and recovery of qualified disaster expenses in the year in which they are paid or incurred, and raises the net operating loss carryback period for disasters from three years to five. Taxpayers would also be allowed to use mortgage revenue bonds to finance loans of up to $150,000 for repairing principal residences damaged by presidentially declared disasters.

This report will be updated as warranted by legislative events.

Contents

Tables

Contacts

Introduction

When natural or man-made disasters occur, there are several tax relief provisions that apply to affected taxpayers. This report focuses on permanent tax relief laws that are intended to benefit victims of disasters such as hurricanes, floods, earthquakes, tornadoes, droughts, wildfires, wars, and terrorist attacks. The selected laws are summarized in table format and are arranged by different categories, including "losses," "gains exempted from income," and "postponements." For each law summarized, the table contains the corresponding Internal Revenue Code (IRC) section citation and a brief description of the provision. The descriptions are combinations of verbatim and summarized IRC text.

Some tax relief provisions are available only to victims of presidentially declared disasters. A presidentially declared disaster is defined in IRC Section 1033(h)(3) to mean "any disaster which, with respect to the area in which the property is located, resulted in a subsequent determination by the President that the area warrants assistance by the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act" (Stafford Act). Other tax relief provisions are more broadly available to disaster victims regardless of the event's presidential declaration status. Descriptions of the IRC sections in this report will indicate whether certain provisions are available only for victims of presidentially declared disasters.

In response to Hurricanes Katrina, Rita, and Wilma in 2005, Congress passed temporary enhancements to existing tax laws to provide extra tax relief to victims of these hurricanes. These modifications were part of the Katrina Emergency Tax Relief Act of 2005 (P.L. 109-73) and the Gulf Opportunity Zone Act of 2005 (P.L. 109-135). Table notes indicate where the permanent laws described in this report were enhanced by either P.L. 109-73 or P.L. 109-135.[1]

Several bills introduced in the 110th Congress propose to create permanent tax relief provisions for disaster victims. The Catastrophe Savings Account Act of 2007 (H.R. 1787 and S. 927) would provide for tax-exempt catastrophe savings accounts (CSAs) and would allow tax-free distributions from these accounts to pay expenses resulting from presidentially declared disasters. The Hurricane and Tornado Mitigation Investment Act of 2007 (S. 930 and H.R. 913) and the Homeowners Insurance and Mitigation Assistance Act of 2008 (H.R. 6762) would allow individual and business taxpayers a tax credit for 25% of their qualified hurricane and tornado mitigation property expenditures up to $5,000 for any taxable year.

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[1] See CRS Report RS22269, *Katrina Emergency Tax Relief Act of 2005*, by Erika Lunder, and CRS Report RS22344, *The Gulf Opportunity Zone Act of 2005*, by Erika Lunder, for information on additional provisions for victims of Hurricanes Katrina, Rita, and Wilma.

[2] Currently, to calculate the deduction for a casualty loss, taxpayers must reduce the loss by $100 and reduce their total losses by 10% of their adjusted gross income. Only the excess over these limits is deductible.

[3] Includes expenses for repairs on property, removal of debris, demolition of structures, and the abatement or control of hazardous substances. Currently, taxpayers may be required to capitalize these expenses over a period of years.

Taxpayers would also be allowed to use mortgage revenue bonds to finance loans of up to $150,000 for repairing principal residences damaged by presidentially declared disasters.

This report focuses solely on provisions for tax relief from disasters. It does not cover legislative actions that have created tax incentives to encourage redevelopment in disaster-affected areas, nor does it discuss tax incentives for charitable giving. Measures providing for direct funding to victims of disasters are also not included in this report.

Table 1. Losses

Internal Revenue Code Section	Description
Sec. 165 Losses	Sec. 165 establishes the general rule that taxpayers may deduct losses, including casualty losses, for which they are not compensated or reimbursed by insurance or otherwise. Secs. 165(h)(1) and 165(h)(2) place limitations on the amount of the unreimbursed losses that individuals can deduct. Ordinarily, to figure a deduction for a casualty or theft loss of personal-use property resulting from a particular disaster, taxpayers must reduce the loss by $100 and also reduce their total casualty and theft losses by 10% of their adjusted gross income. Only the excess over these $100 and 10% limits is deductible.[a] Businesses are generally not limited in deducting losses. Applies to individuals and businesses. See Sec. 165(i) and Sec. 165(k) below for specific provisions relating to losses caused by presidentially declared disasters.
Sec. 165(i) Disaster Losses (also known as "Casualty Losses")	A taxpayer who sustains a loss due to a presidentially declared disaster may elect to deduct the loss on his or her return for the immediately preceding tax year in order to receive an expedited tax benefit. For example, a taxpayer who suffers a disaster loss any time during 2006 may elect to deduct it on his or her 2005 return; if the 2005 return has already been filed, the taxpayer may file an amended 2005 return. Otherwise, the taxpayer may wait and deduct it on his or her 2006 return in the regular manner. Applies to individuals and businesses.
Sec. 165(k) Demolition or Relocation of Residence	In the case of a taxpayer whose residence is located in an area which has been determined by the President to warrant assistance under the Stafford Act, if, • not later than the 120th day after the date of such determination the taxpayer is ordered, by the state or local government in which the residence is located, to demolish or relocate the residence, and if • the residence has been rendered unsafe for use as a residence by reason of the disaster, then the loss shall be treated as a casualty loss, as described in Sec. 165(i). Applies to individuals.

a. The Katrina Emergency Tax Relief Act of 2005 (P.L. 109-73) removed these limits for victims of Hurricanes Katrina, Rita, and Wilma on losses of personal-use property, so that the entire amount of unreimbursed losses is deductible.

Table 2. Net Operating Losses

Internal Revenue Code Section	Description
Sec. 172 Net Operating Loss Deduction	A net operating loss (NOL) occurs when, during a tax year, a taxpayer's allowable tax deductions are greater than the taxable income, resulting in a negative taxable income. This generally occurs when the taxpayer has incurred more expenses than income during the year. In general, a NOL may be carried back and deducted against taxable income in the two tax years[a] before the NOL year, and then carried forward and applied against taxable income for up to 20 years after the NOL year. These methods are known as "carrybacks" and "carryovers," respectively. Applies to individuals and businesses. See Sec. 172(b) below for specific provisions for individuals and businesses affected by disasters.
Sec. 172(b) Net Operating Loss Deduction for Individuals	A three-year carryback for a NOL is allowed when an individual taxpayer sustains a loss of property from fire, storm, shipwreck or other casualty, or from theft.
Sec. 172(b) Net Operating Loss Deduction for Businesses	A three-year carryback for a NOL is allowed for small businesses and farms that sustained NOLs due to presidentially declared disasters.

a. Gulf Opportunity Zone Act of 2005 (P.L. 109-135): The portion of a net operating loss that was a qualified Gulf Opportunity Zone loss can be carried back to the five tax years before the net operating loss year; this applies to both individuals and businesses. See the Internal Revenue Service (IRS) publication 4492, *Information for Taxpayers Affected by Hurricanes Katrina, Rita, and Wilma* for more information.

Table 3. Gains Exempted from Income

Internal Revenue Code Section	Description
Sec. 139 Disaster Relief and Mitigation Payments Exempted from Income	This provision provides for the exemption from income of any payments taxpayers receive as qualified disaster relief payments[a] or make in the case of certain disaster mitigation payments[b]. The provision is intended to ease the burden on individuals affected by terrorist attacks, specific military actions, presidentially declared disasters, common carrier accidents, and other disasters determined by the Secretary of the Treasury to be of a catastrophic nature, or disasters determined to warrant federal, state, or local government assistance. Applies to individuals.

Internal Revenue Code Section	**Description**
Sec. 1033 Conversions	An involuntary conversion occurs when one's property is destroyed, stolen, condemned, or disposed of under the threat of condemnation and he or she receives other property or money in payment, such as insurance or a condemnation award. Gain realized from involuntary conversions is deferred if property is compulsorily or involuntarily disposed of, and reinvested in a timely manner in property similar or related in service or use to the converted property. Applies to individuals and businesses. See Sec. 1033(h) below for special rules for both residential and business property damaged by presidentially declared disasters.
Sec. 1033(h) Involuntary Conversions: Special Rules for Personal Property Damaged by Presidentially Declared Disasters	Taxpayers whose principal residence (or any of its contents) is involuntarily converted as a result of a presidentially declared disaster qualify for three tax breaks regarding certain insurance proceeds: (1) Gain realized from the receipt of insurance proceeds for unscheduled personal property (property in the home that is not listed as being covered under the insurance policy) is not recognized. (2) Any other insurance proceeds received for the residence or its contents may be treated as a common fund. If the fund is used to purchase property that is similar or related in service or use to the converted residence (or its contents), the owner may elect to recognize gain only to the extent that the common fund exceeds the cost of the replacement property. (3) The replacement period for property involuntarily converted as a result of a presidentially declared disaster is four years after the close of the first tax year in which any part of the conversion gain is realized.
Sec. 1033(h) Involuntary Conversions: Special Rule for Business Property Damaged by Presidentially Declared Disasters	If a taxpayer's business property is involuntarily converted as a result of a presidentially declared disaster, the taxpayer is not required to replace it with property that is similar or related in service to the original property in order to avoid having to recognize gain on the conversion, as long as the replacement property is still held for a type of business purpose. The replacement period for business property is two years after the close of the first tax year in which any part of the conversion gain is realized (the replacement period for *condemned* business property is three years).
Sec. 121 Exclusion of Gain from Sale of Principal Residence in the Event of an Unforeseen Circumstance	When an individual sells a personal residence, the excess of the sale price over the original cost, plus home improvements, is a capital gain and is subject to tax. Gain of up to $250,000 for single taxpayers and $500,000 for married couples filing joint returns is excluded if the taxpayer meets a use test (has lived in the house for at least two years out of the last five years) and an ownership test (has owned the house, also for two years out of the last five). If a taxpayer fails to meet the use test but experiences an unforeseen circumstance, the taxpayer may claim a reduced exclusion. As listed under Reg. §1.121-3(e)(2), unforeseen circumstances include the involuntary conversion of a residence and a natural or man-made disaster (or act of war or terrorism) resulting in a casualty to a principal residence. Applies to individuals.
Sec. 123 Payments Received Under Insurance Contracts for Certain Living Expenses	For a taxpayer whose principal residence is damaged or destroyed by fire, storm, or other casualty, or who is denied access to his or her principal residence by governmental authorities because of the occurrence or threat of occurrence of such a casualty, gross income does not include payments made from an insurance contract to compensate or reimburse the individual and members of the household for living expenses incurred from the loss of use or occupancy of the residence. This exclusion is limited to expenses incurred for basic survival, such as housing, food, transportation, etc. Applies to individuals.

a. A qualified disaster relief payment includes any amount paid to or for the benefit of an individual, where the payment is not compensated by insurance or by any other means: (1) to reimburse or pay for reasonable and necessary personal, family, living, or funeral expenses incurred due to a qualified disaster;(2) to reimburse or pay for reasonable and necessary expenses incurred to repair or rehabilitate a personal residence, to repair or replace its contents to the extent that the need for such repair, rehabilitation, or replacement is due to a qualified disaster;(3) by a person engaged in the furnishing or sale of transportation as a common carrier, due to the death or personal physical injuries resulting from a qualified disaster; or(4) if such amount is paid by a Federal, State, local government, agency, or instrumentality thereof, in connection with a qualified disaster in order to promote the general welfare.

b. A qualified disaster mitigation payment is any amount paid pursuant to the Stafford Act or the National Flood Insurance Act. The payments must be made to or for the benefit of the owner of the property for hazard mitigation.

Table 4. Postponements

Internal Revenue Code Section	Description
Sec. 7508A Authority to Postpone Certain Deadlines and Abate Interest and/or Fees by Reason of Presidentially Declared Disaster or Terrorist or Military Actions	The IRS is permitted to postpone any deadline or statute of limitations imposed under federal tax laws for up to one year[a] for taxpayers affected by a presidentially declared disaster or by terrorist or military actions. The taxpayer actions that may be postponed include (per Reg. §301.7508A-1, "Postponement of certain tax-related deadlines by reason of presidentially declared disaster"): (1) the filing of any return of income, estate, gift, employment, or excise tax, (2) the payment of any income, estate, gift tax, generation-skipping transfer tax, excise tax, or employment tax (including income tax withholding), (3) the making of contributions to a qualified retirement plan (including required distributions, recharacterization of contributions or the rollover[b] of plan assets), (4) the filing of a Tax Court petition for redetermination of a deficiency or review of a Tax Court decision, (5) the filing of a claim for credit or refund, (6) the filing of any suit on such claim for credit or refund, or (7) any other act required or permitted under the internal revenue laws. In addition, this provision allows the IRS to waive or abate interest, penalties, and additions to taxes for periods after the date of the disaster, terrorist or military action. Applies to individuals and businesses.

a. The Katrina Emergency Relief Act of 2005 (P.L. 109-73) allows the IRS to extend deadlines that applied to filing returns, paying taxes, and performing certain other time-sensitive acts for certain taxpayers affected by Hurricanes Katrina, Rita, or Wilma, ending no earlier than February 28, 2006.

b. A rollover is the process of transferring the funds in one retirement plan to another without incurring income and penalty taxes.

Table 5. Tax Reimbursements

Internal Revenue Code Section	Description
Sec. 5708 Tax Reimbursement for Loss of Tobacco Products	In the case of a presidentially declared disaster, the Secretary of the Treasury shall reimburse (without interest) the amount of the internal revenue taxes previously paid or determined and customs duties paid on tobacco products, cigarette papers, and tubes removed, which were lost, rendered unmarketable, or condemned by a duly authorized official by reason of such disaster. Reimbursements are made only if such tobacco products or cigarette papers or tubes were held and intended for sale at the time of such disaster. The payments authorized by this section shall be made to the person holding such tobacco products or cigarette papers or tubes for sale at the time of such disaster. Applies to businesses.

Table 6. Retirement Plans—Rollovers

Internal Revenue Code Section	Description
Rollovers of Tax-Deferred Distributions into Retirement Plans—Deadline Extension Applies to sections: Sec. 402 Employer Retirement Plans and Sec. 408 Individual Retirement Accounts	Secs. 402 and 408 dictate that rollover distributions from tax-deferred plans received by the employee, participant, or beneficiary, must be transferred to an eligible plan within 60 days in order to avoid incurring income and penalty taxes. Both sections also allow for the Secretary of the Treasury to waive the 60-day period in hardship situations where failure to waive the deadline would be against equity or good conscience. Events that could be considered hardships include casualty, disaster, or other events beyond the reasonable control of the individual subject to the rollover deadline. Applies to individuals.

Table 7. Underpayment of Income Tax

Internal Revenue Code Section	Description
Sec. 6654 Failure by Individual to Pay Estimated Income Tax	An individual who underpays his or her estimated income tax is subject to a penalty equal to the interest that would accrue on the underpayment, for the period of the underpayment. The IRS is authorized to waive the underpayment penalty if the underpayment is due to casualty, disaster or other unusual circumstance and the imposition of the penalty would be inequitable and against good conscience. Applies to individuals.

Additional Resources

The toll-free IRS disaster help line is (866) 562-5227.

IRS Publications

Disaster Assistance and Emergency Relief for Individuals and Businesses
http://www.irs.gov/businesses/small/article/0,,id=156138,00.html

Publication 547, *Casualties, Disasters and Thefts*
http://www.irs.gov/pub/irs-pdf/p547.pdf

Publication 4492, *Information for Taxpayers Affected by Hurricanes Katrina, Rita, and Wilma*
http://www.irs.gov/pub/irs-pdf/p4492.pdf

CRS Reports

CRS Report RS22249, *Income Tax Relief in Times of Disaster*, by Pamela J. Jackson.

CRS Report RS22269, *Katrina Emergency Tax Relief Act of 2005*, by Erika Lunder.

CRS Report RS22344, *The Gulf Opportunity Zone Act of 2005*, by Erika Lunder.

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