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WRITTEN TESTIMONY OF TROY K. LEWIS

ON BEHALF OF THE

THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

BEFORE

THE UNITED STATES SENATE
COMMITTEE ON FINANCE
SUBCOMMITTEE ON TAXATION AND IRS OVERSIGHT

HEARING ON

TAX RELIEF AFTER A DISASTER: HOW INDIVIDUALS, SMALL BUSINESS,
AND COMMUNITIES RECOVER

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INTRODUCTION

Chairman Casey, Ranking Member Enzi, and Members of the Subcommittee, thank you for the opportunity to testify today regarding tax relief after a disaster. My name is Troy Lewis. I am the vice president and chief enterprise risk management officer at Heritage Bank in St. George, Utah. I am also a sole tax practitioner, adjunct faculty member at Brigham Young University in Provo, Utah and Chair of the Tax Executive Committee of the American Institute of Certified Public Accountants (AICPA). I am pleased to testify today on behalf of the AICPA.

The AICPA is the world's largest member association representing the accounting profession, with more than 400,000 members in 128 countries and a history of serving the public interest since 1877. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

AICPA members, like you and many others in the U.S., are all too familiar with the devastating consequences of disasters, such as Hurricanes Sandy and Isaac and more recently, the severe storms, fires, floods, landslides, and mudslides in Colorado.¹

We would like to applaud the Subcommittee for their consideration of tax relief for individuals, small businesses, and communities, after a disaster. We are pleased that Congress enacted the Katrina Emergency Tax Relief Act of 2005² and we commend the members of Congress for their dedication and hard work, over the years, in developing tax relief bills for disaster victims.³

NEED FOR PERMANENT AND TIMELY RELIEF

The AICPA continues to stress the need to include, in the Internal Revenue Code (IRC or "Code"), permanent tax provisions that will quickly aid affected taxpayers as they recover from the impacts of natural disasters. Families and communities impacted unexpectedly by disasters are often displaced from their homes, their livelihoods, and their businesses. We believe permanent relief, which is long-overdue, will provide disaster victims with certainty, fairness, and the ability to promptly receive the aid they need after a natural disaster, while reducing the administrative burdens on disaster victims and the Internal Revenue Service (IRS). Therefore, we urge Congress to enact tax legislation that permanently provides meaningful (and timely) relief, which is

¹ [IR-2013-75](#), "IRS Provides Tax Relief to Victims of Colorado Storms," September 16, 2013.

² [PL 109-73](#), "Katrina Emergency Tax Relief Act of 2005," September 23, 2005.

³ See [S. 1696](#), Hurricane Katrina Tax Relief Act of 2005, [S. 93](#), Investment Savings Access After Catastrophes Act of 2013, and [S. 2634](#), National Disaster Tax Relief Act of 2014.

automatically triggered by a declaration of a federal disaster rather than providing for such relief via individual bills following a disaster.

In order to provide assurance to disaster victims, it is important that tax relief provisions are made permanent. Although we cannot prevent natural disasters, predict when or where they will arise, or predict the scope of damages that will result, we know disasters occur annually on a regular basis throughout the country. Each year, we witness the far-reaching effects of these events, which frequently extend across state borders and Congressional districts, impacting hundreds of thousands of people. The implementation of permanent disaster relief provisions will afford taxpayers, across the nation, a certainty in the tax benefits they receive.

Our current system provides inconsistent tax relief. In the past, Congress has considered each disaster as an isolated event and restricted any special tax relief to such individual event. Unfortunately, this unsystematic process results in similarly-situated taxpayers receiving different tax benefits for comparable losses. It is important that all victims – whether they reside in Pennsylvania, Utah or some other state, and whether they endured a hurricane, a mudslide or other type of disaster – receive comparable relief. We recognize that certain tax benefits may not be available to every taxpayer due to his or her personal situation; however, the rules should be consistent among the various disasters.

We propose disaster tax relief in the form of legislation that would immediately take effect when a triggering event occurs. Under the current system, individuals and small business owners do not know what tax relief they will receive until Congress enacts legislation sometimes months or even years after the event.⁴ The AICPA is concerned about the struggles taxpayers face when they need to make home repairs and reopen their businesses immediately after the disaster, even though they may not obtain relief until sometime in the future. The uncertainty surrounding such delayed relief impedes recovery. Unexpected disasters are traumatic to the victims and devastating to small businesses. Families hope to reconstruct homes and small business owners need to rebuild storefronts, but without any extension of relief from Congress or a guarantee that relief is shortly on its way, disaster victims are forced to make difficult and financially burdensome decisions assuming no Federal tax assistance. We believe that providing tax relief in a timely manner will relieve victims from the long periods of uncertainty and concern regarding what tax relief they will receive and when they will receive it, and allow these families and communities to more swiftly recover, rebuild, and return to their homes and businesses.

⁴ PL 109-135, "Gulf Opportunity Zone Act of 2005," was enacted on December 21, 2005 to extend many of the provisions contained in the Katrina Emergency Tax Relief Act of 2005 to cover individuals and businesses affected by hurricanes Rita and Wilma, which occurred only a few months prior in September and October of 2005. However, victims of Hurricane Sandy in 2012 still await tax relief as H.R. 2137, "Hurricane Sandy Tax Relief Act of 2013," introduced in May of 2013, has yet to be enacted.

In order to provide timely relief, we recommend that Congress enact legislation that provides that extraordinary relief is available (i.e., the “trigger” occurs) when a taxpayer resides, or has a principal place of business located, in a Federal Emergency Management Agency’s (FEMA) “Disaster Declaration”⁵ area for which individual “disaster assistance” is available. Having a trigger mechanism that is activated through a federally-defined and controlled FEMA process will allow taxpayers the ability to promptly identify and timely receive tax relief for which they are eligible.

AICPA PROPOSALS

The AICPA urges Congress to consider the following ten legislative proposals as permanent tax provisions, which if enacted, would take effect upon the occurrence of the above mentioned federal disaster declaration trigger by FEMA.

1. Waive Individual Casualty Loss Minimums

Under present law, an individual taxpayer may generally claim a casualty loss⁶ on his/her tax return for disaster-related losses unreimbursed by insurance. The casualty loss is deductible for both regular tax and alternative minimum tax (AMT) purposes. In general, the deduction is calculated by taking the decline in the fair market value (FMV) of the property immediately before the casualty and the FMV after the casualty, then subtracting any insurance recovery or reimbursement and \$100 from the FMV decline. The remaining amount is reduced by 10 percent of the taxpayer’s adjusted gross income (AGI) to compute the deductible casualty loss.⁷ The current rules do not provide any relief to victims until their losses exceed these thresholds.

The AICPA recommends that Congress waive the casualty loss floor of 10 percent of AGI (section 165(h)(i))⁸ and the \$100 per loss floor (section 165(h)(2)) for losses attributable to a disaster event. The elimination of floors will provide additional relief to more individual taxpayer disaster victims. We also believe the current casualty loss deduction is unnecessarily complicated and lacks transparency. Many taxpayers do not know their AGI until after their tax returns have been prepared in the following year, which does not provide clarity to taxpayers at the time of the disaster.

⁵ Federal Emergency Management Agency’s [Disaster Declarations](http://www.fema.gov/disasters) are available at: <http://www.fema.gov/disasters>.

⁶ See [IRC section 165](#).

⁷ See [Treas. Reg. § 1.165-7](#).

⁸ All section references in this letter are to the Internal Revenue Code of 1986, as amended, or the Treasury regulations promulgated there under, unless otherwise specified.

2. Extend Net Operating Loss Carryback to Five Years

A net operating loss (NOL) is generally the amount by which a taxpayer's business deductions exceed its gross income. Under present law, a NOL experienced by either an individual or business may be carried back two years and carried forward 20 years to offset taxable income in those specified years.⁹

We propose a five-year carryback period for NOLs attributable to a disaster event under section 172(b)(1)(A)(i). The current NOL carryback of two years is too short for many taxpayers. An increased carryback period would allow disaster victims to take better advantage of the business losses they have suffered as a result of disasters. The proposal also gives individuals and small business owners the opportunity to amend additional prior tax returns in order to currently receive increased refund amounts that they can use to help rebuild after the disaster. It also allows taxpayers to receive their NOL offsets sooner rather than having to wait to carryforward a portion or all of their loss to future years.

We do not propose any change to the carry forward period of 20 years.

3. Increase Section 179 Expense Limits

Section 179 allows taxpayers to elect to immediately expense certain purchases on their current tax return rather than depreciating the cost of asset over its useful life.¹⁰ The section 179 expense allows businesses to deduct the full purchase price of qualifying equipment purchases from current gross income during the tax year. This provision is a tax incentive created to encourage businesses to buy equipment and invest in their future.

The section 179 deduction is generally permitted for the total cost of qualifying property, subject to three limitations:

- 1) Dollar Limit – Taxpayers may generally elect to expense up to a certain maximum dollar limit (generally \$25,000) of section 179 property placed in service during the tax year.
- 2) Property Cost Threshold – The dollar limit is reduced, but not below zero, if the cost of qualifying property placed in service during that year exceeds a maximum amount (\$200,000 in 2014).
- 3) Business Income Limit – The section 179 deduction may not exceed the taxpayer's business income.

⁹ See [IRC section 172](#).

¹⁰ See [IRC section 179](#).

For tax years 2010 through 2013, the dollar limit, or maximum deduction a taxpayer could elect to deduct in a year was \$500,000 (instead of \$25,000), an enhancement due to the passage of the American Taxpayer Relief Act of 2012.¹¹ For years beginning after 2013, the limit is currently \$25,000.¹²

We recommend that Congress increase the section 179 expensing limits under section 179(b)(1) in either the year of the disaster event, or the following year, by the lesser of a specified amount (\$100,000) or the cost of “qualified disaster assistance property,” as described in section 179(e)(1).¹³ We believe an increased limitation is appropriate for disaster victims because the dollar limit amount is meant for normal operational needs of businesses, rather than considering those disaster stricken small businesses that own severely damaged or completely destroyed equipment and capital assets.

The current section 179 deduction is intended to benefit all taxpayers and stimulate domestic business growth by providing a current cash-flow incentive for businesses to purchase, finance or lease equipment each year in addition to providing administrative relief from required bookkeeping requirements. However, the current section 179 expense limitation amounts are sometimes insufficient for victims who are affected by disasters and rely upon this incentive as a potential source for recovering and rebuilding businesses that are damaged or destroyed by a disaster. Therefore, an increase in the section 179 expense limitation would allow victims to receive immediate tax relief for unanticipated capital expenditures caused by disaster events.

4. Increase Property Replacement Period to Five Years

Under present law, when a taxpayer experiences a loss of business property that is completely or partially destroyed by fire or natural disaster, the period by which the taxpayer must replace the property to defer any resulting gain is limited to two years after the close of the first taxable year in which any part of the gain upon the conversion is realized.¹⁴ Taxpayers are required to make a timely election and asset replacement to defer any gains, which often results when the taxpayer receives an insurance settlement that is greater than the property's cost basis. If property is replaced after the two-year limit, disaster victims are not able to defer gains from insurance settlements and must pay income taxes on these proceeds if a gain from the casualty loss is the result.

¹¹ [PL 112-240](#), “American Taxpayer Relief Act of 2012,” January 2, 2013.

¹² See [JCX-1-14](#), the January 10, 2014 Joint Committee on Taxation report, for the complete list of 57 tax provisions expiring at the end of 2013. Among the tax deductions, credits, exclusions, and other expired provisions are business provisions, such as increased expensing under Code section 179.

¹³ Qualified disaster assistance property replaces or rehabilitates property damaged by the disaster event.

¹⁴ See [IRC section 1033\(a\)\(2\)\(B\)](#).

The AICPA recommends a permanent standard replacement period of five years (increased from two years) under section 1033(a)(2)(B) for all property damaged or destroyed by a disaster event including trade/business property, real property, and/or principal residences that are involuntarily converted during a disaster event.

The current two-year period to replace damaged property is particularly challenging for victims with property damaged by disaster events. For example, many communities impacted by disasters, such as Hurricane Sandy, include historic buildings that require an extensive permit application and approval process, as well as an extended rebuilding or renovation period. Additionally, recent industry trends show that a shortage of construction workers across the nation has become a severe problem, with 83 percent of construction firms reporting difficulty in finding qualified craft workers.¹⁵ A labor shortage in experienced craft workers, including professional carpenters and equipment operators, severely impedes the rate of rebuilding and reconstruction. Thus, a five-year replacement period would grant impacted disaster victims the valuable resource of time in rebuilding their properties, while claiming the benefits intended by the involuntary conversion provisions.

5. Waive the Penalty for Early Retirement Withdrawal

Under present law, individual taxpayers who make withdrawals from a qualified plan or individual retirement account (IRA) may be subject to an additional tax of 10 percent if the distribution is made before the individual reaches age 59.5 years old.¹⁶

We propose that no penalty tax is imposed on victims of a disaster event who withdraw up to or below a specified amount (\$100,000) from a qualified plan or IRA and repay that amount to the plan within five years. Any amount not repaid to the plan within five years of the date of withdrawal is taxable income during that fifth year unless a taxpayer elects to accelerate the amount as taxable income and pay the early withdrawal tax in an earlier year. Any income recognized under this section would not be subject to the 10 percent early withdrawal penalty under section 72(t) for distributions up to a specified amount (\$100,000). Additionally, we recommend the extension of the IRA "rollover" period to a longer time (5 years) than the normal 60 days allowed.

Our recommendation would allow affected taxpayers to immediately access their own retirement funds while waiting for government assistance and insurance reimbursements that are otherwise not immediately forthcoming. The extension of the IRA "rollover" period beyond the normal 60 days also offers victims the time they need to recover and

¹⁵ See [AGC of America article](#): "Eighty-three Percent of Construction Firms Report Having Trouble Finding Qualified Workers to Meet Growing Demand for Construction Services," and [summary article](#) of "Worker Shortage Survey Analysis," October 22, 2014.

¹⁶ See [IRC section 72\(t\)](#).

reestablish financial stability after a disaster. Retirement withdrawals similar to this provision were previously allowed, under section 1400Q(a), for "hurricane" disasters. However, to be clear, our recommendation includes all federal "disaster declaration" events, including but not limited to "hurricanes."

6. Housing Exemption for Displaced Individuals

Under present law, personal exemptions are deductions that individuals are entitled to claim for themselves and any dependents they support.¹⁷ Generally, a taxpayer may claim an exemption amount that is comprised of the exemptions for the individual taxpayer, his/her spouse, and dependents. The exemption amount is adjusted annually for inflation (\$3,900 in 2013, \$3,950 in 2014).

We propose to allow an additional partial or full exemption (as defined under section 151(d)) to individuals who provide at least 60 days of temporary rent-free housing to a person dislocated by a disaster event. Taxpayers could claim this exemption only once for each such person by claiming the exemption for said dislocated person for the tax year which contains the latter of the 60th day or the day that the temporary housing period ends. The exemption amount is calculated as the number of rent-free days (up to 365) provided to the displaced individual, divided by 365, and multiplied by the personal exemption allowed for a single taxpayer during the applicable year. The maximum number of individuals for which a taxpayer may claim this exemption is four individuals per disaster. Furthermore, no phase-out under section 151(d)(3) would apply to this exemption. The displaced individual would continue to otherwise be subject to the normal rules (for purposes of evaluating their own personal exemption for themselves, spouses, and dependents), and entitled to claim a full personal exemption for themselves and others, as appropriate, as though no disaster had occurred.

Current legislation does not offer an incentive for individuals to extend free temporary housing to disaster victims. Our proposal provides a tax deduction that incentivizes people within a community to supply free housing to those victims displaced from their homes and do not have a place to live or enough emergency savings to pay for a temporary residence.

7. Discharge of Indebtedness

Under present law, a lender's forgiveness of a taxpayer's debt (i.e., a discharge of indebtedness) is generally considered gross income to the taxpayer, and therefore, a realized taxable amount.¹⁸

¹⁷ See [IRC section 151](#).

¹⁸ See [IRC section 108](#).

We propose to allow individual victims of disasters to exclude from taxable income, under section 108, cancellation of debt income for non-business debts (provided that the cancellation occurs within one year of the beginning date of the disaster event). The discharging entity must certify that the discharge is a direct result of loss, property damage, or other factors caused exclusively by the disaster event.¹⁹

The current rules are harsh and unintuitive for victims who suffer from significant losses due to a disaster. If individuals affected by a disaster are unable to repay their outstanding loans, they are also generally unable to pay tax on the resulting phantom income caused by debt forgiveness. The AICPA proposal would allow victims to exclude non-business debt from taxable income if the debt were forgiven by a governmental agency or certain financial institutions.

8. Work Opportunity Tax Credit

Under present law, the Work Opportunity Tax Credit (WOTC)²⁰ is a federal tax credit available to employers for hiring individuals from certain target groups who have consistently faced significant barriers to employment. WOTC is a program that incentivizes workplace diversity and promotes the hiring of groups facing high rates of unemployment such as veterans, youths, and others. The WOTC is a direct benefit to the employer as a tax credit and it is calculated based on the number of hours an employee works.

We propose, under section 38, to allow a tax credit of 40 percent of qualified wages (up to \$6,000 in qualified wages per employee) for specified disaster-damaged businesses. Qualified wages (as defined for WOTC purposes under section 51(a)) are wages paid to employees who are unable to work because their employer's business was rendered inoperable due to damage from the disaster event. The Code would provide that qualified wages for an employee are calculated based on their regular wages, not including overtime, for the lesser of the period the business is rendered inoperable or 16 weeks. Specified disaster-damaged businesses must have the affected place of business located within the declared disaster area, employ less than 200 full-time equivalent employees, and may only claim the credit for employees who were employed at the affected place of business for at least 30 days prior to the disaster event.

¹⁹ Similar to provision enacted in 2005: see [Sec. 401](#), "Exclusions of certain cancellations of indebtedness by reason of Hurricane Katrina," from Title IV, Additional Tax Relief Provisions, of [PL 109-73](#), "Katrina Emergency Tax Relief Act of 2005," September 23, 2005.

²⁰ See [JCX-1-14](#), the January 10, 2014 Joint Committee on Taxation report, for the complete list of 57 tax provisions expiring at the end of 2013. Among the tax deductions, credits, exclusions, and other expired provisions are business provisions, such as the Work Opportunity Tax Credit.

The AICPA proposal also allows the work opportunity credit to be claimed by employers for wages paid to eligible employees located in a disaster area. Eligible employees are individuals who have a principal place of abode in the declared disaster area on the day of a specific disaster event.

The current WOTC provision does not include disaster victims as a target group. However, disaster events frequently shut down local businesses and leave a community with individuals and small business owners without jobs or places of employment. Therefore, allowing businesses to include disaster victim wages as part of the WOTC would significantly help to promote the hiring of individuals in areas affected by disasters and also expedite the restoration of the disaster-damaged communities.

9. Increase the Medical Expense Deduction

Under present law, individual taxpayers can claim the medical expense deduction as an itemized deduction for unreimbursed medical expenses. Taxpayers may deduct the amount by which total medical expenses exceed 10 percent of his/her AGI or 7.5 percent if the taxpayer is 65 or older (this 7.5 percent limitation is a temporary exemption from January 1, 2013 to December 31, 2016 for individuals and spouses who are age 65 and older).²¹

We propose to eliminate the medical deduction floor (section 213(a), generally 10 percent of AGI, and 7.5 percent for taxpayers over 65) for an individual who incurs deductible medical expenses directly related to an injury caused by a disaster. This reduction is available only for the directly related expenses incurred for up to two tax years (the year of the event and the subsequent year).

The current medical expense deduction is complicated and severely restricted in its use. Impairment, damage and/or loss resulting from an unexpected disaster affect not only physical property but also the health and well-being of victims. The intent of our proposal is to simplify the medical expense calculation and vastly increase the tax benefit for victims of disaster events.

CONCLUDING REMARKS

The AICPA acknowledges the prompt response and aid that Congress provides to individual, self-employed and business taxpayers impacted by natural disasters each year. However, the implementation of timely and permanent disaster relief provisions as foundational aid will allow disaster victims to have certainty, fairness, consistency, and the ability to promptly receive the relief they need after a natural disaster. Additionally, a

²¹ See [IRC section 213](#).

set of standard disaster tax relief provisions will minimize the administrative burdens on the victims as well as the IRS. Therefore, we urge Congress to enact tax legislation that is timely, permanent, and triggered by a federal disaster declaration

Again, Mr. Chairman, thank you for the opportunity to testify in support of disaster tax relief, and I would be happy to answer any questions you and the Members of the Subcommittee may have.