



NATURAL DISASTERS

THE CASE FOR PERMANENT TAX RELIEF



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EXECUTIVE SUMMARY

Every year, natural disasters victimize tens of thousands of Americans. Floods, tornadoes, hurricanes, drought and forest and brush fires take lives; destroy homes and businesses; and tear apart communications and transportation networks. The financial losses can run into the billions. In 2014 alone, eight events each created a billion dollars or more in damages.¹ Hurricane Katrina, which struck the Gulf Coast in 2005, caused more than \$151 billion in damages and claimed more than 1,800 lives. In 2012, Hurricane Sandy left behind \$67 billion in damages along the eastern seaboard.

Individual Americans, civic groups, charitable organizations, and the federal government pitch in with help, generally with Washington in the lead through a proven process that has worked well for some 65 years. Set in motion by a presidential disaster declaration, the Federal Emergency Management Administration (FEMA) sets up operations in affected areas to coordinate and help finance recovery.

A HOLE IN THE DISASTER RELIEF SYSTEM

But in one regard, the process has been less fair and less consistent than it should be. In some disasters, the federal government has supplemented direct aid by adjusting tax rules so that disaster victims can keep and use more of their own money to pay bills, repair damage, and rebuild businesses. The concept is simple — tax rules and penalties that make sense in normal circumstances so that people pay their fair share become illogical when disaster wipes out homes, businesses, and jobs.

Because tax relief is dependent on Congressional action after every disaster, it has been available only sporadically — provided for some disasters, but denied for others without clear reason. For Hurricane Katrina, Congress granted tax relief. For Hurricane Sandy it did not. In 2008, Congress enacted the National Disaster Relief Act of 2008, which granted tax relief to all taxpayers affected by federally-declared disasters in 2008 and 2009. Since then, there's been no tax relief at all.

This disparate treatment hurts every person and business in disaster areas by slowing general recovery, prolonging unemployment created by the disaster, and adding to the cost of various government unemployment and income support programs.

¹ ncdc.noaa.gov/billions/events

AUTOMATIC, CONSISTENT AND PERMANENT TAX RELIEF FOR DISASTER VICTIMS

Why not treat every disaster alike? Shouldn't every victim get the same helping hand from Washington? The CPA profession believes Congress should provide fairness, certainty, and consistency with permanent tax relief measures that automatically apply once the President issues a disaster declaration.

Based on experience and previous disaster tax bills, the CPA profession has identified 10 disaster tax relief measures that should be permanently enacted into law. The relief, which would expand victims' financial capabilities and allow greater access to their own funds, would be automatic for taxpayers with a main residence or business in a federal disaster area.

Among other things, the proposals would enable victims to use their own money from retirement accounts without penalty. They also would ease limits on deductions for casualty losses for individuals and increase the deduction for medical expenses. Businesses would gain additional time to claim net operating losses and be able to expense a greater amount of business equipment purchases.

Congress should close the gap in disaster relief and permanently provide automatic tax relief that is fair, consistent, and certain. All disaster victims across our country deserve help on the same terms so they can rebuild as fast as possible.



NATURAL DISASTERS

THE CASE FOR PERMANENT TAX RELIEF

Every year, natural disasters victimize tens of thousands of Americans. Floods, tornadoes, hurricanes, drought and forest and brush fires take lives; destroy homes and businesses; and tear apart communications lines and transportation networks. Sometimes, the devastation is so great that a single word — Katrina or Sandy — lives in our minds to sum up the horror.

Rich and poor, people of every ethnicity and color, individuals of prominence and those who are little known may be afflicted in any part of the country. Nature does not discriminate.

The human suffering is immeasurable; the financial losses can run into the billions. In 2014 alone, eight events each created a billion dollars or more in damages.¹ Hurricane Katrina, which struck the Gulf Coast in 2005, caused more than \$151 billion in damages and claimed more than 1,800 lives. In 2012, Hurricane Sandy left behind \$67 billion in damages along the eastern seaboard. In April and May 2011, scores of tornadoes combined for some \$21 billion in damages across more than a dozen states. Severe drought and heat, though less dramatic, wiped out some \$31 billion in food crops in 2012.

The number of catastrophic events and the dollar costs vary from year to year. The only constants are that they *will* happen and that, as a nation, we will reach out to help. Instinctively, charities, religious organizations, civic groups, and individuals from across the country step forward to console the wounded, offer food and shelter, clear debris, and help to rebuild.

Washington pitches in, too, through a well-tested process that has provided support from the federal government for some 65 years. Once put in motion by a presidential disaster declaration, the Federal Emergency Management Administration (FEMA) sets up operations in affected areas to coordinate and help finance recovery. The country works hard to help victims reassemble their lives as quickly as possible.



¹ ncdc.noaa.gov/billions/events

A HOLE IN THE DISASTER RELIEF SYSTEM

In one regard, however, the current process has been less predictable, less fair, and less consistent than it should be. In some disasters, the federal government has supplemented direct aid by temporarily adjusting tax rules so that disaster victims can keep and use more of their own money to pay bills, repair damage, and rebuild businesses. This logical, proven tax relief has helped millions get back on their feet — without additional direct outlays from the U.S. Treasury. But this type of help has been available only sporadically. It's been provided in some years for some disasters, but denied in other years for other disasters without any evident reason or rationale. For Hurricane Katrina, as well as Wilma and Rita, Congress granted tax relief. For Sandy and Isaac, Congress did not. For 2008 and 2009, Congress enacted broad legislation making tax relief automatic for federally declared disasters. Since then, there's been no tax relief.

Why not treat every disaster alike? Isn't it fair and reasonable for every victim to count on the same helping hand from Washington? It's time to fix that inconsistency and give every American an equal chance to rebuild after a disaster.



THE DISASTER RELIEF PROCESS — A FEDERAL SYSTEM SINCE 1950

Before 1950, disaster relief was generally left to state and local government and private charitable groups. Since then, it has shifted from “a largely uncoordinated and decentralized system of relief funding to one dominated by the federal government.”²

The change partly reflected the increasing complexity of relief efforts when disasters cross state lines and involve interconnected infrastructure such as highways, railroads, airports, utilities and communications networks. Civil defense concerns, including fear of nuclear conflict during the Cold War, were an additional impetus for a centralized response with dollars and coordination from the federal government.

The shift toward Washington began with enactment of the Federal Disaster Relief Act of 1950. It empowered the President for the first time to offer federal aid without a specific act of Congress. Subsequent laws expanded the types of federal aid to include direct assistance to individual citizens and households in addition to funding provided to local and state government agencies. Today, federal disaster relief efforts are governed by the Robert T. Stafford Disaster Relief and Emergency Assistance Act, enacted in 1988, which empowered the President to issue major disaster, emergency, and fire management declarations. It also established a permanent Disaster Relief Fund (DRF) to maintain relief infrastructure and cover expenditures for “normal” disasters involving costs of less than \$500 million. Following a request for help from state governors, a presidential declaration automatically triggers funding from the DRF for three broad types of aid — individual

assistance such as housing and disaster-related unemployment; public assistance for removing debris and repairing or replacing damaged structures such as roads, bridges, utilities, and public buildings; and hazard mitigation to reduce the potential impact of future disasters.³

Historically, annual appropriations for the DRF have not been sufficient for a full response to actual disasters, and Congress generally has been required to appropriate additional funds as disasters occur. From FY 2000 to FY 2013 some \$123.2 billion has been paid out through the DRF. That’s an average of about \$9 billion a year, but outlays can vary substantially from year to year. Nearly \$48 billion was dispensed in FY 2005 alone, primarily in response to Hurricane Katrina, which required nine separate supplemental appropriations by Congress.

Although relief measures have generally passed quickly with bi-partisan support, disaster funding occasionally has been slowed by political or fiscal considerations. In some instances, disaster legislation has become a vehicle for unrelated funding that might not have passed on its own. For example, the Disaster Relief and Summer Jobs Act of 2010 also included \$33 billion in war funding.⁴

FEMA generally administers the relief, under a National Disaster Recovery Framework, that assigns lead responsibility for specific functions to six separate federal agencies. Adopted in 2010, this Framework reflected consultations with federal, state, local, and tribal government agencies, as well as private sector partners.

² “Disaster Relief Funding and Emergency Supplemental Appropriations,” Congressional Research Service, April 12, 2011

³ Ibid, CRS

⁴ Ibid, CRS

THE TAX RELIEF CHALLENGE

Unfortunately, one type of help — tax relief — that disaster victims should get has become a bit of a guessing game. It's been granted for some disasters, but denied in others where the need is as great or greater. The concept is simple — tax rules and penalties that make sense in normal circumstances so that people pay their fair share become illogical when disaster wipes out people's homes, businesses, income, and jobs. It makes little sense for the government to pay out aid with one hand, but tax victims' money with the other.

In 2005, Congress provided tax relief to victims of hurricanes Katrina, Rita, and Wilma by enacting the Gulf Opportunity Zone Act, which enabled early access to funds in IRAs and other retirement accounts without the normal penalties, expanded deductions for casualty losses by removing various income limitations, and eased the terms for earned income tax credits and refundable child tax credits. It also allowed victims to benefit from debt cancellation without counting it as income.⁵ After all, if you can't pay your debts, you probably don't have money to pay taxes either. Relief also was granted in 2008 to victims of flooding in the Midwest, and the National Disaster Relief Act of 2008 extended relief, in advance, to individuals in all federally declared disaster areas in 2008 and 2009.⁶

But Americans victimized by disasters since 2010, when the last automatic tax relief expired, haven't received the same help.⁷

Legislation to grant tax relief to victims of Hurricane Isaac, which hit many of the same locations as Katrina, Rita and Wilma, stalled in 2013. Tax relief for Hurricane Sandy, which affected two dozen states, has been stuck in Congress since 2012. The National Disaster Relief Act of 2014, introduced with bi-partisan sponsorship to cover disasters that occurred in 2012, 2013 and 2014, never made it out of committee.

Unless tax relief or other aid is approved in the early stages of a disaster while emotion is high, it tends not to happen. As the images of disaster fade from memory, enthusiasm for relief measures dims, too. Other concerns and priorities move to the fore.

This disparate treatment hurts every person and business in disaster areas by slowing general economic recovery, prolonging unemployment created by the disaster, and adding to the cost of various government unemployment and income support programs.

Rep. Bill Pascrell (D-NJ), who co-sponsored the Natural Disaster Tax Relief Act, summed it up well: Because of this inconsistent treatment, disaster victims are "left holding the bag."⁸

"It's only fair communities hit hard by recent natural disasters get the same care and opportunities to rebuild that other parts of the country received," said Rep. Tom Reed (R-NY), who introduced the legislation in the last Congress. "Right now, there's no consistency in tax relief for natural disasters and that's putting a real strain on anyone

⁵ "Tax Law Changes Related to Hurricanes, Katrina, Rita and Wilma," Internal Revenue Service, January 2006, irs.gov/uac/Tax-Law-Changes-Related-to-Hurricanes-Katrina,-Rita-and-Wilma

⁶ "Tax Impacts of Natural Disasters," by Heather Drake for Beta Alpha Psi Journal, March 13, 2014, bappdx.org/tax-impacts-of-natural-disasters/

⁷ The National Disaster Relief Act of 2008, signed into law on October 3, 2008, provided automatic tax relief for individuals affected by a federally declared disaster during 2008 and 2009. It expired at the end of 2009.

⁸ "Pascrell Fights for Tax Relief for Federally Declared Natural Disasters," August 5, 2014, pascrell.house.gov/media-center/press-releases/pascrell-fights-for-tax-relief-to-federally-declared-natural-disasters

trying to get back on their own two feet. Families that recently went through a natural disaster fairly deserve the same treatment Congress has historically given to the families of natural disasters in years past.”⁹

“To provide fairness, consistency, and certainty for disaster victims, the CPA profession believes Congress should enact permanent tax relief measures that automatically apply once a presidential disaster declaration is issued.”

THE CPA PROFESSION HAS AN ANSWER

To provide fairness, consistency and certainty for disaster victims, the CPA profession believes Congress should enact permanent tax relief measures that automatically apply once a presidential disaster declaration is issued. Similarly situated citizens should be treated alike with automatic and legally mandated access to the same tax benefits for comparable losses. The help they receive should not vary because one disaster affects more people than another, or the damage is more devastating, or the spokespeople more eloquent, or the images more heartrending.

Any individual who loses a home, or a business or a job faces a difficult uphill battle for recovery. Victims need to know from day one where they stand, what taxes they will pay, and what relief they can count on. With that knowledge, they can figure out what

funds will be available and the best way to use them. A disaster relief process that allows a taxpayer to access a retirement account without penalty, for example, opens a host of financial options that may not be available if a penalty payment is required. It’s tough enough to bounce back from disaster without having to guess about the tax consequences, whether tax relief is on the way, when it might arrive, and what exactly it will cover. It’s counterproductive if tax penalties created for non-disaster situations prevent disaster victims from using their own money to rebuild. But, under the current system, relief may come months or years after a disaster — or not at all — and penalties and limits on credits and deductions may wall off money that should be available for digging out.

Fast and guaranteed relief that lets disaster victims know where they stand from day one will eliminate the guesswork so that families and businesses can make informed decisions that speed recovery. A permanent and consistent set of rules for disaster tax relief is smart public policy that will provide fair treatment for disaster victims and help communities get back on their feet faster. Consistency helps the IRS, too, by easing the burden and cutting the cost of administering different rules for different taxpayers caught in different disasters.

The CPA profession has a solution. Based on experience with past tax relief and in partnership with state CPA societies, which have long urged consistent tax treatment for disaster victims and have worked closely with FEMA and the IRS in helping taxpayers as they rebuild, the AICPA has identified 10 disaster tax relief measures that should be permanently enacted into law. The relief,

⁹ “Reed Bill Would Provide Tax Relief to Federally-Declared Natural Disasters,” August 5, 2014, reed.house.gov/press-release/reed-bill-would-provide-tax-relief-federally-declared-natural-disasters

much of which has proven successful in past disasters, would effectively expand victims' financial capabilities and allow greater access to their own funds. It would be automatically triggered for taxpayers residing in or with a principal place of business located in a federal disaster area and for which FEMA has authorized "individual assistance."

Among other things, the profession's proposals would enable disaster victims to access their own funds more easily by waiving the normal penalty for early withdrawal from retirement accounts. They would provide significant financial benefit to individuals by easing limits on deductions for casualty losses for disaster damages not covered by insurance, increase the deduction for medical expenses, and allow victims to benefit from cancellation of a debt without reporting it as income. The proposals would help workers and businesses alike by offering a tax credit to businesses that continue to pay wages to workers when disaster shuts down their workplace.

We also propose benefits to directly assist affected businesses by extending the time period for net operating losses, raising the expense limit for purchases of business equipment, and increasing from two to five years the property replacement period for property damaged by a disaster. Our proposals also would provide a financial incentive in the form of an additional exemption for taxpayers who provide housing for individuals displaced by a disaster.

The proposals are explained in detail in the attached Appendix.

"Based on experience with past tax relief and in partnership with state CPA societies ... the AICPA has identified 10 disaster tax relief measures that should be permanently enacted into law."

A CALL TO ACTION

We can't predict when or where, but every year natural disasters tragically disrupt lives. They inflict enormous personal pain and create billions of dollars in property damage and other losses. Every year, tens of thousands, sometimes millions, of Americans confront the task of rebuilding. They look to government for help, and substantial aid rolls in. But no system is perfect. In disaster relief, one easily-fixable flaw stands out — the failure to provide the same consistent level of tax relief to every victim in every federal disaster area.

It's time to close that hole in the system and permanently provide automatic tax relief that is fair, consistent, and certain so that every disaster victim receives help on the same terms and can rebuild as fast as possible. Congress should do it now.

APPENDIX

AICPA PROPOSAL FOR PERMANENT DISASTER TAX RELIEF

1	Waive Individual Casualty Loss Limitations	Waive the casualty loss floor of 10 percent of adjusted gross income (AGI) (section 165(h)(i)) ¹ and the \$100 per loss floor (section 165(h)(2)) for losses attributable to a disaster event. The purpose of this provision is to extend adequate relief to the affected taxpayers under section 165(h)(i).
2	Extend Net Operating Loss Carryback to Five Years	Allow a five-year carryback period for net operating losses (NOLs) attributable to a disaster event under section 172(b)(2). By allowing a five-year carryback period for NOLs attributable to a disaster event, affected taxpayers will have the benefit of an extended carryback (increase of three years) from the normal NOL carryback period of two years.
3	Increase Section 179 Expense Limits	Increase 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 property,” as described in section 179(e)(1). “Qualified property” replaces or rehabilitates property damaged by the “disaster event.” This provision is intended to provide immediate tax relief to business owners for unanticipated capital expenditures caused by the disaster event.
4	Increase Property Replacement Period to Five Years	Allow a five-year replacement period (increased from two) under section 1033(a)(2)(B) for property damaged or destroyed by a disaster event. For certain disasters that have occurred, a five-year replacement period is already in place. This provision simply makes five years the standard replacement period. Also, allow this revision to the replacement period to cover trade/business property, real property, and/or principal residences that are involuntarily converted during a disaster event.

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¹ All section references in this Appendix are to the Internal Revenue Code of 1986, as amended, or the Treasury regulations promulgated there under, unless otherwise specified.

5	Waive the Penalty for Early Retirement Withdrawal	<p>Impose no tax on qualified disaster victims who withdraw up to a specified amount (\$100,000) from a qualified plan or individual retirement account (IRA) and repay that amount within five years. Any amount not repaid within five years of the date of withdrawal is taxable income during that fifth year unless a taxpayer chooses to report the amount as income and pay the tax in any 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). Such favored distributions were previously allowed under section 1400Q(a) for "hurricane" disasters; however, this provision would include all federally declared "disaster events," including but not limited to hurricanes. One purpose of this provision is to allow affected taxpayers to access their own funds immediately while waiting for government assistance and insurance reimbursements that are not immediately forthcoming.</p>
6	Allow a Housing Exemption for Displaced Individuals	<p>Allow a 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 may claim this exemption only once for each such person and shall claim the exemption 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, divided by 365, and multiplied by the personal exemption allowed 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 event. Furthermore, no phase-out under section 151(d)(3) would apply to this exemption.</p>
7	Allow Discharge of Indebtedness	<p>Allow disaster victims 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. Currently, the Code provides only limited exclusions for discharge of indebtedness income. This recommendation would allow for a much needed provision that recognizes that if individuals affected by a disaster are unable to repay their outstanding loans, they are also likely unable to pay tax on the phantom income.</p>

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8	Employee Retention Credit for Affected Employers	Allow a credit under section 38 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 Work Opportunity Credit 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 fewer 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.
9	Permit the Use of Prior Year's Income to Calculate the Earned Income Tax Credit, Child Tax Credit, and Premium Tax Credit	Allow affected taxpayers in the disaster area to use either their current year or previous year's income amounts for purposes of calculating the Earned Income Tax Credit (section 32), the Child Tax Credit (section 24) and the Premium Tax Credit (section 36B). With this suggested provision, the affected taxpayer would have the opportunity to use a more beneficial income year, thus allowing the affected taxpayer the opportunity to benefit from various credits that might not have been available to the taxpayer because of the fluctuation of income caused by the disaster.
10	Increase the Medical Expense Deduction	Eliminate the medical deduction floor percentage (as defined under 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 the disaster event. 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 purpose of this provision is to provide potential relief from the deduction limitations for taxpayers incurring unexpected disaster related medical expenses.



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