Southeastern Disaster Tax Relief Act

In response to the tornadoes, severe storms, and flooding that have devastated parts of the Southeast over the past few weeks, this tax relief bill would provide assistance to families, businesses, and local governments as they recover from the tragic storms. This legislation consists of temporary tax provisions that were included in previous natural disaster responses that enjoyed overwhelming bipartisan support including the Heartland Disaster Tax Relief Act, Gulf Opportunity Zone Act, Katrina Emergency Tax Relief Act, and the tax relief provided to southern Kansas due to flooding in 2008. The bill is fully offset by rescinding unobligated federal spending, and it will not increase the federal debt.

Under this bill, the Southeastern disaster area would be established in the Internal Revenue Code to designate regions in the South that were affected by the recent tornadoes, severe storms or flooding. In order for counties to be eligible for all of the benefits in the bill, they must be Presidentially-declared major disaster areas and determined by the President to warrant individual assistance for damage between April 13, 2011, and June 7, 2011. Additionally, a limited number of benefits will be provided for areas designated eligible for public assistance by the Federal Emergency Management Agency (FEMA), including expensing for demolition and clean-up costs, education tax benefits, qualified retirement withdrawals, suspension of limitations on charitable contributions and casualty losses, special exemption for housing displaced individuals, look-back rule for earned income tax credit and child tax credit, exclusion of cancellation of indebtedness income, and the extension of replacement period for non-recognition of gains.

Under these criteria set forth in the Robert T. Stafford Disaster Relief and Emergency Assistance Act, the eligible states are: Alabama, Arkansas, Georgia, Kentucky, Mississippi, Missouri, North Carolina, Oklahoma, and Tennessee.

Tax Provisions in the Legislation

Penalty-Free Withdrawals from Retirement Plans
This bill waives the 10 percent penalty tax for early withdrawals from retirement plans to allow individuals who were affected by the storms to utilize their savings in their recovery. The total amount of penalty-free distributions an individual can receive from all plans, annuities, or IRAs is $100,000. Individuals would be permitted to pay the income tax on distributions over a three-year period, and they could also re-contribute the distributions over a three-year period and receive rollover treatment.

Losses to Individual's Home and Property
Personal casualty losses result from the damage, destruction or loss of property from unexpected events, such as natural disasters. Under present law, these losses are deductible by taxpayers who itemize only to the extent that the losses exceed 10 percent of individuals' adjusted gross income and a $100 floor. This proposal eliminates the 10 percent and $100 floor requirements for casualty losses resulting from these storms for 2011, allowing the full dollar amount of the losses not reimbursed by insurance to be deducted on individuals' 2011 tax returns.

Tax-Exempt Bond Financing
This bill provides states and local governments in the Southeastern disaster area the authority to issue private activity bonds to spur private investment in the areas affected by the storms. The amount of tax exempt bonds each state may issue is based on the state's population in the disaster area multiplied by $1,000, resulting in $3.2 billion in bond authority for Alabama. Bond proceeds can be used to pay for acquisition, construction, and renovation of nonresidential real property, low-income rental housing, low-income single-family residential housing, and public utility property (e.g. gas, water, electric, and telecommunication lines). In order to participate, businesses must have either suffered an economic loss attributable to the disaster or be designated by the state as replacing a business that suffered a loss. These provisions would remain in effect until January 1, 2018.

Employee Retention Credit for Employers
This bill provides a 40 percent tax credit to small businesses who continue to pay their employees while their business is inoperable. These provisions apply to employers with fewer than 200 employees for wages paid up to $23,400 prior to January 1, 2012.

Low-Income Housing Credit
Under current law, states receive allocations of low-income housing credit based on population. This proposal allows states to receive additional housing credit allocations through 2013 of $8 per person in the disaster area.

Special Rules for the Earned Income Tax Credit and Child Tax Credit
Under current law, these tax benefits are only available to working individuals with earned income. However, given the number of individuals and businesses affected by the storm and the resulting loss of employment, this bill allows individuals in affected areas to calculate their earned income for the Earned Income Tax Credit and Child Tax Credit using earnings from the previous year if their income this year is less than it was last year.

Expensing for Demolition and Clean-up Costs
Businesses may immediately expense 50 percent of the demolition and clean up costs associated with the disaster rather than capitalize the costs in the taxpayer's basis and depreciate over time. These benefits would expire on December 31, 2013.

Special Rules for Small Timber Producers
Under current law, taxpayers may only deduct $10,000 of reforestation cost. The amendment raises the limit to $20,000 and allows losses to be carried back for 5 years, rather than two years. The proposal only applies to taxpayers owning less than 500 acres of timber.

Treatment of NOL Attributable to Disaster Losses
This bill extends the net operating loss carryback period from two to five years for net operating losses attributable to casualty losses caused by the disaster and new investment and repairing existing investment in the areas damaged by the storms.

Tax Relief for Public Utilities
This legislation allows entities with casualty losses associated with public utility property to

either carryback a net operating loss attributable to the casualty loss for 10 years or treat the casualty losses as having occurred 5 years prior to the storm. Additionally, public utility companies may carry back net operating losses for five years.

Credit to Holders of Tax Credit Bonds

This proposal authorizes the affected states to issue debt service tax credit bonds providing credits against Federal income tax instead of interest payments. These bonds allow states to provide assistance to communities unable to meet their debt service requirements as a result of the storm. These benefits expire January 1, 2013.

Education Tax Benefits

Current law provides a Hope Scholarship Credit for the first two years of postsecondary education equal to 100% of the first $1,000 of qualified tuition and related expenses, and 50% of the next $1,000 for a maximum of $1,500. There is also a Lifetime Learning Credit available to college students equal to 20% of the first $10,000 in qualified tuition and related expenses. This proposal doubles the maximum for the Hope Credit to $3,000, and it doubles the lifetime learning percentage from 20% to 40% for a maximum of $4,000. These benefits are for taxable years 2011 and 2012.

Suspension of Limitations on Charitable Contributions

The bill allows individuals and corporations to deduct cash contributions towards disaster relief efforts without regard to percentage limitations for 2011.

Adjustments Regarding Taxpayer and Dependency States

This provision gives the Treasury Secretary the authority to make adjustments to ensure that taxpayers do not lose any deduction or credit or experience a change of filing status by reason of temporary relocations caused by the disasters (i.e. residency requirements for dependents) for 2011 and 2012.

Advance Refunding of Tax-Exempt Bonds

Advance refunding allows the bond issuer to restructure eligible debt by refinancing at a lower rate or spreading interest payments over a longer period of time. States and municipalities are provided one additional advance refunding for certain governmental bonds and private activity bonds. The maximum amount of advance refunding bonds for each state is equal to one half of the state's amount of the new tax exempt bond authorization.

Special Rules for Mortgage Revenue Bonds

Certain requirements for mortgage revenue bonds issued under the private activity bond authorization may be waived including the first-time homebuyer requirement. The income rules allow the mortgages to be made to mortgagors whose family incomes are 140 percent or less of the applicable median family income. Additionally, the proposal increases from $15,000 to $150,000 the amount of a qualified home-improvement loan to repair residences in the disaster area. These provisions expire December 31, 2016.

Additional Exemption for Housing Displaced Individuals
This proposal provides an additional exemption of $500 for housing each individual displaced by the disaster for 60 consecutive days with a maximum deductable amount of $2,000. These benefits are for taxable years 2011 and 2012.

Exclusion of Certain Cancellation of Indebtedness Income
Gross income generally includes any amount realized from the discharge of indebtedness, such as mortgage debt. This bill would provide an exemption for indebtedness discharged by commercial lenders when the forgiveness is in response to damage suffered from the disaster. These provisions expire for discharges occurring before January 1, 2013.

Extension of Replacement Period for Non-Recognition of Gain
This bill extends from two to five years the replacement period in which a taxpayer may replace property that was compulsorily or involuntarily converted as a result of the disaster.

Revenue Offset

Rescission of Unobligated Federal Funds
All of these provisions are offset by rescinding $12 billion in unspent and uncommitted federal funds. The President's Fiscal Year 2011 budget indicated that over $700 billion in federal funds are unobligated, $80 billion of which are in accounts that are between six and 20 years old. Under CBO conventions, it will take rescissions of approximately $12 billion to pay for the projected cost of the bill (approximately $5-6 billion). Although the official score has not been finalized by the Joint Committee on Taxation, this projection is in line with the Heartland Disaster Tax Relief Act.