TECHNICAL EXPLANATION
OF H.R. 7006, THE
"DISASTER TAX RELIEF ACT OF 2008"

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a technical explanation of H.R. 7006, the "Disaster Tax Relief Act of 2008."

[1] This document may be cited as follows: Joint Committee on Taxation, *Technical Explanation of the Revenue Provisions of H.R. 7006, the "Disaster Tax Relief Act of 2008"* (JCX-73-08), September 24, 2008. This document can also be found on our website at www.jct.gov.

A. Losses Attributable to Federally Declared Disasters (sec. 2 of the bill and secs. 63 and 165 of the Code)

Present Law

Casualty Losses

Under present law, a taxpayer may generally claim a deduction for any loss sustained during the taxable year and not compensated by insurance or otherwise.[2] For individual taxpayers, deductible losses must be incurred in a trade or business or other profit-seeking activity or consist of property losses arising from fire, storm, shipwreck, or other casualty, or from theft. Personal casualty or theft losses for the taxable year are allowable only if they exceed a $100 limitation per casualty or theft.[3] In addition, aggregate net casualty and theft losses are deductible only to the extent they exceed 10 percent of an individual taxpayer's adjusted gross income.[4] If the disaster occurs in a Presidentially declared disaster area, the taxpayer may elect to take into account the casualty loss in the taxable year immediately preceding the taxable year in which the disaster occurs.[5]

Standard Deduction

An individual taxpayer's taxable income is computed by reducing adjusted gross income either by a standard deduction or, if the taxpayer elects, by the taxpayer's itemized deductions. Unless an individual elects, no itemized deductions are allowed for the taxable year. The deduction for casualty losses is an itemized deduction.

Explanation of Provision

Waiver of Adjusted Gross Income Limitation for Personal Casualty Losses

The provision waives the 10 percent of adjusted gross income limitation for a "net disaster loss." The term "net disaster loss" means the excess of personal casualty losses attributable to a "Federally declared disaster" occurring after December 31, 2007, and before January 1, 2012, occurring in a "disaster area," over personal casualty gains. The term "Federally declared disaster" means any disaster subsequently determined by the President of the United States to warrant assistance by the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act. The term "disaster area" means the area so determined to warrant assistance.

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[2] Sec. 165.

[3] Sec. 165(h)(1).

[4] Sec. 165(h)(2).

[5] Sec. 165(i).

Net disaster losses are deductible without regard to whether aggregate net casualty losses exceed 10 percent of a taxpayer's adjusted gross income. For purposes of applying the 10-percent limitation to other personal casualty or theft losses, losses deductible under this provision are disregarded. Thus, the provision has the effect of treating net disaster losses attributable to Federally declared disasters as a deduction separate from all other non-disaster casualty and theft losses.

The following examples show the application of the provision.

Example 1.–An individual taxpayer with $100,000 of adjusted gross income has the following personal casualty items during the taxable year: $5,000 personal casualty gain, $30,000 allowable personal casualty loss attributable to a Federally declared disaster, and a $7,000 allowable personal casualty loss.[6] The deductible net disaster loss is $25,000 ($30,000 disaster casualty loss less the $5,000 personal casualty gain). The deductible non-disaster casualty loss is $0 ($7,000 non-disaster casualty loss less $10,000 (10 percent of adjusted gross income)) limitation. The taxpayer's deductible net personal casualty loss for the taxable year is $25,000 (the sum of the net disaster loss and the excess of the other casualty losses over the 10-percent limitation).

Example 2.–An individual taxpayer with $100,000 of adjusted gross income has the following personal casualty items during the taxable year: $5,000 personal casualty gain, $30,000 allowable personal casualty loss attributable to a Federally declared disaster, and a $12,000 allowable personal casualty loss.[7] The deductible net disaster loss is $25,000 ($30,000 disaster casualty loss less the $5,000 personal casualty gain). The deductible non-disaster casualty loss is $2,000 ($12,000 non-disaster casualty loss less $10,000 (10 percent of adjusted gross income)) limitation. The taxpayer's deductible net personal casualty loss for the taxable year is $27,000 (the sum of the net disaster loss and the excess of the other casualty losses over the 10-percent limitation).

Increase of Standard Deduction

The provision increases an individual taxpayer's standard deduction by the "disaster loss deduction." The "disaster loss deduction" is defined as the net disaster loss.

Increase of Limitation Per Casualty

The provision increases the $100 limitation per casualty to $500 for taxable years beginning after December 31, 2008, and before January 1, 2012.

[6] The allowable casualty losses are after application of the limitation per casualty (the limitation per casualty under section 165(h)(1).

[7] *Id.*

Effective Dates

The provision generally applies to taxable years beginning after December 31, 2007.

The provision applies to the taxpayer's last taxable year beginning before January 1, 2008, solely for purposes of determining the amount allowable as a deduction with respect to any net disaster loss for such year by reason of an election under section 165(i).

The portion of the provision increasing the limitation per casualty to $500 applies to taxable years beginning after December 31, 2008, and before January 1, 2012.

B. Expensing of Qualified Disaster Expenses (sec. 3 of the bill and new sec. 198A of the Code)

Present Law

In general

Present law allows a deduction for ordinary and necessary expenses paid or incurred in carrying on any trade or business.[8] Section 263(a)(1) limits the scope of section 162 by prohibiting a current deduction for certain capital expenditures. Treasury regulations define "capital expenditures" as amounts paid or incurred to add to the value, or substantially prolong the useful life, of property owned by the taxpayer, or to adapt property to a new or different use.[9] Amounts paid or incurred for incidental repairs and maintenance of property that neither materially add to the value of the property nor appreciably prolong its life are not considered to be capital expenditures and may be deducted currently.[10] The determination of whether an expense is deductible or capitalizable is based on the facts and circumstances of each case.

Environmental remediation costs

Taxpayers may elect to treat certain environmental remediation expenditures paid or incurred before January 1, 2008, that would otherwise be chargeable to capital account as deductible in the year paid or incurred.[11] The deduction applies for both regular and alternative minimum tax purposes. The expenditure must be incurred in connection with the abatement or control of hazardous substances at a qualified contaminated site. In general, any expenditure for the acquisition of depreciable property used in connection with the abatement or control of hazardous substances at a qualified contaminated site does not constitute a qualified environmental remediation expenditure. However, depreciation deductions allowable for such property, which would otherwise be allocated to the site under the principles set forth in Commissioner v. Idaho Power Co.[12] and section 263A, are treated as qualified environmental remediation expenditures.

A "qualified contaminated site" (a so-called "brownfield") generally is any property that is held for use in a trade or business, for the production of income, or as inventory and is certified by the appropriate State environmental agency to be an area at or on which there has been a release (or threat of release) or disposal of a hazardous substance. Both urban and rural

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[8] Sec. 162.

[9] Treas. Reg. sec. 1.263(a)-1(b).

[10] Treas. Reg. sec. 1.162-4 and 1.263(a)-1(b).

[11] Sec. 198.

[12] 418 U.S. 1 (1974).

property may qualify. However, sites that are identified on the national priorities list under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA")[13] cannot qualify as targeted areas. Hazardous substances generally are defined by reference to sections 101(14) and 102 of CERCLA, subject to additional limitations applicable to asbestos and similar substances within buildings, certain naturally occurring substances such as radon, and certain other substances released into drinking water supplies due to deterioration through ordinary use, as well as petroleum products defined in section 4612(a)(3) of the Code.

In the case of property to which a qualified environmental remediation expenditure otherwise would have been capitalized, any deduction allowed under section 198 is treated as a depreciation deduction and the property is treated as section 1245 property. Thus, deductions for qualified environmental remediation expenditures are subject to recapture as ordinary income upon a sale or other disposition of the property. In addition, sections 280B (demolition of structures) and 468 (special rules for mining and solid waste reclamation and closing costs) do not apply to amounts that are treated as expenses under this provision.

Section 1400N(g) permits the expensing of environmental remediation expenditures paid or incurred on or after August 28, 2005, and before January 1, 2008, to abate contamination at qualified contaminated sites located in the Gulf Opportunity Zone.

Debris removal and demolition of structures

Under present law, the cost of demolishing a structure is generally capitalized into the taxpayer's basis in the land on which the structure is located.[14] Land is not subject to an allowance for depreciation or amortization.

The treatment of the cost of debris removal depends on the nature of the costs incurred. For example, the cost of debris removal after a storm may in some cases constitute an ordinary and necessary business expense which is deductible in the year paid or incurred. In other cases, debris removal costs may be in the nature of replacement of part of the property that was damaged. In such cases, the costs are capitalized and added to the taxpayer's basis in the property. For example, Revenue Ruling 71-161[15] permits the use of clean-up costs as a measure of casualty loss but requires that such costs be added to the post-casualty basis of the property.

Section 1400N(f) provides a special rule for certain demolition and clean-up costs. Under the provision, a taxpayer is permitted a deduction for 50 percent of any qualified Gulf Opportunity Zone clean-up cost paid or incurred on or after August 28, 2005, and before January 1, 2008. The remaining 50 percent is capitalized and treated under the general rules. A qualified Gulf Opportunity Zone clean-up cost is an amount paid or incurred for the removal of debris from, or the demolition of structures on, real property located in the Gulf Opportunity Zone to

[13] Pub. L. No. 96-510 (1980).

[14] Sec. 280B.

[15] 1971-1 C.B. 76.

the extent that the amount would otherwise be capitalized. In order to qualify, the property must be held for use in a trade or business, for the production of income, or as inventory. This special rule also applies to the Kansas disaster area, as added by the Heartland, Habitat, Harvest, and Horticulture Act of 2008.[16]

Repair of business property

As described above, the cost of incidental repairs that neither materially add to the value of property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted currently as a business expense. In the case of repair expenditures incurred subsequent to a casualty event, the IRS ruled in 1999 that the costs of restoring uninsured property damage caused by severe flooding was that the determination of whether the costs are deductible as repairs or capital expenditures "turns on the taxpayer's particular set of facts."[17] In other words, the treatment of the costs to restore the property after a casualty is determined based on the general treatment of such costs, regardless of the fact that such costs are incurred as a result of a casualty event. In August 2006, Treasury issued proposed regulations with a different view, providing that amounts paid or incurred to restore property are required to be capitalized to the extent the taxpayer deducts a casualty loss under section 165 with respect to the same property.[18] This proposes mandatory capitalization of costs incurred by a taxpayer to repair property after suffering a casualty loss. In an internal legal memorandum issued after the proposed Treasury regulations were issued, the IRS stated that the proposed regulations, which contained a prospective effective date when finalized, were "essentially reflective of current law."[19] In March 2008, Treasury reissued the proposed regulations with the same treatment of restoration expenditures of property destroyed in a casualty.

Explanation of Provision

Under the provision, a taxpayer may elect to treat any qualified disaster expense that is paid or incurred by the taxpayer as a deduction for the taxable year in which paid or incurred. For purposes of the provision, a qualified disaster expense is any otherwise capitalizable expenditure paid or incurred in connection with a trade or business or with business-related property that is: (1) for the abatement or control of hazardous substances that were released on account of a Federally declared disaster;[20] (2) for the removal of debris from, or the demolition of structures on, real property damaged or destroyed as a result of a Federally declared disaster; or (3) for the repair of business-related property damaged as a result of a Federally declared disaster. No inference is intended as to the proper present law treatment of expenditures to repair

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[16] Pub. L. No. 110-234, sec. 15345(a)(3) (2008).

[17] CCA 199903030.

[18] Prop. Reg. sec. 1.263(a)-3(f)(3)(iv). 2006-2 C.B. 532.

[19] AM 2006-006, footnote 2.

[20] See section 2 of this bill for the definition of Federally declared disaster.

business-related property damaged in a casualty event. The purpose of this provision is to provide that, in any case in which such costs are otherwise required to be capitalized, the costs may be deducted in the taxable year paid or incurred to the extent incurred as a result of a Federally declared disaster.

For purposes of this provision, "business-related property" is property held by the taxpayer for use in a trade or business, for the production of income, or as inventory, and a Federally declared disaster is any disaster occurring after December 31, 2007, and before January 1, 2012, that is subsequently determined by the President of the United States to warrant assistance by the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

For purposes of recapture as ordinary income, any deduction allowed under this provision is treated as a deduction for depreciation and section 1245 property for purposes or depreciation recapture.

Effective Date

The provision is effective for amounts paid or incurred after December 31, 2007.

C. Net Operating Losses Attributable to Federally Declared Disasters (sec. 4 of the bill and sec. 172 of the Code)

Present Law

Under present law, a net operating loss ("NOL") is, generally, the amount by which a taxpayer's business deductions exceed its gross income. In general, an NOL may be carried back two years and carried over 20 years to offset taxable income in such years.[21] NOLs offset taxable income in the order of the taxable years to which the NOL may be carried.[22]

Different rules apply with respect to NOLs arising in certain circumstances. A three-year carryback applies with respect to NOLs (1) arising from casualty or theft losses of individuals, or (2) attributable to Presidentially declared disasters for taxpayers engaged in a farming business or a small business. A five-year carryback applies to NOLs (1) arising from a farming loss (regardless of whether the loss was incurred in a Presidentially declared disaster area), or (2) certain amounts related to the Gulf Opportunity Zone and Kansas disaster area. Special rules also apply to real estate investment trusts (no carryback), specified liability losses (10-year carryback), and excess interest losses (no carryback to any year preceding a corporate equity reduction transaction). Additionally, a special rule applies to certain electric utility companies.

Explanation of Provision

The provision provides a special five-year carryback period for NOLs to the extent of a qualified disaster loss. For purposes of the provision, a qualified disaster loss is the lesser of: (1) the sum of (a) section 165 losses for the taxable year attributable to a Federally declared disaster[23] occurring after December 31, 2007, and before January 1, 2012, and occurring in a disaster area,[24] and (b) the deduction for the taxable year for qualified disaster expenses allowable under section 198A(a)[25] or which would be allowable as a deduction under that section if not treated as an expense in another section of the Code; or (2) the NOL for the taxable year.

The amount of the NOL to which the five-year carryback period applies is limited to the amount of the corporation's overall NOL for the taxable year. Any remaining portion of the taxpayer's NOL is subject to the general two-year carryback period. Ordering rules similar to those for specified liability losses apply to losses carried back under the provision.

[21] Sec. 172(b)(1)(A).

[22] Sec. 172(b)(2).

[23] See section 2 of this bill for the definition of Federally declared disaster.

[24] See section 2 of this bill for the definition of disaster area.

[25] See section 3 of this bill.

Any taxpayer entitled to the five-year carryback under this provision may elect to have the carryback period determined without regard to this provision. In addition, the general rule which limits a taxpayer's NOL deduction to 90 percent of AMTI does not apply to any NOL to which the five-year carryback period applies under the provision. Instead, a taxpayer may apply such NOL carrybacks to offset up to 100 percent of AMTI.

Effective Date

The provision is effective for net operating losses for taxable years beginning after December 31, 2007.

D. Special Rules for Mortgage Revenue Bonds in Federally Declared Disaster Areas (sec. 5 of the bill and sec. 143 of the Code)

Present Law

In general

Under present law, gross income does not include interest on State or local bonds (sec. 103). State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds which are primarily used to finance governmental functions or which are repaid with governmental funds. Private activity bonds are bonds with respect to which the State or local government serves as a conduit providing financing to nongovernmental persons (e.g., private businesses or individuals). The exclusion from income for State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds") (secs. 103(b)(1) and 141).

Qualified mortgage bonds

Generally

The definition of a qualified private activity bond includes a qualified mortgage bond (sec. 143). Qualified mortgage bonds are issued to make mortgage loans to qualified mortgagors for the purchase, improvement, or rehabilitation of owner-occupied residences. Rehabilitation loans are eligible for such financing if: (1) the mortgagor receiving the financing is the first resident after the completion of the rehabilitation; (2) at least 20 years have elapsed between the first use of the residence and the start of the physical work of the rehabilitation; (3) certain percentages of internal and external walls are retained after the rehabilitation; and (4) rehabilitation expenditures equal at least 25 percent of the taxpayer's adjusted basis in the residence after such rehabilitation (sec. 141 (k)(5)).

The Code imposes several limitations on qualified mortgage bonds, including purchase price limitations for the home financed with bond proceeds and income limitations for homebuyers. In general the purchase price limitation is met if the acquisition cost of each residence financed does not exceed 90 percent of the average area purchase applicable to the residence (i.e., the average single-family residence purchase price purchased during the one-year period in the statistical area in which the residence is located) (sec. 141(e)). Also, the income limitation generally is met if all the owner-financing provided under the issue is provided to individuals who have family income of 115 percent of the applicable median family income (sec. 141(f)).

First-time homebuyers

In addition to the purchase price and income limitations, qualified mortgage bonds generally cannot be used to finance a mortgage for a homebuyer who had an ownership interest in a principal residence in the three years preceding the execution of the mortgage (the "first-time homebuyer" requirement) (sec. 141 (d)). The first-time homebuyer requirement does not apply to targeted area residences (described below).

Special rules for targeted area residences

A targeted area residence is one located in either (1) a census tract in which at least 70 percent of the families have an income which is 80 percent or less of the state-wide median income or (2) an area of chronic economic distress (sec. 141(j)).

In addition to the waiver of the first-time homebuyer rule, targeted area residences have special purchase price limitations and income limitations. For targeted area residences, the purchase price limitation is applied by substituting 110 percent for 90 percent. (i.e., the purchase price limitation is met if the acquisition cost of each residence financed does not exceed 110 percent of the average area purchase applicable to the residence). For targeted area residences, the income limitation generally is met if at least two-thirds of all the owner-financing provided under the issue is provided to individuals who have family income of 140 percent of the applicable median family income. The other third is not subject to an income limitation.

Special rules for Federally disaster areas

A temporary provision waives the first-time homebuyer requirement for residences located in Federally declared disaster areas (sec. 143(k)(11)). Also, under the provision, residences located in Federally declared disaster areas are treated as targeted area residences for purposes of the income and purchase price limitations. The special rules for residences located in Federally declared disaster areas applies to bonds issued after May 1, 2008 and before January 1, 2010.

Explanation of Provision

The provision replaces the temporary present-law provision for residences located in Federally declared disaster areas with: (1) a waiver of the first-time homebuyer requirement; and (2) the purchase price limitation otherwise applicable to targeted area residences (i.e., the purchase price limitation is met if the acquisition cost of each residence financed does not exceed 110 percent of the average area purchase applicable to the residence). The provision applies for the two-year period beginning on the date of the disaster, when the principal residence of a taxpayer is: (1) rendered unsafe for use by reason of a Federally declared disaster, or (2) demolished or relocated by reason of an order of the government of a State of political subdivision thereof on account of a Federally declared disaster.

Also, the provision expands the definition of rehabilitation loans to include the cost of repair or reconstruction of a taxpayer's principal residence for damage from a Federally declared disaster regardless of whether the present-law rehabilitation requirements are satisfied. Such rehabilitation loans are limited to the lesser of $150,000 or the cost of repair or reconstruction.

For purposes of the provision, the term Federally declared disaster has the same definition as in section 2 of this bill except that it does not apply to any disaster occurring before January 1, 2008, or after December 31, 2011.

Effective Date

The provision is effective for bonds issued after the date of enactment.

E. Increase in Standard Mileage Rate for Charitable Use of Vehicles (sec. 6 of the bill and sec. 170(i) of the Code)

Present Law

In general, an itemized deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. Unreimbursed out-of-pocket expenditures made incident to providing donated services to a qualified charitable organization − such as out-of-pocket transportation expenses necessarily incurred in performing donated services − may qualify as a charitable contribution (Treasury Regulation sec. 1.170A-1(g)). No charitable contribution deduction is allowed for traveling expenses (including expenses for meals and lodging) while away from home, whether paid directly or by reimbursement, unless there is no significant element of personal pleasure, recreation, or vacation in such travel (sec. 170(j)).

In determining the amount treated as a charitable contribution where a taxpayer operates a vehicle in providing donated services to a charity, the taxpayer either may deduct actual out-of-pocket expenditures or, in the case of a passenger automobile, may use the charitable standard mileage rate. The charitable standard mileage rate is set by statute at 14 cents per mile (sec. 170(i)). The taxpayer may also deduct (under either computation method), any parking fees and tolls incurred in rendering the services, but may not deduct any amount (regardless of the computation method used) for general repair or maintenance expenses, depreciation, insurance, registration fees, etc. Regardless of the computation method used, the taxpayer must keep reliable written records of expenses incurred. For example, where a taxpayer uses the charitable standard mileage rate to determine a deduction, the IRS has stated that the taxpayer generally must maintain records of miles driven, time, place (or use), and purpose of the mileage. If the charitable standard mileage rate is not used to determine the deduction, the taxpayer generally must maintain reliable written records of actual expenses incurred.

In lieu of actual operating expenses, an optional standard mileage rate may be used in computing the deductible costs of business use of an automobile. The business standard mileage rate is determined by the IRS and updated periodically. For expenses incurred on or after July 1, 2008, the business standard mileage rate specified by the IRS is 58.5 cents per mile (IRS Announcement 2008-63 (July 14, 2008)). Also, in lieu of actual operating expenses, an optional standard mileage rate may be used in computing deductible transportation expenses for medical purposes (section 213) or for moving (section 217). The medical and moving standard mileage rates are determined by the IRS and updated periodically. For expenses incurred on or after July 1, 2008, the rate for both such purposes is 27 cents per mile (IRS Announcement 2008-63 (July 14, 2008)).

The standard mileage rates for charitable, medical, and moving purposes are lower than the standard business rate because the charitable, medical, and moving rates generally cover only the out-of-pocket operating expenses (including gasoline and oil) directly related to the use of the automobile in performing the donated services that a taxpayer may deduct as a charitable contribution or in traveling for medical or moving purposes. Such rates do not include costs that are not deductible for charitable, medical, or moving purposes, such as general maintenance expenses, depreciation, insurance, and registration fees. Such costs are, however, included in computing the business standard mileage rate.

Explanation of Provision

Under the provision, for use of a passenger automobile after the date of enactment and before January 1, 2012, the standard mileage rate shall be the rate determined by the Secretary, which rate shall not be less than the standard mileage rate used for deducting travel expenses related to medical care under section 213 (currently 27 cents per mile). As under present law, as an alternative to determining the amount of the deduction using the standard mileage rate, a taxpayer may determine the amount of the deduction using actual out-of-pocket expenditures.

Effective Date

The provision is effective for taxable years ending after the date of enactment.

F. Additional Low-Income Housing Credit Allocations for Disaster Areas (sec. 7 of the bill and sec. 42 (h) of the Code)

Present Law

In general

The low-income housing credit may be claimed over a 10-year period by owners of certain residential rental property for the cost of rental housing occupied by tenants having incomes below specified levels (sec. 42). The amount of the credit for any taxable year in the credit period is the applicable percentage of the qualified basis of each qualified low-income building. The qualified basis of any qualified low-income building for any taxable year equals the applicable fraction of the eligible basis of the building.

Volume limits

A low-income housing credit is allowable only if the owner of a qualified building receives a housing credit allocation from the State or local housing credit agency. Generally, the aggregate credit authority provided annually to each State for calendar years 2008 and 2009 is $2.20 per resident, with a minimum annual cap for certain small population States. In 2010, the volume limits will return to lower prescribed levels. These amounts are indexed for inflation. Projects that also receive financing with proceeds of tax-exempt bonds issued subject to the private activity bond volume limit do not require an allocation of the low-income housing credit.

Certain distressed areas

Special allocations of the low income credit are not provided for distressed areas on a regular basis but rather must be separately enacted on a case-by-case basis (e.g., Gulf Opportunity Zones).

Explanation of Provision

The provision provides a National pool of additional low-income credit allocations for Federally declared disaster areas. The total amount of these additional allocations is capped at $190 million. All allocations under the provision must be made by the Secretary of the Treasury (the "Secretary") after consultation with the Director of the Federal Emergency Management Agency (e.g., providing information to help verify that areas satisfy the requirements necessary to be a housing loss disaster area). The allocations must be made ratably over the four-year period 2008-2011 unless the Secretary determines that a different allocation is warranted by the severity or frequency of Federally declared disasters in the period. A State must apply for these allocations to be eligible.

An allocation under this provision is available only to States which include a disaster area. In making these allocations the Secretary is to give priority to housing loss disaster areas but may also provide allocations in respect to other buildings in the disaster area but outside of the housing loss disaster areas. If a priority allocation is made then such priority allocation must be used in the housing loss disaster area pursuant to the terms of the priority allocation. For these purposes, a housing loss disaster area is a county or municipality: (1) where the lesser of

1,000 dwelling units or ten percent of the total dwelling units in such county or municipality have been rendered uninhabitable by reason of damage or destruction caused by a Federally declared disaster area; and (2) located in a Federally declared disaster area.[26]

Any allocation made by the Secretary which is subsequently terminated by the Secretary (e.g., because of lack of use) shall not be treated like other allocation amounts under the present-law housing credit dollar rules but rather shall be eligible for reallocation by the Secretary pursuant to the otherwise applicable rules of the provision.

The additional allocations allowed under the provision may only be made with respect to disasters occurring after December 31, 2007 and before January 1, 2012. No allocations under this provision may be made after December 31, 2012.

Effective Date

The provision applies to credit allocations made after the date of enactment.

[26] See section 2 of this bill for this definition of Federally declared disaster.

G. Private Activity Disaster Bonds
(sec. 8 of the bill and sec. 144 of the Code)

Present Law

In general

Under present law, gross income does not include interest on State or local bonds. State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds which are primarily used to finance governmental functions or which are repaid with governmental funds. Private activity bonds are bonds with respect to which the State or local government serves as a conduit providing financing to nongovernmental persons (e.g., private businesses or individuals). The exclusion from income for State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds").

There are several types of tax-exempt qualified private activity bonds. For example, States or local governments may issue tax-exempt "exempt-facility bonds" to finance property for certain private businesses. Business facilities eligible for this financing include transportation (airports, ports, local mass commuting, and high speed intercity rail facilities); privately owned and/or privately operated public works facilities (sewage, solid waste disposal, local district heating or cooling, hazardous waste disposal facilities, and public educational facilities); privately owned and/or operated low-income rental housing; and certain private facilities for the local furnishing of electricity or gas. A further provision allows tax-exempt financing for "environmental enhancements of hydro-electric generating facilities."

Tax-exempt financing also is authorized for capital expenditures for small manufacturing facilities and land and equipment for first-time farmers ("qualified small-issue bonds"), local redevelopment activities ("qualified redevelopment bonds"), and eligible empowerment zone and enterprise community businesses. Tax-exempt private activity bonds also may be issued to finance limited non-business purposes: certain student loans and mortgage loans for owner-occupied housing ("qualified mortgage bonds" and "qualified veterans' mortgage bonds").

Generally, tax-exempt private activity bonds are subject to restrictions that do not apply to other bonds issued by State or local governments. For example, most tax-exempt private activity bonds are subject to annual volume limits on the aggregate face amount of such bonds that may be issued ("State volume cap"). However, as discussed below, bonds for certain distressed areas have volume limits established separately from the State volume cap.

Tax-exempt financing for certain distressed areas

Present law provides special rules for private activity bonds issued within certain geographic areas to provide incentives for businesses to locate and rebuild in those areas. For example, the Code provides special rules for the New York Liberty Zone, the Gulf Opportunity Zone, and empowerment zones.

New York Liberty Zone Bonds

Present law permits an aggregate of $8 billion in exempt facility bonds for the purpose of financing the construction and rehabilitation of nonresidential real property and residential rental real property in a designated "Liberty Zone" (the "Zone") of New York City ("Liberty Zone bonds"). The Zone consists of all business addresses located on or south of Canal Street, East Broadway (east of its intersection with Canal Street), or Grand Street (east of its intersection with East Broadway) in the Borough of Manhattan.

Property eligible for financing with these bonds includes buildings and their structural components, fixed tenant improvements, and public utility property (e.g., gas, water, electric, and telecommunication lines). Fixtures and equipment that could be removed from the designated zone for use elsewhere are not eligible for financing with these bonds. Issuance of these bonds is limited to projects approved by the Mayor of New York City or the Governor of New York State, each of whom may designate up to $4 billion of the aggregate bond authority.

Liberty Zone Bonds must be issued before January 1, 2010, and are not subject to the State volume cap.

Gulf Opportunity Zone Bonds

Present law permits the issuance of qualified private activity bonds to finance the construction and rehabilitation of residential and nonresidential property located in the Gulf Opportunity Zone ("Gulf Opportunity Zone Bonds"). Gulf Opportunity Zone Bonds must be issued before January 1, 2011.

Gulf Opportunity Zone Bonds may be issued by the State of Alabama, Louisiana, or Mississippi, or any political subdivision thereof. Gulf Opportunity Zone Bonds are not subject to the State volume cap. Rather, the maximum aggregate face amount of Gulf Opportunity Zone Bonds that may be issued in any State is limited to $2,500 multiplied by the population of the respective State within the Gulf Opportunity Zone. Depending on the purpose for which such bonds are issued, Gulf Opportunity Zone Bonds are treated as either exempt facility bonds or qualified mortgage bonds.

Gulf Opportunity Zone Bonds are treated as exempt facility bonds if 95 percent or more of the net proceeds of such bonds are to be used for qualified project costs located in the Gulf Opportunity Zone. Qualified project costs include the cost of acquisition, construction, reconstruction, and renovation of nonresidential real property, qualified residential rental projects (as defined in section 142(d) with certain modifications), and public utility property.

Gulf Opportunity Zone Bonds are treated as qualified mortgage bonds if the bonds of such issue meet the general requirements of a qualified mortgage issue and the residences financed with such bonds are located in the Gulf Opportunity Zone. For these residences the first-time homebuyer rule is waived and purchase and income rules for targeted area residences apply. In addition, 100 percent of the mortgages must be made to mortgagors whose family income is 140 percent or less of the applicable median family income.

Tax-exempt enterprise zone facility bonds

Enterprise zone facility bonds are issued to finance “enterprise zone facilities” located in “enterprise communities” or “empowerment zones” if the principal users of such facilities are “qualified enterprise zone businesses.” Ninety-five percent or more of the net proceeds of the bonds must be used to provide an enterprise zone facility. An enterprise zone facility is defined as any qualified zone property the principal user of which is an “enterprise zone business,” and any land that is functionally related and subordinate to such property. Enterprise zone businesses are defined as certain partnerships, corporations or proprietorships conducting a qualified business in, and employing residents of, an empowerment zone.

Explanation of Provision

The provision creates a new category of tax-exempt private activity bonds, a “qualified disaster bond.” A qualified disaster bond is any bond issued as part of an issue if (1) 95 percent or more of the net proceeds of the issue are to be used for the replacement, repair, reconstruction or renovation of depreciable property that was damaged or destroyed as a result of a Federally declared disaster, and (2) such bond is designated by a State as a qualified disaster bond for purposes of the provision.[27]

In order to designate a bond as a qualified disaster bond, the State that includes the disaster area must apply for and receive an allocation of the national bond limitation from the Secretary. A State cannot designate bonds as qualified disaster bonds in excess of the bond limitation allocated to the State by the Secretary.

Qualified disaster bonds are not subject to the State volume caps. Instead, there is a national bond limitation of $13 billion, to be allocated with respect to disasters occurring during the period January 1, 2008 through December 31, 2011. The Secretary is to make allocations ratably over this period, unless the Secretary determines, on the basis of the severity or frequency of disasters, that a different allocation is appropriate. The allocations are to be made after consultation with the Director of the Federal Emergency Management Agency (e.g., providing information to help verify that areas satisfy the requirements necessary to be a disaster area). The Secretary is not permitted to make allocations after December 31, 2012.

In making allocations of the national bond limitation, the Secretary is to give priority to business loss disaster areas. A “business loss disaster area” means any county or municipality (1) with respect to which the Governor of the State in which such county or municipality is located demonstrates that the business property located in such county or municipality has sustained damages by reason of a Federally declared disaster of $50 million, or five percent of the value of all such business property (as determined immediately before such disaster on the basis of property tax records or other method as the Secretary determines appropriate), whichever is less, and (2) which is located in a disaster area.

[27] See section 2 of this bill for the definition of the terms Federally declared disaster, and disaster area.

The proceeds of qualified disaster bonds may only be used with respect to property located in a disaster area. In the case of an allocation based on priority given to business loss disaster areas, such allocation may only be used to issue bonds with respect to property located in the business loss disaster area given priority. The proceeds of qualified disaster bonds may not be used for any property described in section 1400N(p)(3).[28]

The interest on qualified disaster bonds is not a preference item for purposes of the alternative minimum tax.

Effective Date

The provision applies to obligations issued after the date of enactment.

[28] Specifically, the proceeds of qualified disaster bonds cannot be used for any property used in connection with a golf course, country club, massage parlor, hot tub facility, suntan facility, any store the principal business of which is the sale of alcoholic beverages for off-premises consumption, or any gambling or animal racing property.

H. Suspension of Limitations on Charitable Contributions for Disaster Relief (sec. 9 of the bill and sec. 170 of the Code)

Present Law

In general

In general, an income tax deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization (sec. 170).

Charitable contributions of cash are deductible in the amount contributed. In general, contributions of capital gain property to a qualified charity are deductible at fair market value with certain exceptions. Capital gain property means any capital asset or property used in the taxpayer's trade or business the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Contributions of other appreciated property generally are deductible at the donor's basis in the property. Contributions of depreciated property generally are deductible at the fair market value of the property.

Percentage limitations

Contributions by individuals

For individuals, in any taxable year, the amount deductible as a charitable contribution is limited to a percentage of the taxpayer's contribution base. The applicable percentage of the contribution base varies depending on the type of donee organization and property contributed. The contribution base is defined as the taxpayer's adjusted gross income computed without regard to any net operating loss carryback.

Contributions by an individual taxpayer of property (other than appreciated capital gain property) to a charitable organization described in section 170(b)(1)(A) (e.g., public charities, private foundations other than private non-operating foundations, and certain governmental units) may not exceed 50 percent of the taxpayer's contribution base. Contributions of this type of property to nonoperating private foundations and certain other organizations generally may be deducted up to 30 percent of the taxpayer's contribution base.

Contributions of appreciated capital gain property to charitable organizations described in section 170(b)(1)(A) generally are deductible up to 30 percent of the taxpayer's contribution base. An individual may elect, however, to bring all these contributions of appreciated capital gain property for a taxable year within the 50-percent limitation category by reducing the amount of the contribution deduction by the amount of the appreciation in the capital gain property. Contributions of appreciated capital gain property to charitable organizations described in section 170(b)(1)(B) (e.g., private nonoperating foundations) are deductible up to 20 percent of the taxpayer's contribution base.

Contributions by corporations

For corporations, in any taxable year, charitable contributions are not deductible to the extent the aggregate contributions exceed 10 percent of the corporation's taxable income computed without regard to net operating loss or capital loss carrybacks.

For purposes of determining whether a corporation's aggregate charitable contributions in a taxable year exceed the applicable percentage limitation, contributions of capital gain property are taken into account after other charitable contributions.

Carryforward of excess contributions

Charitable contributions that exceed the applicable percentage limitation may be carried forward for up to five years (sec. 170(d)). The amount that may be carried forward from a taxable year ("contribution year") to a succeeding taxable year may not exceed the applicable percentage of the contribution base for the succeeding taxable year less the sum of contributions made in the succeeding taxable year plus contributions made in taxable years prior to the contribution year and treated as paid in the succeeding taxable year under this provision.

Overall limitation on itemized deductions ("Pease" limitation)

Under present law, the total amount of otherwise allowable itemized deductions (other than medical expenses, investment interest, and casualty, theft, or wagering losses) is reduced by three percent of the amount of the taxpayer's adjusted gross income in excess of a certain threshold. The otherwise allowable itemized deductions may not be reduced by more than 80 percent. For 2008, the adjusted gross income threshold is $159,950 ($79,975 for a married taxpayer filing a joint return). These dollar amounts are adjusted for inflation.

The otherwise applicable overall limitation on itemized deductions is reduced by two-thirds in taxable years beginning in 2008 and 2009. The overall limitation is repealed for taxable years beginning after December 31, 2009, and reinstated for taxable years beginning after December 31, 2010.

Explanation of Provision

Suspension of percentage limitations

Under the provision, in the case of an individual, the deduction for qualified disaster contributions is allowed up to the amount by which the taxpayer's contribution base exceeds the deduction for other charitable contributions. Contributions in excess of this amount are carried over to succeeding taxable years as contributions described in 170(b)(1)(A), subject to the limitations of section 170(d)(1)(A)(i) and (ii).

In the case of a corporation, the deduction for qualified disaster contributions is allowed up to the amount by which the corporation's taxable income (as computed under section 170(b)(2)) exceeds the deduction for other charitable contributions. Contributions in excess of this amount are carried over to succeeding taxable years, subject to the limitations of section 170(d)(2).

In applying subsections (b) and (d) of section 170 to determine the deduction for other contributions, qualified disaster contributions are not taken into account (except to the extent qualified disaster contributions are carried over to succeeding taxable years under the rules described above).

Qualified disaster contributions are cash contributions paid during the period beginning on the date of enactment and ending on December 31, 2009, to a charitable organization described in section 170(b)(1)(A) (generally, public charities) other than supporting organizations described in section 509(a)(3), for relief efforts related to a Federally declared disaster (as defined in section 165(h)(3)(C)(i)). Contributions of noncash property, such as securities, are not qualified disaster contributions. Under the provision, qualified disaster contributions must be to an organization described in section 170(b)(1)(A); thus, contributions to, for example, a charitable remainder trust generally are not qualified contributions, unless the charitable remainder interest is paid in cash to an eligible charity during the applicable time period. A taxpayer must elect to have the contributions treated as qualified disaster contributions.

Qualified disaster contributions do not include a contribution if the contribution is for establishment of a new, or maintenance in an existing, donor advised fund (as defined in section 4966(d)(2)).

Below are examples illustrating the operation of the provision. (The examples assume the taxpayer makes an election to have the provision apply.)

<u>Example 1</u>.–Assume individual A's contribution base for 2009 is $100,000; aggregate qualified disaster contributions are $70,000; and other charitable contributions to organizations described in section 170(b)(1)(A) are $60,000. Under the provision, A is allowed a deduction of $100,000 for 2009 ($50,000 determined without regard to qualified disaster contributions plus $50,000 for the qualified disaster contributions (the lesser of (i) the $70,000 amount of the qualified disaster contribution or (ii) the $50,000 excess of the $100,000 contribution base over the $50,000 amount otherwise deductible)). $30,000 is treated as a contribution described in section 170(b)(1)(A) paid in each of the five succeeding taxable years (subject to the limitations of section 170(d)(1)(A)(i) and (ii)). $30,000 is the sum of the $10,000 excess referred to in section 170(d)(1)(A) (the excess of $60,000 over $50,000) and the $20,000 excess qualified disaster contributions (the excess of $70,000 over $50,000).

<u>Example 2</u>.–For calendar year 2009, B, an individual, has a contribution base of $100,000. On January 10, 2009, B makes a $7,000 cash contribution to an organization described in section 170(b)(1)(A) and a $65,000 cash charitable contribution to an organization not so described. On October 10, 2009, B makes a $70,000 qualified disaster contribution. In 2008, B made charitable contributions to organizations described in section 170(b)(1)(A) that exceeded 50 percent of the contribution base by $5,000.

First, subsections (b) and (d) of section 170 are applied by disregarding the qualified disaster contribution. For 2009, a $12,000 deduction is allowed under section 170(b)(1)(A) – the $7,000 current year contribution and the $5,000 carryover from 2008. For 2009, a $30,000 deduction for the contribution to the organization not described in section 170(b)(1)(A) also is allowed. This amount is the lesser of (i) $38,000 ($50,000 (50 percent of B's contribution base) less the $12,000 allowed under section 170(b)(1)(A)) or (ii) $30,000 (30 percent of B's contribution base). The remaining contribution amount of $35,000 is carried over as a contribution to an organization which is not described in section 170(b)(1)(A). Thus, without regard to the qualified contribution, B is allowed a total contribution deduction of $42,000 in 2009 ($12,000 plus $30,000).

In addition, B may deduct $58,000 of the qualified contribution in 2009 (the lesser of (i) the $70,000 amount of the qualified disaster contribution or (ii) the $58,000 excess of B's $100,000 contribution base over the $42,000 amount otherwise deductible). $12,000 is treated as a contribution described in section 170(b)(1)(A) paid in each of the five succeeding taxable years (subject to the limitations of section 170(d)(1)(A)(i) and (ii)).

In summary, B's deduction for 2009 is $100,000; $12,000 may be carried over as a contribution to an organization described in section 170(b)(1)(A) (subject to the limitations of section 170(d)(1)(A)(i) and (ii)); and $35,000 may be carried over as a contribution to an organization not so described (subject to similar limitations).

Limitation on overall itemized deductions

Under the provision, the charitable contribution deduction up to the amount of qualified contributions (as defined above) paid during the year is not treated as an itemized deduction for purposes of the overall limitation on itemized deductions.

Effective Date

The provision is effective for taxable years ending after the date of enactment.