

IRS Fact Sheet

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Tax Law Changes Related to the Midwestern Disaster Areas

FS-2008-27, December 2008

Washington — The Heartland Disaster Tax Relief Act of 2008 provides certain tax breaks to help victims of the severe storms, flooding and tornadoes that occurred in Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Missouri, Minnesota, Nebraska and Wisconsin (the Midwestern Disaster Area), that the federal government declared a disaster during the period beginning May 20, 2008, and ending July 31, 2008. The recently enacted legislation alters the tax code to help individuals who suffered losses as a result of the Midwestern Disasters and to make it easier for individuals and businesses to engage in charity to benefit those affected by the severe storms, flooding and tornadoes.

The Internal Revenue Service will provide an explanation of the recently enacted legislation in Publication 4492-B, Information for Affected Taxpayers in the Midwestern Disaster Areas, which will be available on IRS.gov in January 2009.

The counties in these states that encompass the “Midwestern Disaster Area” are identified in Tables 1 and 2 at the end of this fact sheet. Taxpayers located in the counties listed in Table 1 are eligible for all portions of the relief made available to the Midwestern Disaster Areas by the recently enacted legislation. Those taxpayers located in the counties listed in Table 2 are eligible only for certain of the special tax provisions. For a more complete listing of the tax relief provisions that the Heartland Disaster Tax Relief Act of 2008 provides to taxpayers located in the counties listed in Tables 1 and 2, see Pub. 4492-B.

INDIVIDUALS AFFECTED BY THE MIDWESTERN DISASTERS

In general, for individuals affected by the Midwestern Disasters, the recently enacted Heartland Disaster Tax Relief Act of 2008 provides tax-favored early distributions and loans from retirement accounts, eliminates the limitations on claiming losses and permits certain earned income tax credit (EITC) and refundable child tax credit recipients to choose either tax year 2008 or 2007 to determine their earned income and use the more beneficial result.

The recently enacted legislation also allows affected individuals to exclude from income certain cancellations of debt and extends, from two years to five years, the replacement period for converted properties. Portions of the Heartland Disaster Tax Relief Act of 2008 are highlighted below.

Removal of Loss Limitations

For taxpayers who suffered casualty or theft losses to property owned for personal use that are attributable to the Midwestern Disasters, recently enacted legislation removes certain loss limitations. Ordinarily, to figure a deduction for a casualty or theft loss of personal-use property from a particular disaster, taxpayers who itemize must reduce the loss by \$100 and also reduce their total casualty and theft losses by 10 percent of their adjusted gross income. Only the excess over these \$100 and 10 percent limits is deductible for those taxpayers who itemize their deductions. The recently enacted legislation, however, removes these limits for the Midwestern Disasters on losses of personal-use property, so that the entire amount of unreimbursed losses is deductible if a taxpayer itemizes.

To qualify, a loss must arise in the Midwestern Disaster Area and be attributable to the severe storms, flooding or tornadoes for which the Disaster Declarations identified in Tables 1 and 2 were issued. Alternatively, taxpayers who don't itemize their deductions can increase their standard deduction by the net disaster losses suffered from a federally declared disaster. See the worksheet in the instructions for Forms 1040 and 1040A.

Cancellation of Debt

Individuals whose main home was located in the Midwestern Disaster Area on the date that a disaster was declared for the county in which they live, will not include in income any non-business debt (such as a mortgage) that is cancelled on or after the applicable disaster date and before Jan. 1, 2010, provided that the debt is not secured by property located outside the Midwestern Disaster Area. If the individual's main home was located in a Midwestern Disaster Area as shown in Table 2, the individual must also have had an economic loss because of the severe storms, floods or tornadoes. Examples of economic losses include, but are not limited to: (a) loss, damage to, or destruction of real or personal property from fire, flooding, looting, vandalism, theft, wind or other cause; (b) loss related to displacement from one's home; or (c) loss of livelihood due to temporary or permanent layoffs. Usually, the cancellation of debt is treated as income by the person for whom the debt is forgiven.

Earned Income Tax Credit and Refundable Child Tax Credit

The recently enacted legislation allows eligible individuals to choose to calculate their earned income tax credit (EITC) or refundable child tax credit using their prior year's earned income. An eligible individual is one whose earned income in 2008 is less than their earned income in 2007 and their main home on the applicable disaster date was in a Midwestern Disaster Area as shown in Table 1 or their main home on the applicable disaster date was in a Midwestern Disaster Area as shown in Table 2 and they were displaced from that home because of the severe storms, tornadoes or flooding. Taxpayers eligible to make the choice should figure their EITC and refundable child tax credit using their earned income for each year before making the choice to see which gives them the higher credits.

Education Credits

The recently enacted legislation provides educational assistance to students enrolled and paying tuition at eligible educational institutions located in the Midwestern Disaster Area counties identified in Table 1 for any tax year beginning in 2008 or 2009. Basically, the new legislation expands the Hope and Lifetime Learning educational credits in the following way:

- The Hope Credit is expanded to 100 percent of the first \$2,400 in eligible expenses plus 50 percent of the next \$2,400 – doubling the maximum Hope Credit from \$1,800 to \$3,600 for each eligible student.
- The Lifetime Learning Credit is expanded from 20 percent to 40 percent.

Exemption for Taxpayers Housing Individuals Displaced by the Midwestern Disasters

Taxpayers who provided housing in their main homes to individuals displaced by the severe storms, tornadoes or flooding that occurred in the Midwestern Disaster Areas may be able to claim an additional exemption amount of \$500 for each such displaced individual. The additional exemption amount is allowable once per taxpayer for a specific Midwestern Disaster displaced individual in 2008 or 2009, but not in both years. The maximum additional exemption amount that can be claimed for all displaced individuals is \$2,000 (\$1,000 if married filing separately). Any exemption amount claimed in 2008 will reduce the \$2,000 maximum for 2009.

To qualify as a displaced individual, the individual must have had his or her main home in a Midwestern Disaster Area on the applicable disaster date, and he or she must have been displaced from that home. If the displaced individual's main home was located in a Midwestern Disaster Area as shown in Table 2, that home must have been damaged by the severe storms, tornadoes or flooding or the individual must have been evacuated from the home because of the severe storms, tornadoes or flooding. In addition, the displaced individual must have been provided housing in the taxpayer's main home for a period of at least 60 consecutive days ending in the tax year in which the exemption is claimed. The displaced individual cannot be the taxpayer's spouse or dependent.

This benefit applies to the counties listed in Tables 1 and 2. More detailed information on claiming the additional exemption can be found in Pub. 4492-B.

Recapture of Federal Mortgage Subsidy

Generally, taxpayers who financed their homes under a federally-subsidized program may have to repay all or part of the benefit they received from that program when they sell or otherwise dispose of their home. This repayment is known, technically, as recapture. Taxpayers do not, however, have to recapture any benefit if their mortgage loan was a qualified home improvement loan of not more than \$15,000. The recently enacted legislation provides for this amount to be increased to \$150,000, if the loan was provided prior to 2011 and was used to alter, repair, or improve an existing owner-occupied residence in a Midwestern Disaster Area as shown in Table 1.

RETIREMENT FUNDS

To help victims of the severe storms, flooding and tornadoes in the Midwestern Disaster Area, the recently enacted legislation provides certain tax-favored treatment for early distributions, plan loans and re-contributions. These benefits apply to the counties listed in Tables 1 and 2.

Qualified Disaster Recovery Assistance Distributions

A qualified disaster recovery distribution is any distribution from an eligible retirement plan that meets the following requirements: (1) the distribution was made on or after an applicable disaster date listed in Tables 1 or 2 and before Jan. 1, 2010; (2) the distribution was made to a taxpayer whose main home was located in a Midwestern Disaster Area on the applicable disaster date; and (3) the taxpayer sustained an economic loss because of the severe storms, tornadoes or flooding that affected the Midwestern Disaster Area. If these requirements are met, the taxpayer can generally designate any distribution from an eligible retirement plan as a qualified disaster recovery assistance distribution, regardless of whether the distribution was made on account of the severe storms, tornadoes or flooding. The total amount of tax-favored distributions an individual can receive from all plans, annuities or IRAs is \$100,000.

Taxation of Qualified Disaster Recovery Assistance Distributions

Qualified disaster recovery assistance distributions are included in income in equal amounts over three years. The taxpayer can, however, elect to include the entire distribution income in the year it was received. An eligible individual who receives qualified disaster recovery assistance distributions does not have to pay the 10% additional tax on early distributions (or the additional 25% tax for certain distributions from SIMPLE IRAs). Under the new law, qualified disaster recovery assistance distributions are not subject to the mandatory 20% withholding. Any distributions received in excess of the \$100,000 qualified disaster recovery assistance distribution limit may be subject to the additional tax on early distributions.

Repayment of Qualified Disaster Recovery Assistance Distributions

Taxpayers may choose to repay any portion of a qualified disaster recovery distribution that is eligible for tax-free rollover treatment into an eligible retirement plan within three years from the date of the distribution. The distribution will be treated as though it were paid in a direct rollover (note that for purposes of the one-rollover-per-year limitation for IRAs, a repayment to an IRA is not considered a qualified rollover). To report a re-contribution, the eligible individual must also file a Form 8930, Qualified Disaster Recovery Assistance Retirement Plan Distributions and Repayments. Refer to Pub. 4492-B for additional information on repaying qualified disaster recovery assistance distributions and for a list of the qualified disaster recovery assistance distributions that cannot be repaid.

Repayment of Qualified Distributions for the Purchase or Construction of a Main Home

An individual who received a qualified distribution to purchase or construct a main home in a Midwestern disaster area can repay part or all of that distribution to an eligible retirement plan on or after the applicable disaster date, but no later than March 3, 2009. To be a qualified distribution, the distribution must meet all of the following requirements: (1) the distribution is a hardship distribution from a 401(k) plan or a tax-sheltered annuity contract, or a qualified first-time homebuyer distribution from an IRA; (2) the distribution was received

within six months prior to the day after the applicable disaster date; and (3) the distribution was used to purchase or construct a main home in a Midwestern Disaster Area that was not purchased or constructed because of the severe storms, tornadoes or flooding.

Amounts that are repaid before March 4, 2009, are treated as a qualified rollover and are not included in income (note that for purposes of the one-rollover-per-year limitation for IRAs, a repayment to an IRA is not considered a qualified rollover). If the qualified distribution is not repaid by March 4, 2009, the distribution may be taxable for 2007 or 2008, as well as subject to the additional 10% tax on early distributions (or the additional 25% tax for certain SIMPLE IRAs). Any repayments must be reported on Form 8930, Qualified Disaster Recovery Assistance Retirement Plan Distributions and Repayments.

Retirement Plan Loans

Under the new law, the allowable retirement plan loan amount for eligible individuals is increased from \$50,000 to \$100,000. To figure the dollar limit, an eligible individual would start with (a) \$100,000 and subtract the highest outstanding balance of loans from these plans during the prior year and compare that figure to (b) the eligible individual's vested benefit under the plan. Whichever figure is less is the limit that the eligible individual can borrow from the employer's plans without a tax consequence.

For an eligible individual, payments on retirement plan loans outstanding on or after the applicable disaster date may be suspended for one year by the plan administrator. To qualify for suspension, the due date for any loan payment must occur during the period beginning on the applicable disaster date and ending on December 31, 2009.

CHARITY ENCOURAGED BY NEW LAW

To encourage charity, the recently enacted legislation suspends the limits on certain charitable contributions, creates an exemption for those housing Midwestern Disaster displaced individuals, increases the standard mileage rate for charitable use of vehicles and excludes from gross income mileage reimbursements to charitable volunteers.

Suspension of Charitable Limits for Certain Charitable Contributions

In the case of an individual, the recently enacted legislation allows a deduction for qualified contributions up to the amount by which the taxpayer's contribution base – adjusted gross income – exceeds the deduction for other charitable contributions. Contributions in excess of this amount are generally carried over to succeeding taxable years. The recently enacted legislation allows corporations to elect to deduct qualified cash contributions without regard to the 10% of taxable income limit.

Qualified contributions are defined as cash contributions to a charitable organization described in section 170(b)(1)(A) (other than a supporting organization described in section 509(a)(3)), for relief efforts in one or more Midwestern Disaster Areas made after May 1, 2008, and before Jan. 1, 2009. Contributions of non-cash property, such as securities, are not qualified contributions.

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. This benefit applies only to the counties listed in Table 1.

Increase in the Standard Mileage Rate for Charitable Use of Vehicles

The recently enacted legislation provides special standard mileage rates for taxpayers who used their vehicles to provide charitable services related solely to the severe storms, tornadoes and flooding that occurred in the Midwestern Disaster Area during the period May 2, 2008, through Dec. 31, 2008. The special rate is 36 cents per mile for the period May 2, 2008, through June 30, 2008. For the period July 1, 2008, through Dec. 31, 2008, the special rate is 41 cents per mile.

Taxpayers may also exclude from income any amounts received as mileage reimbursement for the use of a private passenger automobile for the benefit of a qualified charitable organization in responding to the severe storms, tornadoes and flooding that occurred in the Midwestern Disaster Area during the period May 2, 2008, through December 31, 2008. Taxpayers cannot claim a deduction or credit for any amounts excluded and must keep records of miles driven, time, place (or use) and purpose of the mileage. The amount that can be excluded from income cannot exceed 50.5 cents per mile for the period May 2, 2008, through June 30, 2008; and 58.5 cents per mile for the period July 1, 2008, through Dec. 31, 2008. This benefit applies only to the counties listed in Table 1.

Related Information

Publication 4492-B, Information for Affected Taxpayers in the Midwestern Disaster Areas

Table 1

**Taxpayers located in the counties listed in Table 1 are eligible
for all portions of relief identified in this document.**

<u>Applicable Disaster Date*</u>	<u>State</u>	<u>Affected Counties — Midwestern Disaster Areas</u>
05/02/2008	Arkansas	Arkansas, Benton, Cleburne, Conway, Crittenden, Grant, Lonoke, Mississippi, Phillips, Pulaski, Saline and Van Buren.
06/01/2008	Illinois	Adams, Calhoun, Clark, Coles, Crawford, Cumberland, Douglas, Edgar, Hancock, Henderson, Jasper, Jersey, Lake, Lawrence, Mercer, Rock Island, Whiteside, and Winnebago.
06/06/2008	Indiana	Adams, Bartholomew, Brown, Clay, Daviess, Dearborn, Decatur, Gibson, Grant, Greene, Hamilton, Hancock, Hendricks, Henry, Huntington, Jackson, Jefferson, Jennings, Johnson, Knox, Lawrence, Madison, Marion, Monroe, Morgan, Owen, Parke, Pike, Posey, Putnam, Randolph, Ripley, Rush, Shelby, Sullivan, Tippecanoe, Vermillion, Vigo, Washington and Wayne.
05/25/2008	Iowa	Adair, Adams, Allamakee, Appanoose, Audubon, Benton, Black Hawk, Boone, Bremer, Buchanan, Butler, Cass, Cedar, Cerro Gordo, Chickasaw, Clarke, Clayton, Clinton, Crawford, Dallas, Davis, Decatur, Delaware, Des Moines, Dubuque, Fayette, Floyd, Franklin, Fremont, Greene, Grundy, Guthrie, Hamilton, Hancock, Hardin, Harrison, Henry, Howard, Humboldt, Iowa, Jackson, Jasper, Johnson, Jones, Keokuk, Kossuth, Lee, Linn, Louisa, Lucas, Madison, Mahaska, Marion, Marshall, Mills, Mitchell, Monona, Monroe, Montgomery, Muscatine, Page, Polk, Pottawattamie, Poweshiek, Ringgold, Scott, Story, Tama, Union, Van Buren, Wapello, Warren, Washington, Webster, Winnebago, Winneshiek, Worth and Wright.
05/10/2008	Missouri	Barry, Jasper and Newton.
06/01/2008	Missouri	Adair, Andrew, Callaway, Cass, Chariton, Clark, Gentry, Greene, Harrison, Holt, Johnson, Lewis, Lincoln, Linn, Livingston, Macon, Marion, Monroe, Nodaway, Pike, Putnam, Ralls, St. Charles, Stone, Taney, Vernon and Webster.
05/22/2008	Nebraska	Buffalo, Butler, Colfax, Custer, Dawson, Douglas, Gage, Hamilton, Holt, Jefferson, Kearney, Lancaster, Platte, Richardson, Sarpy and Saunders.
06/05/2008	Wisconsin	Adams, Calumet, Crawford, Columbia, Dane, Dodge, Fond du Lac, Grant, Green, Green Lake, Iowa, Jefferson, Juneau, Kenosha, La Crosse, Manitowoc, Marquette, Milwaukee, Monroe, Ozaukee, Racine, Richland, Rock, Sauk, Sheboygan, Vernon, Walworth, Washington, Waukesha and Winnebago.

Table 2
Taxpayers located in the counties listed in Table 2 are eligible for certain portions of the relief identified in this document.

Taxpayers located in the counties listed in Table 2 below are eligible for all of the special tax provisions identified in this fact sheet **except** the education credits, charitable giving incentives (suspension of charitable limits and increase in standard mileage rates) and the recapture of federal mortgage subsidy.**

<u>Applicable Disaster Date*</u>	<u>State</u>	<u>Affected Counties — Midwestern Disaster Areas</u>
06/01/2008	Illinois	Greene, Madison, Monroe, Pike, Randolph, St. Clair and Scott.
06/06/2008	Indiana	Benton, Boone, Fountain, Franklin, Jay, Montgomery, Ohio, Switzerland, Union and Wabash.
05/25/2008	Iowa	Carroll, Cherokee, Lyon, Palo Alto, Pocahontas, Taylor and Wayne.
05/22/2008	Kansas	Barber, Barton, Bourbon, Brown, Butler, Chautauqua, Cherokee, Clark, Clay, Comanche, Cowley, Crawford, Decatur, Dickinson, Edwards, Elk, Ellis, Ellsworth, Franklin, Gove, Graham, Harper, Haskell, Hodgeman, Jackson, Jewell, Kingman, Kiowa, Lane, Linn, Logan, Mitchell, Montgomery, Ness, Norton, Osborne, Pawnee, Phillips, Pratt, Reno, Republic, Riley, Rooks, Rush, Saline, Seward, Sheridan, Smith, Stafford, Sumner, Thomas, Trego, Wallace and Wilson.
06/06/2008	Michigan	Allegan, Barry, Eaton, Ingham, Lake, Manistee, Mason, Missaukee, Osceola, Ottawa, Saginaw and Wexford.
06/07/2008	Minnesota	Cook, Fillmore, Freeborn, Houston, Mower and Nobles.
06/01/2008	Missouri	Atchison, Audrain, Bates, Buchanan, Cape Girardeau, Carroll, Christian, Daviess, Grundy, Howard, Jefferson, Knox, Mercer, Miller, Mississippi, Morgan, New Madrid, Pemiscot, Perry, Pettis, Platte, Polk, Randolph, Ray, Saline, Schuyler, Scotland, Scott, Shelby, St. Genevieve, St. Louis, Sullivan, the Independent City of St. Louis and Worth.
04/23/2008	Nebraska	Gage, Johnson, Morrill, Nemaha and Pawnee.
05/22/2008	Nebraska	Adams, Blaine, Boone, Boyd, Brown, Burt, Cass, Chase, Cherry, Cuming, Dundy, Fillmore, Frontier, Furnas, Garfield, Gosper, Greeley, Hall, Hayes, Howard, Johnson, Keya Paha, Lincoln, Logan, Loup, Merrick, McPherson, Morrill, Nance, Nemaha, Otoe, Phelps, Polk, Red Willow, Rock, Saline, Seward, Sherman, Stanton, Thayer, Thomas, Thurston, Valley, Webster, Wheeler and York.
06/27/2008	Nebraska	Dodge, Douglas, Sarpy and Saunders.
06/05/2008	Wisconsin	Lafayette.

* In some cases the date will be later due to the continuation of the severe storms, tornadoes or flooding that began on the above date. For more details, go to www.fema.gov.

** See Pub. 4492-B for a more complete listing of the tax provisions that are available to taxpayers located in the affected counties in the Midwestern Disaster Areas listed in Tables 1 and 2.