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## Tax and Insurance Consequences of Major Disasters: Weathering the Storm

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## TAX AND INSURANCE CONSEQUENCES OF MAJOR DISASTERS: WEATHERING THE STORM<sup>+</sup>

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+ Issues of tax law and policy are frequently controversial, and the opinions expressed herein are not necessarily those of the Editors or Nova Southeastern University. This article is intended to provide accurate and authoritative information in regard to the subject matter covered. It is published with the understanding that *Nova Law Review* is not engaged in rendering tax legal advice. If legal advice is required, the services of a competent professional should be sought.

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I. INTRODUCTION

“With hurricanes, tornados, flooding, and severe t[hunder]-storms tearing up the country from one end to another . . . [a]re we sure this is a good time to take God out of the Pledge of Allegiance?”<sup>1</sup>

All kidding aside, the hurricanes of 2005 captured national attention and continue to cause many Americans to ask what they can do to better prepare for the next major disaster. There is cause for continued concern: according to the Insurance Information Institute,<sup>2</sup> there are an average of twenty-five catastrophes each year causing at least \$25 million in direct insured damages.<sup>3</sup> In 2006, there were thirty-three events of this major magnitude.<sup>4</sup> Like any other American, those in the legal community may find themselves victimized by disaster. Even firms who are not themselves the victims of disaster would benefit in knowing how to advise clients who have been victims.

This article examines the tax and insurance implications of disasters on law firms. Whether a large firm or a sole practitioner, it is prudent to anticipate and prepare for emergencies. Examining consequences along the full spectrum of contingencies will enable law offices to posture themselves to minimize their risk and to take advantage of opportunities to improve cash flow during recovery.

Tax relief available to all victims forms the baseline for discussion. Particular emphasis is placed on additional tax benefits from major disasters (i.e., those the president has declared as disaster areas under the Robert T.

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1. Father Joe, *Wit & Wisdom of Jay Leno*, <http://fatherjoe.wordpress.com/2006/07/28/wit-wisdom-of-jay-leno/> (last visited June 14, 2007).

2. Insurance Information Institute, About I.I.I., <http://www.iii.org/media/about/> (last visited June 14, 2007). The Insurance Information Institute has tracked and provided insurance information to the government, media, universities, and the public for over forty years. *Id.*

3. Insurance Information Institute, *Catastrophes: Facts and Statistics: Insured Losses for U.S. Catastrophes 1997–2006*, <http://www.iii.org/media/facts/statsbyissue/catastrophes/content.print> (last visited June 14, 2007) [hereinafter *Catastrophes: Facts and Statistics*].

4. *Id.*

Stafford Disaster Relief and Emergency Assistance Act—also called the Stafford Act).<sup>5</sup> In addition, because costs of insurance are deductible as business expenses, so long as “ordinary and necessary,”<sup>6</sup> the interface between taxes and insurance should be examined to maximize protection, minimize risk, and optimize tax treatment.

Hurricane Katrina was the most expensive disaster in United States history.<sup>7</sup> Section II of this article puts this tragedy in perspective and discusses the risks of a repeat disaster of this magnitude.

Section III discusses tax relief available to victims of disaster. It looks specifically at noteworthy disasters to give the reader an appreciation of the scope and flavor of tax relief that might be occasioned by future national disasters. Tax relief ranges from a minimum threshold available to all taxpayer victims up to the unprecedented tax relief to the victims of Hurricane Katrina.

The article next emphasizes precautionary measures firms should take to insulate themselves as much as possible from the significant financial costs of being struck by a hurricane or other disaster. Section IV exposes specific gaps in insurance coverage, often found in policy “exclusions,” which leave many holding the bag after a major disaster. Post-Katrina cases upholding flood damage exclusions are specifically discussed. Recent, proposed, and pending legislation, including proposed federal catastrophe insurance or reinsurance, is also evaluated.

Section IV also considers existing and proposed tax measures to allow both individuals and businesses to accelerate recovery. The prospects of tax-advantaged catastrophe savings accounts, small business administration relief, and other potential federal emergency tax relief are detailed.

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5. Robert T. Stafford Disaster Relief and Emergency Assistance Act, 42 U.S.C. §§ 5121-5206 (2000 & Supp.) (authority of the president to declare National Disaster Areas is pursuant to § 401 of the Stafford Act at 42 U.S.C. § 5170).

6. I.R.C. § 162 (2004); *Welch v. Helvering*, 290 U.S. 111, 113–14 (1933).

7. *Catastrophes: Facts and Statistics*, *supra* note 3.

## II. BACKGROUND

### A. *Catastrophes in Context*

The year 2005 was the most active and devastating hurricane season in United States history.<sup>8</sup> In fact, the National Hurricane Center issued more hurricane forecasts in 2005 than in any previous year.<sup>9</sup> Prior to these storms, Hurricane Ivan and Hurricane Charlie in 2004 had refreshed our memory about the widespread scope of damage and destruction a hurricane could produce.<sup>10</sup> Indeed, these hurricanes should have served as a wake up call to Americans who may have forgotten about the horrors of Hurricane Andrew in 1992, a category 5 hurricane,<sup>11</sup> and the most costly disaster in world history before Hurricane Katrina.<sup>12</sup>

According to the Federal Emergency Management Agency (FEMA), “flooding, severe storms, and hurricanes are the most common and costly causes of disaster declarations in the United States; at least 10 such events since 1989 have each required FEMA relief expenditures in excess of a bil-

8. *See id.* Three of the ten most costly disasters ever occurred in 2005. *Id.* The government recognizes damages wrought (in constant dollar values) versus loss of life as the measure of destruction, because evacuations and emergency life-saving response can prevent loss of life. *See* FRANCES F. TOWNSEND, *THE FEDERAL RESPONSE TO HURRICANE KATRINA: LESSONS LEARNED* 1, 151 n.2 (2006), <http://www.whitehouse.gov/reports/katrina-lessons-learned.pdf>. “[P]roperty destruction correlates more directly to the magnitude of the disaster alone.” *Id.*

9. For a detailed examination of tropical storm prediction accuracy and methodology, see generally James L. Franklin, *2005 National Hurricane Center Forecast Verification Report*, NAT’L HURRICANE CTR., May 21, 2006, at 1, [http://www.nhc.noaa.gov/verification/pdfs/Verification\\_2005.pdf](http://www.nhc.noaa.gov/verification/pdfs/Verification_2005.pdf). “Not only were the 12-72 h[our] forecasts more accurate in 2005 than they had been over the previous decade, but the forecasts were also more skillful.” *Id.* at 6.

10. At the time, Hurricanes Ivan and Charley were two of the top five most costly storms in world history. *Catastrophes: Facts and Statistics*, *supra* note 3.

11. Hurricanes are rated on the Saffir-Simpson Scale from Category 1 (mildest; winds 74-95 mph) through Category 5 (most severe; winds greater than 155 mph). *Hurricane! 2006: A Hurricane Preparedness Booklet*, ACCUWEATHER.COM (May 2006), [http://vortex.accuweather.com/adc2004/pub/images/promos/florida2004/hurricane\\_book.pdf](http://vortex.accuweather.com/adc2004/pub/images/promos/florida2004/hurricane_book.pdf). Although Hurricane Katrina reached Category 5, it was actually lower at landfall. *See* National Weather Service, National Hurricane Center: Hurricane Katrina Advisory Archive, <http://www.nhc.noaa.gov/archive/2005/KATRINA.shtml> (last visited June 14, 2007) (view links for Monday, August 29, 2005).

12. *Catastrophes: Facts and Statistics*, *supra* note 3.

lion dollars.”<sup>13</sup> Of course, any major disaster could leave a legal office in ruins, in addition to causing personal tragedy and loss for its victims.

Hurricanes are only one form of natural disaster. Tornados, earthquakes, wildfires, blizzards, volcanoes, landslides, mudslides, flooding, and hailstorms also wreak havoc. Other disasters, such as tsunamis, could potentially threaten the United States, though the threat, historically, has been comparatively minor.<sup>14</sup>

However, even a smaller tragedy, such as a lightning strike triggering a fire, could be devastating. Because fires are vastly more numerous,<sup>15</sup> they continue to impact tens of thousands of taxpayers each year.<sup>16</sup> For example, while the major hurricanes of 2005 captured all of the media’s attention, over the same timeframe, the American Red Cross responded to a record 72,883 disasters, most of them fire-related.<sup>17</sup>

Based upon these statistics, it is prudent to understand the full range of tax relief and insurance options that might be available. The tragedy that disrupts your law practice may not be a hurricane or even a declared national disaster. If you fail to adequately prepare, a disaster may end your business. Even if a disaster is not financially fatal, appreciating the tax consequences is in every practitioner’s interest.

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13. U.S. GOV’T ACCOUNTABILITY OFFICE, U.S. TSUNAMI PREPAREDNESS: FEDERAL AND STATE PARTNERS COLLABORATE TO HELP COMMUNITIES REDUCE POTENTIAL IMPACTS, BUT SIGNIFICANT CHALLENGES REMAIN, GAO-06-519, at 11 (June 5, 2006), *available at* <http://www.gao.gov/new.items/d06519.pdf>.

14. *Id.* “[T]he frequency of damaging tsunamis in the United States has been low, compared with other natural hazards.” *Id.* at 10. According to the National Oceanic and Atmospheric Administration, the last significant tsunami struck Skagway, Alaska, in 1994, causing “one death and \$25 million in damages.” *Id.* at 10–11.

15. On average, there have been over 1.5 million fires annually in the United States over the past ten years. *See* U.S. Fire Administration, <http://www.usfa.dhs.gov/statistics/national/> (last visited June 14, 2007).

16. *Id.*

17. Press Release, Am. Red Cross, Survey Reveals Americans Not as Prepared as They Think (May 23, 2006), *available at* [http://www.redcross.org/pressrelease/0,1077,0\\_314\\_5398,00.html](http://www.redcross.org/pressrelease/0,1077,0_314_5398,00.html).

### B. *Demographic and Weather Trends*

The United States should expect a major catastrophic hurricane, Category 3, 4, or 5, to make landfall every six to seven years.<sup>18</sup> Even weaker storm systems can cause tremendous flood damage.<sup>19</sup> For example, Category 2 hurricanes, while weaker than major catastrophic hurricanes, generally have higher moisture content and account for considerable flood damage.<sup>20</sup>

Mitigation measures, predominantly improved building codes, have helped to “harden” vulnerable property.<sup>21</sup> However, the lure of the coast continues to bring more people and property into the areas most likely to be affected by hurricanes.<sup>22</sup> Over half of all Americans now live in coastal counties, which is an increase of thirty-three million people since 1980.<sup>23</sup> Because of these predictable weather profiles and demonstrated demographic trends, the risks from hurricanes will always be present.<sup>24</sup>

## III. TAX ADVICE FOR DISASTER VICTIMS

Presuming the survival and functionality of the firm or practitioner, the next question becomes how best to help both the business itself and any cli-

18. See Eric S. Blake et al., *The Deadliest, Costliest, and Most Intense United States Tropical Cyclones from 1851 to 2005 (and Other Frequently Requested Hurricane Facts)*, NAT'L WEATHER SERV., NAT'L HURRICANE CTR. (Apr. 2007), <http://www.nhc.noaa.gov/pdf/NWS-TPC-5.pdf>.

19. H.R. REP. NO. 107-495, at 1104 (2002) (testimony of Dr. Len Pietrafesa, North Carolina State University, in support of the Inland Flood Forecasting and Warning System Act of 2002).

20. *Id.*

21. See ROBERT P. HARTWIG, PRESENTATION TO THE WHARTON RISK MANAGEMENT AND DECISION PROCESSES CENTER ROUNDTABLE: THE LESSONS OF HURRICANE ANDREW: IS FLORIDA REALLY READY? 37 (June 11, 2002), [http://server.iii.org/yy\\_obj\\_data/binary/686021\\_1\\_0/hurricanestudy.pdf](http://server.iii.org/yy_obj_data/binary/686021_1_0/hurricanestudy.pdf).

22. For example, in the past twenty-five years, “communities along the . . . East Coast have dramatically increased development . . . despite the knowledge that a hurricane or large tropical storm could cause significant damage to property and life.” H.R. REP. NO. 107-495 at 4; see also Insurance Information Institute, *Hurricanes: Facts and Statistics: Leading States in Population Growth 1980–2003* (1), <http://www.iii.org/media/facts/statsbyissue/hurricanes/> (last visited June 14, 2007) [hereinafter *Hurricanes: Facts and Statistics*].

23. *Hurricanes: Facts and Statistics*, *supra* note 22 (stating that fifty-three percent of the United States populace resided in coastal areas in 2003).

24. Forecasters have long predicted a “damaging period of frequent storms” that could “cost more than \$110 billion if it hit . . . New England.” H.R. REP. NO. 106-526, at 16 (2000) (testimony in support of Homeowners’ Insurance Availability Act of 2000); see H.R. REP. NO. 107-495, at 3.

ents who are disaster victims. For this reason, appreciating the tax consequences of the disaster is doubly important. First, it allows the firm itself to maximize its own tax relief, which is perhaps the key to survival for smaller or less capitalized firms. Second, those firms and practitioners that survive and rebound must be able to competently help their clients to do the same.

To address both facets, the discussion below examines individual as well as business tax issues. It emphasizes knowledge and preparation ahead of time to minimize and to help posture to mitigate the effects of the damage. This advice can also be funneled to clients proactively so that they may better plan, and then execute, their emergency plans.

#### A. *Tax Relief for Victims of All Casualties*

Fortunately, the federal government has historically afforded some relief to victims of all casualties.<sup>25</sup> Section 165 of the *Internal Revenue Code* allows a tax deduction for “casualty losses.”<sup>26</sup> A casualty loss is a loss due to “fire, storm, shipwreck or other casualty, or from theft.”<sup>27</sup> The “other casualties” language has been construed by the courts to require a sudden and unexpected loss, as opposed to a loss derived from gradual deterioration.<sup>28</sup> For example, flooding due to a hurricane would be a casualty, while flooding due to worn-out pipes would not.

Section 165 entitlement is independent of any nationally declared emergency.<sup>29</sup> Therefore, any natural disaster, flood, or fire will be a casualty entitling the taxpayer to favorable treatment under the code.<sup>30</sup> One disadvantage of section 165, for individuals, is that it is only available to taxpayers who itemize their deductions.<sup>31</sup> For businesses, of course, all expenses are item-

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25. For an excellent discussion of the pre-2005 tax treatment of disasters, see generally Francine J. Lipman, *Anatomy of a Disaster Under the Internal Revenue Code*, 6 FLA. TAX REV. 953 (2005).

26. I.R.C. § 165(a), (c)(3) (2004 & Supp.).

27. *Id.* § 165(c)(3). For individuals, deductible losses must be “incurred in a trade or business,” derive from some other profit-seeking activity, or “arise from fire, storm, shipwreck, theft, or other casualty.” *Id.* § 165(c).

28. *See, e.g.,* Corbaley v. Comm’r, 47 T.C.M. (CCH) 1570, 1572 (1984) (aircraft crash due to engine failure not a casualty if caused by inadequate maintenance).

29. *But see* I.R.C. § 165(i) (timing advantage in declared emergency).

30. *See generally id.* § 165.

31. *See generally id.* §§ 161-199.



ized.<sup>32</sup> Other limitations reducing section 165's efficacy in compensating individuals for personal loss<sup>33</sup> are similarly not applicable to businesses.<sup>34</sup>

A disadvantage for businesses is that uninsured "loss" is confined to the depreciated value of property that is damaged or destroyed.<sup>35</sup> Because this "book value" often radically understates the costs of replacement property, the advantage to the taxpayer may not be nearly as generous as it would first appear.

A corollary would be that insurance proceeds, based on replacement cost, would lead to a casualty gain for the same reason. For instance, office furniture purchased in 2002 for \$10,000 and depreciated to \$5,000 may cost \$15,000 to replace in 2007. If insured with replacement cost coverage, the taxpayer would have a casualty gain of \$10,000, which would be a gain on the books only, because the \$15,000 would be needed to replace the damaged items. One source of relief from this dilemma would be section 1033 of the *Internal Revenue Code*.<sup>36</sup> This section allows a taxpayer to replace property that has been involuntarily converted without recognizing any gain,<sup>37</sup> unless the taxpayer receives cash above the amount actually reinvested.<sup>38</sup> In a declared emergency, the taxpayer has four years,<sup>39</sup> versus the typical two years,<sup>40</sup> to secure qualifying replacement property.

Despite the statutory presumption that, unless otherwise excluded, all accessions to wealth constitute income pursuant to section 61 of the code,<sup>41</sup> the Internal Revenue Service (IRS) has long acknowledged that welfare payments need not be reported as income.<sup>42</sup> Disaster relief is a type of welfare payment because it helps individuals and families who are put in need based on the emergency confronting them.<sup>43</sup> "The assistance that a government grants its citizens who sustain personal injury and property damage as

32. *See id.* § 162.

33. *See id.* § 165(h) (10 percent adjusted gross income reduction and \$100 per casualty reduction in the amount allowed to be deducted by individuals, unless loss is to property held for trade, business, or investment).

34. *See* I.R.C. § 165(c). Damages to an individual's property used in a trade or business (such as a sole practitioner's law practice) are not subject to these reductions. *Compare id.* § 165(c)(1), *with id.* § 165(c)(3).

35. *Id.* § 165(b). *See generally id.* §§ 1011, 1012, 1016.

36. *Id.* § 1033.

37. *See id.* § 1033(a)(1).

38. I.R.C. § 1033(a)(2)(A).

39. *Id.* § 1033(a)(2)(B)(i).

40. *Id.* § 1033(h)(1)(B).

41. *Id.* § 61(a).

42. Rev. Rul. 74-205, 1974-1 C.B. 21; *see also* I.R.S. Notice 2002-76, 2002-2 C.B. 917 (tax-exempt grants following September 11, 2001).

43. Rev. Rul. 76-144, 1976-1 C.B. 17, 17-18.

the result of hurricanes, tornadoes, earth-quakes and other natural disasters is motivated by its obligation to assist in alleviating the suffering and damage caused by the disaster.”<sup>44</sup> However, while government public welfare payments to individuals are tax exempt, similar relief payments to businesses are not.<sup>45</sup>

Because of the turmoil of the moment—safeguarding family members and trying to put lives back together—paying taxes may be the last thing on anyone’s mind. In addition, law firms and sole practitioners may be confronted with lost or destroyed records. Taxpayers, whose records are lost or who are otherwise unable to meet filing deadlines because of a natural disaster, *may* be granted an extension by the IRS based upon “reasonable cause.”<sup>46</sup> The mere fact you were the victim of a disaster does not automatically qualify as reasonable cause; instead, the IRS evaluates all such requests on a case-by-case basis.<sup>47</sup>

#### B. *Advantages for Victims of Presidentially Declared Disasters*

There is more flexibility in the *Internal Revenue Code* for victims of presidentially declared disasters than for victims of other casualties.<sup>48</sup> The Secretary of the Treasury has discretionary authority in times of presidentially declared disasters to offer a blanket extension for up to one year for affected taxpayers to file and pay taxes.<sup>49</sup> Compare this favorable treatment with sections 6081 and 6161 of the code, which allow the Secretary discretion to extend deadlines for “a reasonable time not to exceed six months” for disasters that do not result in a declared<sup>50</sup> disaster area.<sup>51</sup>

44. *Id.* at 18.

45. Compare Rev. Rul. 74-205, 1974-1 C.B. 21 (social benefit program payments not includible in income), and Rev. Rul. 76-144, 1976-1 C.B. 17 (disaster relief in interest of general welfare—not income), and Rev. Rul. 98-19, 1998-1 C.B. 840 (relocation payments for moving from flood-damaged residence not taxable), with Rev. Rul. 2005-46, 2005-30 I.R.B. 120 (emergency grants to businesses are not tax exempt).

46. Internal Revenue Manual 25.16.1.1 (2003), available at <http://www.irs.gov/irm/part25/ch12s01.html>.

47. *Id.* For example, if a taxpayer arranged for a loan to pay taxes due on his business, but the bank scheduled to close on the loan where the business was not open due to severe damages, the IRS would consider abatement “using reasonable cause criteria.” *Id.*

48. Compare I.R.C. § 7508A (2004 & Supp.), with *id.* §§ 6081, 6161.

49. *Id.* § 7508A(a).

50. “Declared” is used throughout as an equivalent to “presidentially declared.” See Robert T. Stafford Disaster Relief and Emergency Assistance Act, Pub. L. No. 100-707, 102 Stat. 4689 (1988) (codified at 42 U.S.C. § 5170 (2000 & Supp.)). Both relate to areas declared by the president to be National Disaster Areas pursuant to section 401 of the Stafford Act. *Id.* at § 401, 102 Stat. at 4696.

The code also allows other advantages for victims of presidentially declared tragedies.<sup>52</sup> For example, section 7508A allows the Secretary discretion to disregard deadlines for filing and payment of taxes in declared disaster areas.<sup>53</sup> It states:

In the case of a taxpayer determined by the Secretary to be affected by a Presidentially declared disaster . . . the Secretary *may specify* a period of up to one year that may be disregarded in determining . . . [whether filing or payment of tax]<sup>54</sup> were performed within the time prescribed . . . the amount of any interest, penalty, additional amount, or addition to the tax . . . [and] the amount of any credit or refund.<sup>55</sup>

These extensions are then automatic for affected taxpayers in the declared disaster region.<sup>56</sup> In addition to the obvious advantage of additional time pursuant to this relief, the IRS has been empowered to forgive interest and penalties whenever such relief is granted.<sup>57</sup> For taxpayers who fail to qualify as “affected taxpayers” or who are outside declared disaster areas,

51. I.R.C. § 6161(a)(1); *see also id.* § 6081 (discretion to extend filing any time based on reasonable cause).

52. *See, e.g., id.* § 1033(h) (favorable treatment of insurance proceeds and doubling of time to replace involuntarily converted property). *See infra* notes 65–66 and accompanying text.

53. *See* I.R.C. § 7508A.

54. *Id.* § 7508A(a)(1) specifically allows the following relief when time is disregarded:

- (A) Filing any return of income, estate, . . . gift tax, [employment, or excise tax];
- (B) Payment of any income, estate, . . . gift tax, [employment, or excise tax] . . . or any installment thereof or of any other liability to the United States in respect thereof;
- (C) Filing a petition with the Tax Court for redetermination of a deficiency, or for review of a decision rendered by the Tax Court;
- (D) Allowance of a credit or refund of any tax;
- (E) Filing a claim for credit or refund of any tax;
- (F) Bringing suit upon any such claim for credit or refund;
- (G) Assessment of any tax;
- (H) Giving or making any notice or demand for the payment of any tax, or with respect to any liability to the United States in respect of any tax;
- (I) Collection, by the Secretary, by levy or otherwise, of the amount of any liability in respect of any tax;
- (J) Bringing suit by the United States, or any officer on its behalf, in respect of any liability in respect of any tax; and
- (K) Any other act required or permitted under the internal revenue laws specified by the Secretary.

*Id.* § 7508A(a)(1)(A)-(K).

55. *Id.* § 7508A(a) (emphasis added).

56. *See supra* note 46 and accompanying text.

57. Katrina Emergency Tax Relief Act of 2005 (KETRA), I.R.C. § 7508(a)(1).

there is no authority to forgive interest, and the IRS will consider abatement of late payment penalties on a case-by-case basis.<sup>58</sup>

The authority to disregard time under section 7508A offers important additional procedural protections.<sup>59</sup> Perhaps most critical for a tax practitioner, it extends the time to file a petition with the Tax Court and to file a claim for a refund or credit, or any other act required or permitted “under the internal revenue laws.”<sup>60</sup>

Section 165(i) allows another substantial advantage to victims of declared disasters—an “[e]lection to take the deduction” for casualty losses in the immediately preceding tax year.<sup>61</sup> The benefit of this preference is twofold. Obviously, taking the election affords earlier tax relief for the loss. Additionally, allowing the taxpayer the option to choose the year to take the deduction allows the taxpayer the benefit of selecting the tax year that yields a better result. The preceding tax year may well reflect greater income due to the lack of catastrophic interruption; therefore, relief for the earlier period may well be from a higher marginal tax rate.

After the terrorist bombings of September 11, 2001, section 139 was promulgated to codify that recipients are not taxed on “qualified disaster relief payment[s].”<sup>62</sup> However, this section only applies to relief payments made to individuals.<sup>63</sup> Thus, any disaster relief granted to businesses would be includable as income.<sup>64</sup>

### C. *Additional Tax Relief Following Specific National Disasters*

Congress and the IRS have acted on an ad hoc basis in the past in affording tax relief to victims of disaster. This section captures some of the more predictable responses (time extensions to file and pay taxes), as well as the more generous breaks that have accompanied some tragedies. It is not intended as an exhaustive discussion; rather, this section will provide insight

58. *See id.*; I.R.C. §§ 6081, 6161, 6601, 7508A.

59. *See id.* § 7508A(a).

60. *Id.*

61. *Id.* § 165(i)(1). The election is irrevocable after ninety days. 26 C.F.R. § 1.165-11(e) (2006).

62. I.R.C. § 139(a) (added by Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, § 111, 115 Stat. 2427, 2432 (2002)). Qualified disasters include presidentially declared disasters, disasters from terrorist or military activity, disasters resulting from accidents involving common carriers, or other events determined by the Secretary to be catastrophic. *Id.* § 139(c)(1)-(3). Amounts paid by federal, state, or local governments determined to warrant assistance are also not taxable. *Id.* § 139(c)(4).

63. *Id.* § 139(a).

64. *See Rev. Rul.* 2005-46, 2005-2 C.B. 120, 122 (emergency grants to businesses are not tax exempt).

into the spectrum of tax relief that has been afforded, at times in the past, and to suggest that tax relief has, at times, been more creative and substantial in the recent past.<sup>65</sup>

As noted above, under section 6081, the Secretary may extend the deadline for filing a return for a reasonable amount of time.<sup>66</sup> The deadline for payment of taxes due may similarly be extended “for a reasonable period not to exceed [six] months.”<sup>67</sup> The IRS used this authority to grant automatic tax relief to victims of Hurricane Hugo,<sup>68</sup> Hurricane Andrew,<sup>69</sup> and Hurricane Iniki.<sup>70</sup> To qualify for this blanket extension, taxpayers had to be affected by the disaster.<sup>71</sup> Taxpayers alerted the IRS that they were affected by writing the name of the disaster on the top of their tax return.<sup>72</sup> Taxpayers with an address within the disaster area were presumed to be affected; other taxpayers needed to submit a short statement of how the hurricanes “adversely affected their ability to meet their tax obligations.”<sup>73</sup>

Although no tax relief was provided by Congress to the victims of Hurricane Hugo, Congress extended explicit tax relief to the victims of Hurricanes Andrew and Iniki.<sup>74</sup> It also retroactively afforded tax relief to victims of all presidentially-declared disasters after September 1, 1991.<sup>75</sup> The new law allowed victims of declared emergencies four years versus two years to replace their home and its scheduled contents without recognizing a taxable gain.<sup>76</sup> Congress also created tax advantages for insured individuals to the

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65. For a more detailed discussion of the tax relief related to each of the disasters in this section, see generally Patrick E. Tolan, Jr., *The Flurry of Tax Law Changes Following the 2005 Hurricanes: A Strategy for More Equitable Tax Treatment of Victims*, 72 BROOK. L. REV. 799 (2007).

66. I.R.C. § 6081(a).

67. *Id.* § 6161(a)(1). The limit may be longer for persons abroad and is twelve months for estate tax payments. *Id.*

68. I.R.S. Notice 89-136, 1989-2 C.B. 451, 451–52.

69. I.R.S. Notice 92-40, 1992-2 C.B. 371, 371–72.

70. I.R.S. Notice 92-44, 1992-2 C.B. 373, 375.

71. *See id.*; *supra* notes 66–67 and accompanying text.

72. I.R.S. Notice 92-44, 1992-2 C.B. at 375; I.R.S. Notice 92-40, 1992-2 C.B. at 372; I.R.S. Notice 89-136, 1989-2 C.B. at 452.

73. *Id.*

74. *See Omnibus Budget Reconciliation Act of 1993*, I.R.C. § 1033(h)(1) (1996).

75. *Id.* § 1033(h)(2). This benefit included victims of Hurricane Andrew, Hurricane Iniki (the worst hurricane to strike the Hawaiian Islands in a century), any other declared disasters occurring in 1992, and all subsequent disasters. *See Proclamation No. 6491*, 57 Fed. Reg. 47, 553 (Oct. 14, 1992).

76. I.R.C. § 1033(h)(1)(B).

extent their unscheduled contents were destroyed—involuntarily converted—as a result of a declared disaster.<sup>77</sup>

Changes granting identical treatment to businesses followed many years later.<sup>78</sup> The Small Business Job Protection Act of 1996 extended the four-year replacement period in declared disaster areas to property held for a trade or business.<sup>79</sup> Therefore, any business property—real or personal—is now subject to the same favorable tax treatment when the property destroyed is in a declared disaster area.<sup>80</sup> This authority would allow a law firm to rebuild on the same site or to relocate its practice to another area within the four-year window without recognizing any gain on the involuntary conversion.<sup>81</sup>

In addition to substantive tax relief following Hurricanes Andrew and Iniki, the IRS announced that it would expedite review of applications for tax exempt status by groups newly formed to aid the disaster victims.<sup>82</sup> The IRS also indicated it would not raise issues concerning approved charitable organizations that might otherwise affect an organization's qualification for tax exempt status—such as an organization rendering assistance in good faith to its own employees who were victims of the disasters.<sup>83</sup> Finally, for designated counties and parishes impacted by Hurricane Andrew, the IRS provided relief from certain low income housing credit requirements.<sup>84</sup>

After Hurricane Andrew, the Northridge Earthquake was the most costly U.S. natural disaster before Hurricane Katrina.<sup>85</sup> On January 17, 1994, this earthquake, which measured 6.8 on the Richter scale, “jolted the San Fernando Valley, [just] 20 miles northwest of downtown Los Ange-

77. *Id.* § 1033(h)(1)(A). The IRS interpreted this provision generously for the taxpayer. See generally Rev. Rul. 95-22, 1995-1 C.B. 145, 145-46 (excluding from income all gain on nonscheduled personal property).

78. See Small Business Job Protection Act of 1996, Pub. L. No. 104-188, §1119, 110 Stat. 1755, 756.

79. *Id.* at § 1119(b) (referring to I.R.C. §1033(h)(1)(B)).

80. *Id.* at § 1119(a).

81. See *id.*

82. I.R.S. Announcement 92-140, 1992-41 I.R.B. 75 (referring to Hurricane Iniki relief); I.R.S. Announcement 92-128, 1992-38 I.R.B. 42 (referring to Hurricane Andrew relief).

83. I.R.S. Notice 92-45, 1992-2 C.B. 375.

84. I.R.S. Notice 92-43, 1992-2 C.B. 373 (authorizing relief from carryover allocations under I.R.C. § 42(h)(1)(E) and recapture under § 42(j)(4)(E)).

85. ROBERT P. HARTWIG, HURRICANE SEASON OF 2005: IMPACTS ON US P/C INSURANCE MARKETS IN 2006 & BEYOND 13 (2006), [http://server.iii.org/yy\\_obj\\_data/binary/744085\\_1\\_0/katrina.pdf](http://server.iii.org/yy_obj_data/binary/744085_1_0/katrina.pdf) [hereinafter HARTWIG, HURRICANE SEASON].

les.”<sup>86</sup> The Northridge Earthquake “caus[ed] more than 60 deaths [and] 12,000 injuries.”<sup>87</sup> It destroyed 8,000 homes and damaged more than 114,000 buildings.<sup>88</sup> According to the Insurance Information Institute, it caused \$15.3 billion in insured losses.<sup>89</sup>

Congress provided no tax relief to the earthquake disaster victims.<sup>90</sup> Perhaps because such a low percentage of the buildings damaged were homes, Congress felt less sympathy for business and other property loss.<sup>91</sup> In any event, the IRS response was also less pronounced.<sup>92</sup> The quake relief was less extensive than the relief to the 1992 hurricane victims.<sup>93</sup> Like the 1992 relief, the IRS granted extensions of time to file and pay taxes, but instead of a six month extension, the extension was only for ten calendar days.<sup>94</sup> The IRS also suspended normal collection and examination actions for two weeks—versus thirty days for affected taxpayers in the 1992 hurricane disaster areas.<sup>95</sup> Finally, the IRS announced that it would expedite review of applications for tax exempt status by groups newly formed to aid the disaster victims, and it would “not raise certain issues” concerning charitable organizations that might affect an organization’s tax exempt status.<sup>96</sup>

Following Hurricane Andrew, Hurricane Iniki, and the Northridge Earthquake, the states of Florida, California, and Hawaii intervened to prevent a near total collapse of their respective insurance markets.<sup>97</sup> Perhaps these state bail-outs averted the need for serious discussion of federal tax

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86. Insurance Information Institute, Hot Topics & Issues Updates, Catastrophes: Insurance Issues, <http://www.iii.org/media/hottopics/insurance/xxx> (last visited June 14, 2007) [hereinafter Catastrophes: Insurance Issues].

87. *Id.*

88. *Id.*

89. *Id.*

90. *See id.*

91. *See Catastrophes: Insurance Issues, supra* note 86.

92. *Id.*

93. *Compare id., with* I.R.S. Announcement 92-128, 1992-38 I.R.B. 42.

94. I.R.S. News Release IR-94-5 (Jan. 19, 1994) (“IRS Offices to Provide Disaster Tax Assistance”). Taxpayers were directed to mark the return: “LA EARTHQUAKE.” *Id.*

95. I.R.S. News Release IR-92-88 (Aug. 28, 1992); I.R.S. News Release IR-92-91 (Sept. 16, 1992).

96. I.R.S. Notice 94-15, 1994-1 C.B. 337, 337 (2000).

97. *See* H.R. REP. NO. 106-526, at 15 (2006). Other risk-prone states lacking state insurance programs saw “applications to state FAIR (Fair Access Insurance Requirements) plans and beach plans (so-called markets of last resort for homeowners’ insurance which generally provide less coverage at a greater price) increased dramatically during the last half of the 1990s.” *Id.* at 16.

relief. In any event, other than the limited relief discussed above, no tax relief was spawned by these major tragedies.<sup>98</sup>

Compared with the limited tax relief to victims of earlier natural disasters, Congress was quick to authorize federal tax relief for the victims of the terrorist attacks of September 11, 2001.<sup>99</sup> The Victims of Terrorism Tax Relief Act of 2001<sup>100</sup> granted the victims of these atrocities substantial tax relief, including—among other things—relief from income taxes at a minimum of \$10,000;<sup>101</sup> “exclusion of certain death benefits;”<sup>102</sup> “estate tax reduction;”<sup>103</sup> “exclusion of disaster relief payments;”<sup>104</sup> and, “exclusion of certain cancellations of indebtedness.”<sup>105</sup> It also allowed “payments by charitable organizations [to be] treated as exempt payments.”<sup>106</sup> Finally, the Act delegated authority to the IRS to postpone certain deadlines for up to one year in cases of natural disaster, military, or terrorist attack.<sup>107</sup>

In addition to tax relief for individual victims, another Act also created a “New York Liberty Zone” with substantial tax advantages for Liberty Zone businesses.<sup>108</sup> These benefits included employment credits,<sup>109</sup> bonus and

98. See *Catastrophes: Insurance Issues*, *supra* note 86. Perhaps the most notable by-product of Hurricane Andrew was the call for better building codes and better enforcement of existing codes. *Id.*

99. Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, § 105(a)(1), 115 Stat. 2427, 2432 (2002) (codified as amended in scattered sections of the I.R.C.).

100. *Id.*

101. *Id.* § 101(a) (codified at I.R.C. § 692(d)(2) (2004 & Supp.)). The IRS allowed full abatement of all tax liability for tax years 2000 and 2001 for victims killed in the attacks. I.R.S. News Release IR-2002-07 (Jan. 23, 2002). At the same time, the IRS forgave the tax liability for 1994 and 1995 for the victims of the Oklahoma City bombing. *Id.*

102. Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, § 102, 115 Stat. at 2429 (codified at I.R.C. § 101).

103. *Id.* § 103 (codified at I.R.C. § 2201).

104. *Id.* § 111 (codified at I.R.C. § 139). “[Section] 139(b)(4) codifies . . . [the] general welfare exclusion for qualified disaster relief payments to individuals.” I.R.S. Notice 2002-76, 2002-2 C.B. 917, 918. “Because of the extraordinary circumstances surrounding [such disasters], [the IRS] anticipate[s] that individuals will not be required to account for actual expenses” so long as the amount of relief is commensurate with the anticipated expenses incurred. *Id.* (internal quotations omitted).

105. Victims of Terrorism Tax Relief Act of 2001, § 105, 115 Stat. at 2432 (codified at I.R.C. § 108).

106. *Id.* § 104, 115 Stat. at 2431 (codified at I.R.C. § 501).

107. *Id.* § 112, 115 Stat. at 2431 (codified at I.R.C. § 7508A) (increased from 120 days).

108. Job Creation and Worker Assistance Act of 2002, Pub. L. No. 107-147, § 301, 116 Stat. 21, 33 (codified at I.R.C. § 1400L). “‘New York Liberty Zone’ means the area 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 in the City of New York, New York.” I.R.C. § 1400L(h). Liberty Zone businesses are those employing no more than 200 employees which rebuilt in the footprint of the terrorist bombings of



accelerated depreciation and increased expensing for qualified Liberty Zone property;<sup>110</sup> tax exempt bond advantages;<sup>111</sup> and, an extension from two to five years for not recognizing gains for property involuntarily converted (where replacement property was in the Liberty Zone).<sup>112</sup> Some of the tax advantages for individuals and businesses foreshadowed a similar Congressional response to the massive 2005 hurricane disasters.<sup>113</sup>

After 9/11, Congress extended the IRS authority to “disregard” time under section 7508A from 120 days to one year.<sup>114</sup> The IRS was also empowered to waive interest, as well as penalties, when disregarding time.<sup>115</sup> These important provisions are now part of the statutory framework protecting disaster victims in declared emergencies.<sup>116</sup>

Despite the high number of hurricanes in 2004—Charley, Ivan, Frances, and Jeanne—and the magnitude of the damages they caused, Congress afforded no tax relief to victims.<sup>117</sup> The IRS, however, used its discretion to disregard time and extend time for filing and payment of taxes.<sup>118</sup> Although

September 11, 2001 (commonly thought of as ground zero), as well as any businesses damaged or destroyed by the attacks that relocated anywhere else within New York City. *See id.* § 1400L(a)(2)(C).

109. *See* I.R.C. § 1400L(a)(2)(D); *see also id.* § 51.

110. *See id.* § 1400L(b)(2)(C); *see also id.* § 168(k).

111. *See generally id.* § 1400L(d)-(e).

112. *See* I.R.C. § 1400L(g).

113. *Compare id.* § 1400L, with I.R.S. Notice 2001-61, 2001-2 C.B. 305, 305-07.

114. I.R.S. Notice 2001-61, 2001-2 C.B. at 306. Earlier in 2001, in response to the New Mexico wildfires, the IRS had similarly construed its authority under code section 7508A to run consecutively (versus concurrently) with its extension authorities under sections 6081 and 6161. I.R.S. Notice 2001-30, 2001-1 C.B. 989, 989-90.

115. *See* I.R.S. Notice 2002-40, 2002-1 C.B. 1152, 1152. This notice is based on new authority from the Victims of Terrorism Tax Relief Act of 2001. *Id.*; *see also* Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, § 112, 115 Stat. 2427, 2433-34 (2002).

116. *See generally* I.R.C. § 1400.

117. *But cf.* Katrina Emergency Tax Relief Act of 2005 (KETRA), Pub. L. No. 109-73, § 403(a), 119 Stat. 2016, 2027 (providing tax relief to victims of Hurricane Katrina).

118. While it was, at that time, the most expensive ever, the widespread loss in 2004 did not lead to any federal legislative tax relief. *See* Blake et al., *supra* note 18. There was a flurry of IRS activity. *See, e.g.,* I.R.S. Notice 2004-76, 2004-2 C.B. 878, 878 (relief from certain requirements due to Hurricanes Charley, Frances, Ivan, and Jeanne); I.R.S. Notice 2004-62, 2004-2 C.B. 565, 565 (additional relief for areas affected by Tropical Storm Bonnie, and Hurricanes Charley and Frances); I.R.S. News Release IR-2004-115 (Sept. 10, 2004) (extending time to file and pay taxes for Hurricane Frances); I.R.S. News Release IR-2004-108 (Aug. 16, 2004) (extending time to file and pay taxes for areas affected by Tropical Storm Bonnie and Hurricane Charley). The IRS granted extensions of time to file and pay taxes; relief from deadlines involved in section 1031 like-kind exchange transactions; and, a suspension of the income limitations (ordinarily required for occupants of low-income housing) to

massive IRS activity was the norm again in 2005, this time Congress was awakened by the devastation and stepped in with the most comprehensive tax relief ever for victims of natural disasters.<sup>119</sup> This flurry of activity is the subject of the next section.

#### D. *The Post-Katrina High Water Mark for Tax Relief*

The Katrina Emergency Tax Relief Act of 2005 (KETRA) was signed by President Bush and became law on September 23, 2005.<sup>120</sup> KETRA contained important tax benefits both for individuals and for businesses.<sup>121</sup> Title I crafted special rules for using retirement funds.<sup>122</sup> Title II allowed employment relief.<sup>123</sup> Title III contained incentives for charity and Title IV created miscellaneous additional benefits.<sup>124</sup> These benefits are discussed in detail in the sections that follow. The cumulative benefit was significant, as KETRA was estimated to cost the federal government \$6.1 billion in foregone tax revenue.<sup>125</sup>

KETRA opened the door to wide-ranging tax relief for hurricane victims.<sup>126</sup> Following the continued devastation wrought by Hurricanes Rita and Wilma over the ensuing weeks, Congress passed additional tax relief legislation.<sup>127</sup> The Gulf Opportunity Zone Act of 2005 (GO Zone Act) was passed on December 15, 2005, and signed into law on December 21, 2005.<sup>128</sup>

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allow landlords of such property to provide temporary lodging to individuals displaced by Hurricanes Charley, Frances, Ivan, and Jeanne. I.R.S. Notice 2004-76, 2004-2 C.B. at 878; *see also* I.R.S. Notice 2005-3, 2005-1 C.B. 447, 447; I.R.S. Notice 2004-74, 2004-2 C.B. 875, 875; I.R.S. Notice 2004-75, 2004-2 C.B. 876, 876 (relief in Ohio due to post-hurricane severe storms and flooding); I.R.S. News Release IR-2004-118 (Sept. 22, 2004).

119. *See infra* part D.

120. *See* KETRA, Pub. L. No. 109-73, 119 Stat. 2016 (codified in scattered sections of the I.R.C.).

121. *See generally id.*

122. *See generally id.* §§ 101-104.

123. *See generally id.* §§ 201-202.

124. *See generally id.* §§ 301-306, 401-407.

125. DAVID L. BRUMBAUGH, MAJOR TAX ISSUES IN THE 109TH CONGRESS, CRS REPORT FOR CONGRESS 9 (May 22, 2006), *available at* <http://www.house.gov/english/pdf/majortaxissues.pdf>.

126. *See generally* KETRA, § 403(a), 119 Stat. at 2027.

127. Before Rita had struck, the president had announced a desire to create an opportunity zone for redevelopment, and Congress was working to pass such legislation. U.S. Senate Committee on Finance, Remarks of Senator Chuck Grassley of Iowa (Sept. 12, 2005), *available at* <http://www.senate.gov/~finance/press/Gpress/2005/prg091205.pdf>. “We’re looking at depreciation changes, tax-exempt bond authority, [tax-exempt bond funding], and enterprise-zone initiatives.” *Id.*

128. Gulf Opportunity Zone Act of 2005, Pub. L. No. 109-135, 119 Stat. 2577, 2642.

The tax relief for those affected by the later hurricanes was packaged with more far-reaching relief for those affected by Hurricane Katrina.

The core disaster area for Hurricane Katrina was renamed the “Gulf Opportunity Zone,” or “GO Zone,”<sup>129</sup> and similar tax advantaged areas were established for the victims of Hurricanes Rita and Wilma—the “Rita GO Zone”<sup>130</sup> and “Wilma GO Zone.”<sup>131</sup> As with the initial KETRA relief, only those areas “determined by the President to warrant individual or individual and public assistance from the Federal Government” qualified for special GO Zone tax benefits.<sup>132</sup>

This layered scheme of relief, with KETRA at times supplemented by and at times superseded by the GO Zone Act, is complex and confusing. It also created disparate tax treatment.<sup>133</sup> Those within the “GO Zone” (Katrina victims) were afforded some benefits not shared by those in the “Rita GO Zone” or “Wilma GO Zone.”<sup>134</sup> For example, Congress provided an enhanced education tax credit, for tax years 2005 and 2006, for students who attended educational institutions in the (Katrina) GO Zone.<sup>135</sup> A variety of economic stimuli were also uniquely targeted to the victims of Katrina’s devastation.<sup>136</sup> This article does not detail the disparities in treatment between the victims of the various 2005 disasters;<sup>137</sup> rather, it looks at the range of tax remedies that Congress unleashed to try to deal with the aftermath of the disasters. The following sections summarize the significant tax relief remedies from the 2005 legislation.

### 1. Statutory Extensions to File and Pay Taxes

Congress required the Secretary of the Treasury to extend *inter alia* the period for filing and payment of taxes to all taxpayers in the three declared disaster areas, “for a period ending not earlier than February 28, 2006.”<sup>138</sup> While the IRS could, and ultimately did, “disregard” a year under code sec-

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129. I.R.C. § 1400M(1) (2004 & Supp.).

130. *Id.* § 1400M(3).

131. *Id.* § 1400M(5).

132. *Id.* § 1400M(1), (3), (5).

133. *Id.*

134. Note, some of the victims of Hurricane Katrina were also victims of Hurricane Rita; if they qualify for individual or individual and public relief due to Katrina, these measures protect them. *See* I.R.C. § 1400M(1).

135. *See id.* § 1400O.

136. *See infra* notes 155–77 and accompanying text.

137. For such an analysis, see Tolan, Jr., *supra* note 65.

138. I.R.C. § 1400S(c).

tion 7508A,<sup>139</sup> KETRA represented the first time Congress had usurped this discretionary authority. For the future, if a catastrophe is sufficiently tragic or widespread, Congress may again be prompted to act, because there is no reason to expect that loss of records and inability to timely prepare and file returns will not ensue.

## 2. Enhanced Retirement Account Access

Special rules for use of retirement funds first adopted in KETRA were extended to also include individuals who sustained economic loss from Hurricanes Rita and Wilma.<sup>140</sup> Victims whose primary residences were located in the designated disaster areas were authorized to withdraw, without penalty, up to \$100,000 from an eligible retirement plan.<sup>141</sup>

Under this authority, individuals may prorate income over three years,<sup>142</sup> repay within three years (and characterize the distribution as a rollover),<sup>143</sup> or, if preferred, borrow up to \$100,000 from their employer retirement savings plan and repay the sum within five years.<sup>144</sup> Such flexibility allows people to borrow from themselves without penalty at a time when they are most desperate for funds. Despite pension reform and congressional efforts to relax some of the IRA rules in 2006, Congress did not make access to retirement accounts for disaster victims a permanent part of the code.<sup>145</sup>

## 3. Improved Casualty Loss Deduction and Other Deductions

Those suffering casualty losses attributable to Hurricanes Katrina, Rita, or Wilma were allowed relief from the ten percent AGI and \$100 reductions on casualty losses under code section 165.<sup>146</sup> The dates of the losses necessarily needed to correspond to the periods after the respective hurricanes made landfall.<sup>147</sup>

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139. *Id.* § 7508A.

140. *See id.* § 1400Q.

141. *Id.* § 1400Q(a); Section 402(c)(8)(B) of the *Internal Revenue Code* defines an eligible retirement plan. *Id.* § 402(c)(8)(B).

142. I.R.C. § 1400Q(a)(5).

143. *Id.* § 1400Q(a)(3)(A).

144. *Id.* § 1400Q(c).

145. *See* Pension Protection Act of 2006, Pub. L. 109-280, § 1201(a), 120 Stat. 780, 1063 (codified at I.R.C. § 408(d)(8)) (allowing tax exempt distributions for charitable donation); Tax Relief and Health Care Act of 2004, Pub. L. 109-432, §307(a), 120 Stat. 2922, 2951 (codified at I.R.C. § 408(d)(9)) (allowing tax-free one-time IRA distribution to fund Health Savings Account).

146. I.R.C. § 165(h)(1); *see also id.* § 1400S(b).

147. *Id.* § 1400S(b).

Special rules for determining earned income related to the Earned Income Credit and the refundable component of the Child Tax Credit were likewise afforded to “qualified individuals” in all three disaster areas.<sup>148</sup> To qualify, the victims had to either be displaced from their principal place of abode by the hurricane, or had to qualify for individual or individual and public assistance from the federal government.<sup>149</sup>

#### 4. Improved Deductibility of Charitable Donations

As an incentive for charitable donations, Congress lifted the ceiling on charitable deductions.<sup>150</sup> The ceiling is typically ten percent of a corporate taxpayer’s taxable income<sup>151</sup> or one-half of an individual taxpayer’s adjusted gross income.<sup>152</sup> KETRA and the GO Zone Act broadly enhanced charitable giving incentives.<sup>153</sup> To enjoy relief from the limitations on charitable giving, corporate taxpayers were allowed to make contributions in 2005 to relief efforts supporting any of the three 2005 hurricanes.<sup>154</sup> Individual taxpayers enjoyed tax relief, so long as cash donations were made after August 28, 2005, and before December 31, 2005, regardless of whether the donations were linked to hurricane relief.<sup>155</sup>

Other changes beneficial to charity were also conceived. The mileage rate for charitable use of a vehicle in 2005 hurricane relief efforts was substantially increased.<sup>156</sup> In the alternative, reimbursement for charitable use of a vehicle to provide Hurricane Katrina relief was excluded from income.<sup>157</sup> Donors of books to public schools were given explicit relief from downward adjustments of the deduction (to offset capital gains, as required

148. *Id.* § 1400S(d)(2)(B), (C), (D).

149. *Id.*

150. Katrina Emergency Tax Relief Act of 2005 (KETRA), Pub. L. No. 109-73, § 301, 119 Stat. 2016, 2022; *see* I.R.C. § 170(b)(1)(A) (limiting most charitable deductions to 50% of the taxpayer’s contribution base); *id.* § 170(b)(1)(B)(i) (limiting other charitable deductions to 30% of the taxpayer’s contribution base). Ordinarily, excess donations may be carried forward for the next five years. *Id.* § 170(b)(1)(B)(ii).

151. I.R.C. § 170(b)(2)(A).

152. *See id.* § 170(b)(1)(A), (B). The taxpayer’s contribution base is adjusted gross income computed without regard to any net operating loss carryback. *Id.* § 170(b)(1)(F); *see also id.* § 172. KETRA also excluded qualifying contributions from itemized deductions for purposes of the overall limitations in section 68 of the code. KETRA, § 301(c), 119 Stat. at 2023; *see* I.R.C. § 68.

153. I.R.C. § 1400S(a).

154. *Id.* § 1400S(a)(4)(A)(ii).

155. *Id.* § 1400S(a)(4)(A)(i).

156. *Compare id.* § 170(i) (fourteen cents per mile), *with* KETRA, § 303, 119 Stat. at 2024 (70% of standard business rate—yielding thirty-two cents per mile).

157. KETRA, § 304, 119 Stat. at 2024.

by section 170(e) of the *Internal Revenue Code*).<sup>158</sup> Finally, businesses were encouraged to donate food inventory before December 31, 2005.<sup>159</sup>

### 5. GO Zone Business Relief

While many of the GO Zone business tax incentives would not be helpful to rebuilding a law practice,<sup>160</sup> employee retention credits<sup>161</sup> and the other measures explained here may be significant. Of course, these benefits are all limited to the victims of the 2005 hurricanes. For future mega-disasters, however, Congress could allow similar relief.

Employee retention credits were created to motivate employers to retain employees in the disaster areas. These credits were extended to eligible employers in the Hurricane Katrina GO Zone,<sup>162</sup> the Hurricane Rita GO Zone,<sup>163</sup> and the Hurricane Wilma GO Zone.<sup>164</sup> The credit was made available to large and small businesses alike.<sup>165</sup>

For employers meeting the geographic requirements, the tax relief is very similar to the Work Opportunity Tax Credit in section 51 of the *Internal Revenue Code*.<sup>166</sup> The qualifying business can claim a 40% tax credit of the first \$6,000 for each retained employee.<sup>167</sup> For a company retaining a large number of workers, the relief could be substantial. For example, a company retaining 100 workers could potentially claim a \$240,000 credit.<sup>168</sup> Of course, a credit is much more valuable than a deduction since it directly off-

158. *Id.* § 306, 119 Stat. at 2025. While undoubtedly prompted by the need to restock public school books following Katrina, tax relief was not limited to donations to those affected by Hurricane Katrina. *Id.* However, the December 31, 2005, termination eliminates its utility for future crisis situations. *Id.* § 306(a)(iv), 119 Stat. at 2026.

159. *Id.* § 305(a)(iv), 119 Stat. at 2025. The limitation on contributions of food inventory is up to 10% of the business' aggregate income. KETRA, § 305(a)(ii), 119 Stat. at 2025.

160. While \$700 million in new market tax credits were created to redevelop the GO Zone, credits were available only to qualified community development agencies making qualified low-income community investments. Gulf Opportunity Zone Act of 2005, I.R.C. §§ 1400M-T. As a possible indirect benefit, Congress authorized nearly \$8 billion in tax-exempt bonds for construction in the disaster of residential rental projects, nonresidential real property, or public utilities in the GO Zone. *Id.* § 1400N(a)-(b).

161. *Id.* § 1400R.

162. *Id.* §§ 1400M(2), 1400R(a).

163. *Id.* §§ 1400M(3), 1400R(b).

164. I.R.C. §§ 1400M(5), 1400R(c).

165. Initially, under KETRA, the relief was only available for small businesses. *Compare* Katrina Emergency Tax Relief Act of 2005 (KETRA), Pub. L. No. 109-73, § 202(c), 119 Stat. 2016, 2022, *with* Gulf Opportunity Zone Act of 2005, I.R.C. § 1400R.

166. I.R.C. § 51 (2004).

167. *Id.* § 1400R(a)(1), (b)(1), (c)(1).

168.  $(40\% \times \$6,000 = \$2,400) \times 100 = \$240,000$ .

sets tax liability. In this example, the \$240,000 credit would be equivalent to a deduction of \$685,714 for a corporation in the 35% tax bracket.<sup>169</sup>

The credit amount is, however, limited to “qualified wages” paid after the business became inoperable, but before the business resumed significant operations.<sup>170</sup> Thus, if a business was only shut down for two days and payroll to each eligible employee was \$100 per day, the credit would only be \$8,000, versus the \$240,000 potential credit described above.<sup>171</sup> This additional restriction is sensible given the circumstances, because it prevents a business only incidentally impacted from receiving a windfall.

It is also interesting to note that the Work Opportunity Tax Credit, an incentive to employers to hire members of disadvantaged groups,<sup>172</sup> was offered to those hiring Hurricane Katrina employees (including displaced employees), but was not extended to employers hiring those affected by the later hurricanes.<sup>173</sup> This may reflect a concern that Katrina victims were more disadvantaged or more displaced than those of the later hurricanes or it may be that Congress later decided to restrict the advantage exclusively to employers within the relief areas.

Special depreciation allowances were established for GO Zone property placed into service from August 28, 2005, through the end of 2007 (2008 for nonresidential real property and residential rental property).<sup>174</sup> Half of the adjusted basis of the property can be written off the first year, plus ordinary depreciation can then be taken on the remaining half.<sup>175</sup> Code section 179 limits were also increased for the GO Zone by up to \$100,000.<sup>176</sup> Section 179 establishes a limit for the maximum cost of capital property (otherwise required to be depreciated over time) that can be deducted in the immediate tax year as a current expense.<sup>177</sup>

In a similar vein, taxpayers in all three GO Zones may elect to take up to fifty percent of any GO Zone clean-up cost as a deduction for the taxable year in which the cost is incurred.<sup>178</sup> They can also deduct one hundred per-

169.  $\$240,000 / .35 = \$685,714.29$ .

170. I.R.C. § 1400R(a)(2)(C), (b)(2)(C), (c)(2)(C).

171.  $(\$100 \times 2 \text{ days})(100 \text{ employees}) = \$20,000 \times 40\% \text{ credit} = \$8,000$ .

172. I.R.C. § 51.

173. See Katrina Emergency Tax Relief Act of 2005 (KETRA), Pub. L. No. 109-73, § 201, 119 Stat. 2016, 2020. Katrina employees were identified as members of a targeted group under section 51 for purposes of this credit; the deadline for hiring displaced workers was December 31, 2005. *Id.* § 201(b)(2), 119 Stat. at 2021.

174. Gulf Opportunity Zone Act of 2005, I.R.C §§ 1400M–T (2004 & Supp.).

175. *Id.*

176. *Id.* § 1400N(e).

177. *Id.*

178. *Id.* § 1400N(f).

cent of any environmental remediation costs, including remediation of hazardous substances as well as petroleum products, in the year clean-up costs are incurred.<sup>179</sup> To qualify for either of these special provisions, the clean-up must be conducted before December 31, 2007.<sup>180</sup>

Finally, instead of the typical two-year carryback period for net operating losses (pursuant to section 172(b)(1) of the *Internal Revenue Code*), the act allows a five-year carryback for any qualified GO Zone loss.<sup>181</sup> This period is the same period as the net operating losses carryback after 9/11, when Congress was trying to jumpstart the economy,<sup>182</sup> and is two years more generous than the net operating losses carryback period allowed for casualty losses for individuals or for any size business under section 165 of the code.<sup>183</sup> Like the preceding relief, the increased flexibility is also accompanied by substantive tax advantages. Here, the longer carryback period may enable a taxpayer to offset income in a tax year that would otherwise be unreachable.<sup>184</sup>

## 6. Housing Credit for Displaced Individuals

Perhaps the most novel 2005 tax relief was the creation of a new exemption for housing displaced hurricane victims. A \$500 exemption was created for tax years 2005 or 2006 for each Katrina victim taken in.<sup>185</sup> The maximum reduction of income for any taxpayer is limited to \$2000 (four displaced persons).<sup>186</sup> Relief is restricted to situations where the taxpayer does not receive rent from the displaced individual—or any other amount from any source—in connection with providing the housing.<sup>187</sup> Also, the displaced individual cannot be the spouse or dependent of the taxpayer.<sup>188</sup>

GO Zone measures also included tax relief for situations involving employer-provided housing.<sup>189</sup> Qualified employees were allowed to exclude

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179. I.R.C. § 1400N(g).

180. *Id.* § 1400N(f), (g).

181. *Id.* § 1400N(k).

182. *Id.* § 172(b)(1)(H).

183. *Id.* § 172(b)(1)(F). Note that the net operating loss carryback for small businesses in a declared disaster area is also three years (versus two) for any operating loss, not just those losses due to the casualty. I.R.C. § 172(b)(1)(F)(ii)(II).

184. The entire net operating loss is carried to the earliest of the taxable years to which such loss may be carried. I.R.C. § 172(b)(1)(F)(i).

185. Katrina Emergency Tax Relief Act of 2005 (KETRA), Pub. L. No. 109-73, § 302(a), 119 Stat. 2016, 2023.

186. *Id.* § 302(b)(1).

187. *Id.* § 302(c)(3).

188. *Id.* § 302(c). There is no restriction on other relatives. *Id.*

189. See I.R.C. § 1400P(a), (b), (f) (2004 & Supp.).



from gross income up to \$600 of the value of lodging provided by their employer from January 1, 2006, through July 1, 2006.<sup>190</sup> Additionally, the employer was allowed a tax credit of “30 percent of any amount which is excludable from the gross income of a qualified employee.”<sup>191</sup>

#### IV. IDENTIFYING AND ELIMINATING EXPOSURE TO DISASTER

##### A. Insurance Challenges

###### 1. Coverage Inadequacies (Type and Amount)

Individuals and businesses have used insurance to protect against financial perils for hundreds of years.<sup>192</sup> Standard insurance typically protects against fires, vandalism, burglary, theft, or storm activity.<sup>193</sup> However, insurance against water damage from storms has been seriously limited.<sup>194</sup> Most policies contain an express flood exclusion.<sup>195</sup> However, catastrophic damage from hurricanes often results from flood damage due to the storm surge and heavy rains.<sup>196</sup> Consequently, many do not have the right types of insurance coverage.<sup>197</sup>

Unfortunately, many disaster victims find out too late that they lack the proper flood insurance. Historically, floods have been “one of the most destructive national hazards facing the people of the United States.”<sup>198</sup> For

190. *Id.*

191. *Id.*

192. *See, e.g., Ins. Co. v. Dunham*, 78 U.S. (1 Wall.) 1, 30–33 (1870) (discussing evolution of maritime insurance over the past ten centuries).

193. *See generally* National Flood Insurance Act of 1968, 42 U.S.C. § 4001 (2000 & Supp.); *see also* Catastrophes: Insurance Issues, *supra* note 86.

194. Policies typically insure against some severe weather damage, such as wind and hail coverage, but exclude flood and storm surge damage. *See, e.g., Leonard v. Nationwide Mut. Ins. Co.*, 438 F. Supp. 2d 684, 695–96 (S.D. Miss. 2006) (policy precluded damage from flooding and storm surge during Hurricane Katrina, but covered damage caused by wind). The Insurance Information Issues indicates a typical homeowner’s policy contains a provision stating “[w]e do not pay for loss to the interior of a building or to personal property inside, caused by rain, snow, sleet, sand, or dust *unless the wind or hail first damages the roof or walls and the wind forces rain, snow, sleet, sand, or dust through the opening.*” HARTWIG, HURRICANE SEASON, *supra* note 85, at 145.

195. *See id.* at 146.

196. For example, Hurricane Katrina damages, due to storm surge and flooding, were estimated at \$44 billion, compared to \$38 billion for all other property damage. HARTWIG, HURRICANE SEASON, *supra* note 85, at 36, 48.

197. For a discussion regarding problems arising in litigation concerning the flood exclusion, see *infra* part IV.A.2.

198. S. REP. NO. 93-583 (1973), *reprinted in* 1973 U.S.C.C.A.N. 3217, 3218 (mandating coverage of federally-backed housing loans in flood hazard areas).

decades, Congress has been “acutely aware of the national need for a reliable and comprehensive flood insurance program,”<sup>199</sup> because as many as “ninety percent of all natural disasters in [this country] involve flooding.”<sup>200</sup>

The hurricane and flood devastation of 2005 was no exception. In Louisiana alone, Hurricane Katrina caused over \$38 billion in flood and storm surge damage—most of it uninsured.<sup>201</sup> In comparison, Louisiana was also the hardest hit with conventional insured losses due to Katrina of over \$22.5 billion.<sup>202</sup>

With the real property boom of the past few years, those who have not simultaneously increased their coverage may find themselves underinsured.<sup>203</sup> Currently, fifty-nine percent of homeowners are uninsured or under-insured.<sup>204</sup> While comparable data is not available for commercial property, with vacancy rates dropping, the commercial realty sector has likewise shown positive growth over the past two years.<sup>205</sup>

199. *Id.*

200. U.S. GOV'T ACCOUNTABILITY OFFICE, FEDERAL EMERGENCY MANAGEMENT AGENCY: IMPROVEMENTS NEEDED TO ENHANCE OVERSIGHT AND MANAGEMENT OF THE NATIONAL FLOOD INSURANCE PROGRAM, GAO-06-119, at 1 (Oct. 18, 2005), available at <http://www.gao.gov/new.items/d06119.pdf>; see generally JANE G. GRAVELLE, TAX POLICY OPTIONS AFTER HURRICANE KATRINA, CRS REPORT FOR CONGRESS (Sept. 16, 2005), available at <http://fpc.state.gov/documents/organization/53669.pdf>.

201. See ROBERT P. HARTWIG, LOUISIANA LEGISLATIVE WOMEN'S CAUCUS WORKSHOP ON INSURANCE & ECONOMIC DEVELOPMENT, LOUISIANA INSURANCE MARKET OVERVIEW: TOWARD VIABLE INSURANCE MARKETS IN THE POST-KATRINA & RITA ERA, 25–27 (Jan. 27, 2007), [http://server.iii.org/yy\\_obj\\_data/binary/754699\\_1\\_0/louisiana.pdf](http://server.iii.org/yy_obj_data/binary/754699_1_0/louisiana.pdf) [hereinafter HARTWIG, LOUISIANA INSURANCE MARKET OVERVIEW].

202. See *id.* at 26 (excludes \$1.47 billion in flood-damaged vehicles covered by comprehensive policies).

203. See Press Release, National Association of Realtors, Metro Home Prices Transition in Second Quarter (Aug. 15, 2006), [http://www.realtor.org/press\\_room/news\\_releases/2006/2ndqtrmetros06.html](http://www.realtor.org/press_room/news_releases/2006/2ndqtrmetros06.html) (price increases easing to single digit rise); Press Release, National Association of Realtors, Home-Price Appreciation Stays Hot in Most Metro Areas (Nov. 15, 2005), [http://www.realtor.org/press\\_room/news\\_releases/2005/homeprices3rdqtr05.html](http://www.realtor.org/press_room/news_releases/2005/homeprices3rdqtr05.html) (median home prices reflect 14.7% increase in 2005 compared to historically typical increase—1% to 2% over inflation rate since 1968).

204. See HARTWIG, LOUISIANA INSURANCE MARKET OVERVIEW, *supra* note 201, at 48 (although the numbers have improved in the past few years, most homes are still undervalued by 22%).

205. Press Release, National Association of Realtors, Commercial Real Estate Continues Uptrend (May 18, 2006), [http://www.realtor.org/press\\_room/news\\_releases/2006/comrelnktupdatemay06.html](http://www.realtor.org/press_room/news_releases/2006/comrelnktupdatemay06.html). David Lereah, the chief economist for the National Association of Realtors, noted, “we are seeing healthy levels of commercial real estate space being purchased, rented, and occupied.” Press Release, National Association of Realtors, Commercial Real Estate Market on Uptrack with Lower Vacancies (June 14, 2005), [http://www.realtor.org/press\\_room/news\\_releases/2005/commreouptrack.html](http://www.realtor.org/press_room/news_releases/2005/commreouptrack.html).

Flood insurance has not been commercially available through the private insurance industry “[b]ecause of the high risks and the lack of underwriting standards.”<sup>206</sup> Therefore, in 1968, Congress created a voluntary National Flood Insurance Program (NFIP) underwritten by the federal government.<sup>207</sup> Over the years, the federal government assumed responsibility for providing relief and for partial indemnification for property losses resulting from floods.<sup>208</sup>

One serious fault of the NFIP is that communities must decide to “opt in” to the plan—if the community does not opt in, flood insurance under the NFIP is not available within that community.<sup>209</sup> This presents an obviously insurmountable obstacle for a firm seeking such insurance.

Other significant drawbacks derive from non-participation by communities in Special Flood Hazard Areas (SFHA) that fail to opt in. For example, SFHA that fail to opt in are ineligible for any form of federally-funded or supported financial assistance for acquisition or construction purposes.<sup>210</sup> Furthermore, if flooding in a declared disaster area occurs in a non-participating SFHA community, no federal financial assistance can be provided for permanent repair or reconstruction of insurable buildings (although other disaster assistance is not cut off).<sup>211</sup> However, if the community applies and is accepted into the NFIP within six months of a presidential disaster declaration, the limitations on federal disaster assistance are lifted.<sup>212</sup>

This community option to retroactively opt in after a declared disaster created a free-rider problem. Without opening up its constituents to any liability for premiums, the community remained eligible for federal assistance for the first declared emergency (a “try it before you buy it” approach for the city), while at the same time such a community’s residents were prevented from obtaining any flood insurance.<sup>213</sup> With such a dichotomy, it is no surprise that the NFIP was underutilized and undercapitalized.

206. S. REP. NO. 93-583 (1973), *reprinted in* 1973 U.S.C.C.A.N. 3217, 3219.

207. National Flood Insurance Act of 1968, Pub. L. No. 90-448, 82 Stat. 572, 574 (codified at 42 U.S.C. § 4001 (2000 & Supp.)); *see also* S. REP. NO. 93-583.

208. *See id.*

209. *See* 42 U.S.C. § 4012a(a).

210. Flood Disaster Protection Act of 1973, Pub. L. No. 93-234, § 202(a), 87 Stat. 975.

211. *See* 42 U.S.C. § 5172(a).

212. *See generally id.*

213. *See generally* GAO’s *Preliminary Observations Regarding Preparedness, Response, and Recovery: Hearing on Hurricane Katrina Before the S. Homeland Sec. & Gov’t Affairs Comm.*, 109th Cong. (2006) (statement of David M. Walker, Comptroller General of the United States), available at [http://hsgac.senate.gov/\\_files/030806Walker.pdf](http://hsgac.senate.gov/_files/030806Walker.pdf) [hereinafter Walker Statement].

In his 2006 testimony before Congress, the Comptroller General declared the NFIP program “essentially bankrupt.”<sup>214</sup> To meet pressing needs from the 2005 flooding, produced by the hurricanes, Congress agreed to a \$17 billion bail out.<sup>215</sup> As demonstrated by system failure in 2005, Congress has yet to strike the right balance with the NFIP.<sup>216</sup>

The NFIP is broken for a variety of reasons. Most who need flood insurance do not purchase it.<sup>217</sup> Premiums are also “woefully inadequate given the technical bankruptcy of the NFIP.”<sup>218</sup> Even for those who do insure, because of subsidies, they do not bear the true share of costs associated with their risks.<sup>219</sup> In this regard, subsidies, like federal emergency relief itself, could actually stimulate overdevelopment of risky areas.<sup>220</sup> Although a legislative fix to the NFIP was proposed in 2006, it failed to gather the necessary momentum for passage.<sup>221</sup>

Regardless of whether the government or private industries offer insurance, tax relief measures should serve as incentives for people to carry adequate insurance. Indeed, one of the goals of the Stafford Act is “encouraging individuals, [s]tates, and local governments to protect themselves by obtaining insurance coverage to supplement or replace governmental assistance.”<sup>222</sup>

214. *Id.* at 38. “The magnitude and severity of the flood losses from Hurricanes Katrina and Rita overwhelmed the ability of the NFIP to absorb the costs of paying claims, providing an illustration of the extent to which the federal government is exposed to claims coverage in catastrophic loss years.” *Id.*

215. National Flood Insurance Program Further Enhanced Borrowing Authority Act of 2005, 42 U.S.C. § 4016(a) (increasing maximum loan from \$3.5 to 18.5 million), *amending* National Flood Insurance Program Enhanced Borrowing Authority Act of 1968, 42 U.S.C. § 4016(a) (increasing maximum loan from \$1.5 to \$3.5 million).

216. U.S. GOV’T ACCOUNTABILITY OFFICE, FISCAL EXPOSURES: IMPROVING THE BUDGETARY FOCUS ON LONG-TERM COSTS AND UNCERTAINTIES, GAO-03-213, at 1 (Jan. 24, 2003), *available at* <http://www.gao.gov/new.items/d03213.pdf> (federal insurance exposes government to future, potentially significant, unbudgeted costs).

217. “More than 11 million U.S. homes are in flood zones, . . . [but] [o]nly about one in four homeowners who live in areas vulnerable to floods purchase federal flood insurance.” Catastrophes: Insurance Issues, *supra* note 86.

218. HARTWIG, HURRICANE SEASON, *supra* note 85, at 138.

219. *See* L. JAMES VALVERDE, JR., MANAGING NATURAL DISASTER RISK: WHAT ROLE SHOULD THE FEDERAL GOVERNMENT PLAY? 5 (Jan. 2006), *available at* [http://server.iii.org/yy\\_obj\\_data/binary/749407\\_1\\_0/Disaster\\_Risk.pdf](http://server.iii.org/yy_obj_data/binary/749407_1_0/Disaster_Risk.pdf). “[F]ederal insurance programs are rarely actuarially sound.” *Id.*

220. *See generally* Catastrophes: Facts and Statistics, *supra* note 3; *see also* HARTWIG, HURRICANE SEASON, *supra* note 85, at 15, 57. Insurers have stated that the cost of natural catastrophes leads to the overdevelopment in risky areas. *See generally* Catastrophes: Facts and Statistics, *supra* note 3.

221. *See* H.R. REP. NO. 109-410 (2006).

222. 42 U.S.C. § 5121(b)(4) (2000 & Supp.).

## 2. Cases Expose Limitations and Systemic Inadequacies

Based on the scope of devastation in the wake of the hurricanes and flooding in 2005, it is not surprising so many lost so much. Given the insurance deficits identified above, it is also not surprising that so many found they were inadequately insured. Indeed, the delayed and rude awakening as to these inadequacies could also be expected. The case law confirms the necessity of securing separate flood insurance because of the flood exclusion in basic casualty policies.

For example, in *Buente v. Allstate Property & Casualty Insurance Co.*,<sup>223</sup> the taxpayer challenged the insurance policy flood exclusion only to find that it prevented recovery for flood damages.<sup>224</sup> Even though the flooding was undeniably a byproduct of the hurricane, the court held, consistently with many other cases,<sup>225</sup> that the flood damage is not within the storm coverage because the language of the flood exclusion is unambiguous.<sup>226</sup>

Beyond this fundamental limitation, case law confirms that merely having two parallel systems leads to confusion—resulting in gaps in coverage and evidencing systemic flaws with the flood insurance scheme. The cases show potential for consumers to be unaware, ill-advised, and perhaps intentionally misled by their insurance agents. In addition, the cases show how the dual scheme can erode the insurer's commitment to pay what is owed, and in some cases, motivate unsavory practices.

Many victims have alleged that their agents negligently failed to disclose the significance of the flood exclusion or mention that additional flood insurance was available at all.<sup>227</sup> Others allege that their agents mistakenly

223. 2006 U.S. App. LEXIS 23742, at \*1 (S.D. Miss. Apr. 11, 2006).

224. *Id.* at \*2.

225. *See, e.g.,* *Brown v. Lexington Ins. Co.*, No. 06-9470, 2007 U.S. Dist. LEXIS 5038 (E.D. La. Jan. 22, 2007); *Andry v. Audubon Ins. Co.*, No. 06-3187, 2006 WL 3904998 (E.D. La. Dec. 27, 2006); *Tropic Sun Towers Condo. Ass'n v. Zurich Am. Ins. Co.*, No. 6:05-cv-1284-Orl-18DAB, 2006 WL 3544854 (M.D. Fla. Dec. 8, 2006); *Leonard v. Nationwide Mut. Ins. Co.*, 438 F. Supp. 2d 684 (S.D. Miss. 2006); *In re Katrina Canal Breaches Consol. Litig.*, 466 F. Supp. 2d 729 (E.D. La. 2006).

226. *Buente*, 2006 U.S. Dist. LEXIS 23742, at \*4–5.

227. *See, e.g.,* *Brown*, 2007 U.S. Dist. LEXIS 5038, at \*2 (agent misrepresented “all encompassing nature” of policy and did not disclose that “deluxe all risk” policy excluded flood coverage); *Word of Faith Christian Fellowship, Inc. v. State Farm Fire & Cas. Co.*, No. 1:05CV691 LTS-RHW, 2006 WL 2359673, at \*1 (S.D. Miss. Aug. 15, 2006) (agent negligently alleged policy was comprehensive to include water damage); *Carter v. Metro. Cas. Ins. Co.*, No. 1:06CV271 LTS-RHW, 2006 WL 2359044, at \*1 (S.D. Miss. Aug. 15, 2006) (agent neglected to advise flooding was excluded); *Harris v. Allstate Ins. Co.*, No. 1:06CV43 LTS-RHW, 2006 WL 2077585, at \*2 (S.D. Miss. July 24, 2006) (agent failed to advise flood insurance was available and necessary); *Ballantyne v. State Farm Fire & Cas. Co.*, No. 1:06CV53

told them that separate flood coverage was not necessary to cover losses from water damage due to a hurricane.<sup>228</sup>

Other litigation was spawned by claimants who alleged that their insurance agents lied to them about the scope of their coverage. In *Denton v. Lamey*,<sup>229</sup> the Dentons alleged that Lamey agreed to provide both homeowner's insurance and flood insurance and negligently failed to do so, even after accepting their premiums for both policies.<sup>230</sup> The United States District Court determined there were triable issues of material fact that allowed plaintiffs to survive a motion for summary judgment.<sup>231</sup>

The case illustrates the mere fact that when two different policies are required for comprehensive protection, it can give rise to confusion—even where both are marketed and administered by the same company.<sup>232</sup> That claimants might mistakenly believe they have purchased both policies is a flaw inherent in the system. Even more troublesome is the potential that the insurance policies could be provided by multiple providers who, by virtue of the system, must share liability for loss and determine how to allocate this loss. Conflicts and disputes between those with directly competing financial interests could be predicted in a hurricane scenario when there is water damage from both high winds and penetrating rain, as well as flooding.

*Andry v. Audubon Insurance Co.*,<sup>233</sup> demonstrates how even those individuals who seek full insurance protection could be caught in the finger pointing between insurers and the necessary evil that ensues in sorting out liability. Gilbert and Alicia Andry were cautious and prudent homeowners who purchased three separate insurance policies to protect their new home in Pass Christian, Mississippi.<sup>234</sup> They purchased their primary homeowner's policy from Nationwide Property and Casualty Insurance Company, obtained a flood policy issued by the federal government through Nationwide, and bought a wind and hail policy through the Mississippi Windstorm Underwrit-

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LTS-RHW, 2006 WL 2359169, at \*1 (S.D. Miss. Aug. 15, 2006) (agent neglected to advise flooding was excluded).

228. *Ladner v. Davis*, No. 1:06CV90 LTS-RHW, 2006 WL 2095338, at \*1 (S.D. Miss. July 27, 2006).

229. No. 1:06CV676 LTS-RHW, 2006 U.S. Dist. LEXIS 82701, at \*1 (S.D. Miss. Nov. 7, 2006).

230. *Id.* at \*2–3.

231. *Id.* at \*4–6.

232. See 42 U.S.C. § 4081(a) (2000 & Supp.) (allows NFIP to select commercial insurance agents to interface administratively with NFIP clients concerning federal flood insurance coverage; the agent may or may not be the same carrier as the insured's casualty policy carrier).

233. No. 06-3187, 2006 WL 3904998 (E.D. La. Dec. 27, 2006).

234. *Id.* at \*2.

ing Association (MWUA).<sup>235</sup> “It is undisputed that both the MWUA and the Nationwide homeowner’s policies exclude[d] coverage for flood damage.”<sup>236</sup>

The dispute arose about whether damage resulted from the wind (allegedly blowing the home away) or from water damage due to flooding (allegedly washing the home away).<sup>237</sup> The Nationwide policy specifically excluded flooding resulting from high tides or storm surge.<sup>238</sup> Plaintiffs alleged Nationwide wrongly failed to pay for the wind damage covered under their policy.<sup>239</sup> Curiously, Nationwide argued that the policy did not include wind damage either, despite the fact the policy “states the exact opposite.”<sup>240</sup>

The MWUA policy was administered by Audubon, who serviced plaintiffs’ claim.<sup>241</sup> Plaintiffs alleged that the Audubon adjuster wrongfully calculated the claim on their completely demolished home, by constructing a hypothetical waterline on the nonexistent wall and estimating damages only above the line (far less than their policy limits or the replacement cost of their home).<sup>242</sup> Presumably, the imaginary line would be used to reduce liability by subtracting the flood damage that would have occurred below the line if the house and its contents had remained. Plaintiffs alleged that the claims adjuster from Audubon admitted upon inspection “that the policy limits [would have been] exhausted,” but that he was required to adjust the claim based upon the imaginary waterline.<sup>243</sup>

The case has not been addressed on the merits, as the United States District Court found that jurisdiction was proper in the state court.<sup>244</sup> Despite Nationwide’s claims that the scope of the flood insurance coverage was a federal issue, the court remanded the case for further proceedings.<sup>245</sup>

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235. *Id.* The MWUA was established in Mississippi in 1970 for coverage against windstorms and hail along the Gulf Coast. MISS. CODE ANN. §§ 83-34-1 to 83-34-29 (1972); *Andry*, 2006 WL 3904998, at \*1 n.2.

236. *Andry*, 2006 WL 3904998, at \*9.

237. *Id.* at \*1-2.

238. *See id.*

239. *Id.*

240. *Id.* at \*9 n.11.

241. *Andry*, 2006 WL 3904998, at \* 1. Audubon Insurance Company (a subsidiary of AIG-American International Group, Inc.) was acting as an agent of the MWUA servicing insurer. *Id.* at \*5.

242. *Id.* at \*7.

243. *Id.*

244. *Id.* at \*9-11. Note that even though the case involved a Mississippi home and insurance policies in effect in Mississippi, the case was brought in Louisiana, as the plaintiffs were Louisiana citizens, and it was remanded to the Judicial District Court for the Parish of Plaquemines, State of Louisiana. *Andry*, 2006 WL 3904998, at \*11.

245. *Id.* at \*10-11.

This multi-insurer tension is inevitable when one obtains policies from two separate insurance companies covering the same property. In any gray area, each insurer is financially motivated to assert that the other is more liable. Allowing insurers to duke it out in litigation or arbitration, at the expense of the insured—who suffers without compensation—is a travesty. Thus, the potential for multiple policies, where neither insurer accepts liability, is a serious flaw undermining the effectiveness of the flood insurance program.

While it is highly predictable that claimants would not be paid for flood damage when their policies contained a flood exclusion, and it is somewhat predictable that some insurers might squabble about the scope of their policy coverage, it is less predictable that insurers would be reluctant to pay for claims admittedly within the scope of coverage.

In *Broussard v. State Farm Fire & Casualty Co. (Broussard II)*,<sup>246</sup> a case involving both wind damage (covered by the policy) as well as excluded flood damage, that is exactly what happened.<sup>247</sup> The plaintiff in *Broussard* suffered both covered and excluded losses.<sup>248</sup> The insurance company expert testified as to the existence of covered losses.<sup>249</sup> Yet, the insurer failed to pay any of the damages, because it had not dispositively established the amount excluded as flood damage.<sup>250</sup>

The court found the burden was on the insurer to prove how much water damage was excluded, after the plaintiff proved a prima facie case that the property sustained wind damage.<sup>251</sup> State Farm failed to meet this burden and paid the price.<sup>252</sup> In addition to relief for the policy limits, the jury awarded \$2.5 million in punitive damages, which later was reduced to \$1 million.<sup>253</sup> The punitive damages awarded in *Broussard* against State Farm might motivate more cooperative claims processing and serve as a deterrent for other insurers refusing to pay at least what they acknowledge is due.

In summary, while those who are savvy about insurance probably appreciated that a flood insurance policy from the National Flood Insurance Program was required for flood protection, others were confused, ignorant, or perhaps even misled by their insurance agents. Regardless of why, most

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246. No. 1:06CV6 LTS-RHW, 2007 WL 1438792, at \*1 (S.D. Miss. May 11, 2007).

247. *Id.* at \*1–2.

248. *See id.*

249. *Id.* at \*2.

250. *Id.*

251. *Broussard II*, 2007 WL 1438792, at \*2.

252. *Id.*

253. *Broussard v. State Farm & Cas. Co. (Broussard I)*, No. 1:06CV6 LTS-RHW, 2007 WL 268344, at \*1, 3 (S.D. Miss. Jan. 31, 2007).



were not adequately protected. The litigation that ensued, and continues, after the 2005 hurricanes reflects this unfortunate reality. However, even though the two separate halves—casualty insurance and flood insurance—are not as advantageous as one comprehensive whole, it is still better for individuals in participating communities to purchase both halves.

### 3. The Push for Insurance Reform

Due to insured losses hitting record proportions, Congress is considering federalizing reinsurance of the hurricane insurance market for homeowners.<sup>254</sup> Despite the fact that many in the private insurance industry are opposed to such federalization—citing ability to withstand the highest loss years on record with sufficient policy reserves<sup>255</sup>—there has been open debate in the insurance industry about the need for federal reinsurance.<sup>256</sup>

As the debate over how to structure catastrophic insurance lingers, no one disputes the need for homeowners to have access to affordable insurance.<sup>257</sup> Congress must take care, however, that any tax relief for victims of disaster encourages prudent decisions—such as motivating individuals to obtain sufficient insurance, including flood insurance for those at risk—versus exacerbating a false sense of security that a government bailout could promote.<sup>258</sup>

Florida House Memorial 11A urges Congress to adopt a federal catastrophe insurance program, to participate in a federal/state issues summit, to

254. See H.R. 91, 110th Cong. (1st Sess. 2007) (reinsurance available under this act “shall provide insurance coverage against residential property losses to homes (including dwellings owned under condominium and cooperative ownership arrangements) and the contents of apartment buildings”). For past failed efforts along these lines, see, e.g., H.R. 846, 109th Cong. (1st Sess. 2005) (federal auctions of catastrophe reinsurance contracts); H.R. 4366, 109th Cong. (1st Sess. 2005); H.R. 4507, 109th Cong. (1st Sess. 2005) (allowing States with catastrophe insurance programs to purchase federal reinsurance).

255. See generally *Is America’s Housing Market Prepared for the Next Natural Catastrophe?: Hearings Before the Subcomm. on Hous. & Cmty. Opportunity of the H. Comm. on Fin. Serv.* 109th Cong. 34–36 (2006) (statement of Dennis C. Burke, Vice President of State Relations, Reinsurance Association of America) [hereinafter *Is America’s Housing Market Prepared for the Next Natural Catastrophe?*].

256. VALVERDE, JR., *supra* note 219, at 4–5; see also *Is America’s Housing Market Prepared for the Next Natural Catastrophe?* *supra* note 255, at 41–43 (statement of Alex Soto, President, InSource, Inc., on behalf of the Independent Insurance Agents and Brokers of America, Inc.).

257. “[U]sing history as a guide, natural catastrophes will inevitably place a tremendous strain on homeowners’ insurance markets in many areas, will raise costs for consumers, and will jeopardize the ability of many consumers to adequately insure their homes and possessions.” H.R. 4366, 109th Cong. (1st Sess. 2005).

258. See *Catastrophes: Facts and Statistics*, *supra* note 3.

provide specific federal tax legislation supporting disaster preparedness and relief (including tax deductions), and to engage in a national hurricane research initiative.<sup>259</sup> The aspect concerning federal reinsurance is discussed here, while the ability of taxpayers and insurers to set aside funds on a tax-advantaged basis is discussed below in section B.2.

The federal government would be the ultimate reinsurer of super large losses associated with only the most severe “mega-catastrophes.”<sup>260</sup> “A national catastrophe insurance program is necessary to promote personal responsibility among policyholders; support strong building codes, development plans, and other mitigation tools; maximize the risk-bearing capacity of the private markets; and provide quantifiable risk management through the Federal Government.”<sup>261</sup> Rather than relying exclusively on FEMA emergency relief and knee-jerk tax cuts and incentives, such a program would allow the promise of federal coverage to enhance insurability within vulnerable markets by making insurance affordable to those most likely to be affected by a hurricane.

Following the overwhelming demand on its Florida Hurricane Catastrophe Fund (FHCF) in 2004–2005, Florida has also been revamping its State Catastrophic Reinsurance Program.<sup>262</sup> Florida House Bill 1A, which became law on January, 25, 2007, allows a temporary opportunity for insurers to increase their premiums for and coverage by the FHCF.<sup>263</sup> The Florida Legislature intended “to create a temporary emergency program, applicable to the 2007, 2008, and 2009, hurricane seasons, to address these market disruptions and enable insurers, at their option, to procure additional coverage from the [FHCF].”<sup>264</sup>

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259. Fla. H.M. 11A (2007) (National Catastrophe Solutions) (enrolled Jan. 22, 2007).

260. *Id.*

261. *Id.*

262. *See* FLA. STAT. § 215.555 (2006).

263. *Id.*

264. *Id.*

## B. *Posturing for the Storm*

### 1. Existing Measures

Every taxpayer can take reasonable measures to prepare for a disaster: hardening buildings and facilities to hurricane and other storm threats, creating redundant records and storing them away from any high risk area (e.g., a fire safe box loaded with an emergency copy of electronic records and critical paper records—such as past tax returns, client records and contact information, etc.), and ensuring an up-to-date inventory of property. With modern technology, most urgent data can be carried on a thumb-drive or saved to other electronic media.

The challenge of creating and maintaining an up-to-date inventory of office items, equipment, furniture, plants, decorations, artwork, etc. can be much more onerous. It is the taxpayer's burden to prove the amount of every claimed deduction, show receipts to establish the initial cost basis of property, and provide accounting documents to establish the depreciated value of items damaged or destroyed.<sup>265</sup> Photo or video evidence of the condition of property before it is destroyed also goes far in encouraging insurance adjusters and the IRS to accept higher valuations. Certainly, any precious items should be periodically appraised.

How frequently to back up electronic data, conduct inventory, and appraise property depends upon how vulnerable the law practice is to known hazards. If a taxpayer is vulnerable to hurricanes or is located in a known floodplain, it would also be prudent to invest in measures to mitigate the effects of storm surge or rising water. The NFIP allows discounted premiums for communities who participate in a Community Rating System (CRS), because they have extensive floodplain management programs.<sup>266</sup> The FEMA website discusses the CRS and other "FloodSmart" programs.<sup>267</sup> Premiums may be reduced by up to forty-five percent for mitigation, planning, and preparedness.<sup>268</sup> In addition, such measures help save lives and property.

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265. I.R.S. Publ'n 547, *Casualties, Disasters, and Thefts*, at 3–5 (2006).

266. FEMA, *Community Rating System*, <http://www.fema.gov/business/nfip/crs.shtm> (last visited June 14, 2007).

267. *Id.*

268. *Id.*

## 2. Proposed Tax Measures Promoting Insurance

In Florida, after the devastating 2004 hurricane season, the notion of a hurricane savings account for individuals was first introduced.<sup>269</sup> The hurricane savings account was forecasted “to cover an insurance deductible or other uninsured portion of the risks of loss from a hurricane, rising flood waters, or other catastrophic windstorm event.”<sup>270</sup> Because the accounts would only safeguard homesteads, they would be beyond the reach of creditors.<sup>271</sup>

However, benefits of such an account are not realized unless or until the federal government creates such a tax-exempt or tax-deferred savings vehicle.<sup>272</sup> While Florida unanimously petitioned Congress for such legislation in 2006,<sup>273</sup> and Congress introduced a bill to create a Catastrophe Savings Account,<sup>274</sup> the legislation was still not enacted in 2006.<sup>275</sup>

Florida renewed its efforts to stimulate such legislation in 2007.<sup>276</sup> As proposed, the Florida House Memorial asks for the creation of tax exempt accounts for taxpayers to accumulate financial reserves on a tax-advantaged basis for the purpose of paying for mitigation enhancements and catastrophic losses.<sup>277</sup> The proposal also requests changes to the tax code that will allow personal income tax deductions for insurance costs and mitigation expenses. “[T]he [Florida] [l]egislature urges Congress to provide a federal income tax deduction for residential property insurance premiums paid by consumers to offset the dramatic cost of property insurance.”<sup>278</sup>

269. See Fla. Judiciary Comm., SB 660 (2005) Staff Analysis 1–5 (Feb. 8, 2005) (on file with comm.), available at <http://www.flsenate.gov/data/session/2005/Senate/bills/analysis/pdf/2005s0660.ju.pdf>.

270. FLA. S. JOUR. 406 (Reg. Sess. 2005), available at <http://www.flsenate.gov/data/session/2005/senate/journals/pdf/bound/sj041305.pdf>.

271. See FLA. STAT. § 222.22 (2006). Section 222.22 of the *Florida Statutes* exempts hurricane savings accounts and other preferred savings programs from legal process. *Id.* However, this benefit attaches only when “the federal government provides tax-exempt or tax-deferred status to a hurricane savings account.” *Id.* § 222.22(4)(c).

272. *Id.* § 222.22. The federal government has not yet created such a favored tax position. See H.R. 4836, 109th Cong. (2d Sess. 2006).

273. *Florida Congressman Files Catastrophe Savings Account Legislation*, INS. J. (Mar. 6, 2006), available at <http://www.insurancejournal.com/news/southeast/2006/03/06/66203.htm>.

274. See RAWLE O. KING, HURRICANE KATRINA: INSURANCE LOSSES AND NATIONAL CAPACITIES FOR FINANCING DISASTER RISK, CRS REPORT FOR CONGRESS 10 (Sept. 15, 2005), available at [http://digital.library.unt.edu/govdocs/crs/data/2005/upl-meta-crs-7611/RL33086\\_2005Sep15.pdf](http://digital.library.unt.edu/govdocs/crs/data/2005/upl-meta-crs-7611/RL33086_2005Sep15.pdf).

275. See Fla. H.M. 11A (2007).

276. See *id.*

277. See *id.*

278. *Id.* at 4.

The Florida legislature also asked Congress to “[c]reat[e] tax-deferred insurance company catastrophe reserves to benefit policyholders.”<sup>279</sup> “These tax-deferred reserves would build up over time and only be eligible to be used to pay for future catastrophic losses.”<sup>280</sup> Congress is already considering the latter form of requested tax relief. The Policy Holders Protection Act is a bill “[t]o amend the *Internal Revenue Code* of 1986 to provide for the creation of disaster protection funds by property and casualty insurance companies for the payment of policyholders’ claims arising from future catastrophic events.”<sup>281</sup>

### C. *Recovery and Rebuilding*

No one knows whether those affected by the next disaster will enjoy the same tax relief as the victims of the 2005 hurricanes. Because congressional response has varied in the past, it is prudent to exploit current code provisions which afford relief to all casualty victims, while remaining alert for new legislation, and paying particular attention to IRS news releases, announcements, and notices likely to follow a major disaster.<sup>282</sup> After Hurricane Katrina, for instance, there were twenty-nine IRS releases within thirty days of the storm.<sup>283</sup>

#### 1. Small Business, Heightened Vulnerabilities

Immediate relief from tax filing deadlines and payment obligations in the wake of Hurricane Katrina was timely and essential, because many important books and records had been lost or destroyed due to the widespread devastation and massive flooding.<sup>284</sup> In addition, where records miraculously survived, the evacuated often had no immediate access to them.<sup>285</sup> Although it sounds obvious, such relief is especially necessary for small businesses that are barely making their payroll week to week.<sup>286</sup> According

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279. *Id.* at 3; see H.R. 4836, 109th Cong. (2d Sess. 2006).

280. Fla. H.M. 11A.

281. See H.R. 164, 110th Cong. (1st Sess. 2007) (modifying I.R.C. § 832 (2004)).

282. After Hurricane Katrina, for example, IRS Commissioner Mark Everson, announced deadline extensions within days of the storm. I.R.S. News Release IR-2005-84 (Aug. 30, 2005) (“IRS Grants Tax Relief for Hurricane Katrina Victims”), <http://www.irs.gov/newsroom/article/0,,id=147055,00.html>.

283. Internal Revenue Service, News Releases for September 2005, <http://www.irs.gov/newsroom/content/0,,id=149346,00.html> (last visited June 14, 2007).

284. See Rodney C. Runyan, *Small Business in the Face of Crisis: Identifying Barriers to Recovery from a Natural Disaster*, 14 J. CONTINGENCIES & CRISIS MGMT. 12, 12–13 (2006).

285. See *id.* at 13.

286. See *id.*

to the Small Business Administration (SBA), twenty-five percent of small businesses may not survive a major disaster.<sup>287</sup>

Of course, tax relief or assistance from the tax system is but one small part of the relief available.<sup>288</sup> Ultimately, the small firm or sole practitioner must have sufficient financial resources to rebuild and reopen. The SBA recognizes the special vulnerability of small businesses and makes loans available for victims of declared natural disasters.<sup>289</sup> Although the loans are obviously available to small businesses, even large businesses and individuals may apply and qualify for these loans.<sup>290</sup> Regrettably, in a major disaster, the SBA may be overwhelmed, making relief in the form of low or no interest loans slow.<sup>291</sup>

## 2. Opportunity Zones

No one can depend on the government to establish an opportunity zone following a disaster. Nevertheless, it is important to realize the potential benefits of an opportunity zone if one is declared. Since history affords the Liberty Zone and the GO Zone as examples of substantial tax advantages for affected victims, it is prudent to stay alert to congressional actions to afford similar relief in the future, and to be postured to immediately take advantage of that relief.

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287. Press Release, Insurance Information Institute, *Can Your Business Survive a National Disaster? Advance Planning, Proper Insurance Are Essential* (Apr. 13, 2004), <http://www.iii.org/media/updates/press.736350/>.

288. See Lipman, *supra* note 25, at 955–61. In her article entitled *Anatomy of a Disaster Under the Internal Revenue Code*, Professor Francine J. Lipman provides an excellent examination of how tax consequences dovetail with other federal relief. *Id.*

289. U.S. Small Business Administration, *Disaster Assistance for Businesses of All Sizes*, available at <http://www.sba.gov/npm2006/NPM2006/disaster-recovery-for-biz-color.doc> (last visited June 14, 2007).

290. Surprisingly, “the majority of SBA disaster assistance is directed to homeowners, to help rebuild their homes.” *The Impact of Hurricane Katrina on Small Businesses: Hearing Before the S. Comm. on Small Business & Entrepreneurship*, 109th Cong. (2005) (statement of Hector V. Barreto, Administrator, United States Small Business Administration), available at <http://sbc.senate.gov/republican/HTML/hearings/109/Barreto%20testimony.pdf>. As of September 22, 2005, the SBA had “distributed approximately 850,000 applications for loans to individuals and businesses.” *Opening Statement on the Impact of Hurricane Katrina on Small Businesses and Entrepreneurship: Hearing Before the S. Comm. on Small Business & Entrepreneurship*, 109th Cong. 3 (2005) (opening statement of Sen. Olympia J. Snowe, Chair, S. Comm. on Small Business & Entrepreneurship), available at <http://sbc.senate.gov/republican/HTML/hearings/92205SnoweStmnt.pdf>.

291. See Walker Statement, *supra* note 213, at 42 (stating that the public expressed widespread dissatisfaction with the SBA and their backlog of about 103,300 hurricane-related loan applications, which averaged about 94 days).

In a nutshell, the procedural advantages of delayed filing and payment of taxes should benefit all taxpayers who otherwise would have taxes due. Forgiveness of interest and penalties should make this especially desirable in a declared emergency area.

The ability to amend past returns to claim net operating losses will afford an excellent opportunity to improve cash flow. Similarly, cash flow could be improved by accelerating any deductions into a previous period. By taking them earlier, there is possibly a twofold advantage. First, there may be more income to offset, perhaps allowing a taxpayer with a marginal rate of twenty-five percent to slip down into the fifteen percent bracket.<sup>292</sup>

Second, the ability to treat a business cost as an expense that is deductible this year, versus a capital asset—which depreciates over time—enhances cash flow by reducing tax liability now as opposed to spreading it out over future tax periods. Reduced liability translates into lower tax withholding right now as estimated payments are reduced to reflect increased expensing.<sup>293</sup> In addition, if offered the opportunity, the taxpayer should take advantage of the immediate deduction for section 179 property instead of spreading these costs through depreciation.

## V. CONCLUSION

Although promising changes are on the horizon, there is no reason for prudent taxpayers to wait for legal developments before getting their financial affairs in order. You will not be able to choose whether you will be a physical victim—that is why they are called acts of God—but you can influence, in important respects, whether you will be a financial victim.

Everyone should seek an appropriate mix of insurance. For businesses, these ordinary and necessary expenses are deductible in the year paid.<sup>294</sup> A prudent business will be fully insured while carrying a substantial deductible, so that catastrophic events will amount to setbacks but not failure.

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292. See I.R.C. § 11(b)(1)(A)-(B) (2004 & Supp.).

293. Estimated tax payments earlier in the tax year would have been based on expectations of greater income and fewer expenses. I.R.S. Publ'n 505, Tax Withholding and Estimated Tax, at 7 (2007) available at <http://www.irs.gov/publications/p505/ch02.html>. Cash flow is improved by either reducing estimated payments immediately, due to changed circumstances based on the disaster and concomitant beneficial tax considerations; or, at worst, a bigger refund will be obtained at the end of the fiscal year if estimated payments are continued at pre-existing levels, resulting in overpayment. *Id.*

294. DAVID. L. BRUMBAUGH, TAX DEDUCTIONS FOR CATASTROPHIC RISK INSURANCE RESERVES: EXPLANATION AND ECONOMIC ANALYSIS, CRS REPORT FOR CONGRESS 1 (Sept. 2, 2005), available at <http://www.fas.org/sgp/crs/misc/RL33060.pdf>.

While an extension of time to file and pay taxes is likely, keeping a redundant set of records in a safe yet accessible location will jumpstart an ability to amend a previous return to take advantage of the three-year net operating loss carryback under code section 172(b)(1)(F),<sup>295</sup> or the retroactive relief afforded under code section 165(i)<sup>296</sup> in a major disaster.

Finally, staying abreast of IRS releases and post-disaster relief legislation will allow firms and clients alike to maximize whatever compassionate tax relief is afforded. Together, these measures should help both lawyers and clients weather the storm.

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295. I.R.C. § 172(b)(1)(F).

296. *Id.* § 165(i).