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Tax Credit Programs Show Value during Natural Disaster Recovery

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Nothing can fully fix what broke when Hurricane Harvey pounded the coast of Texas in late August and Hurricane Irma slammed into Puerto Rico, U.S. Virgin Islands and Florida less than two weeks later. Harvey killed more than 70 people and displaced 50,000-plus residents, while Irma killed more than two dozen people and damaged thousands of homes, including devastation in the Florida Keys. AccuWeather estimated a combined economic impact of $290 billion from the two hurricanes–although other estimates varied from $49 billion to $300 billion, depending on the source.

It was a nightmare one-two punch from which disaster-struck communities will take years to fully recover, but a smart use of community development tax credits could provide a platform from which the affected regions can facilitate that recovery from two of the worst natural disasters in American history.

Community development tax credits are a proven tool and they hold significant potential in the wake of the more than 50 inches of rain Hurricane Harvey dumped on the coast of Texas and powerful winds and rain inflicted tremendous damage to Puerto Rico, U.S. Virgin Islands and Florida. As they were following Hurricane Katrina and the 2008 Midwestern storms, community development tax credits have again been proposed to help finance the rebuilding. In fact, these credits' repeated and widespread value in disaster recovery has led many to propose making additional tax credit allocations for presidentially declared disaster areas a permanent part of the tax code.

Significantly, legislators reintroduced the National Disaster Tax Relief Act in the wake of Hurricane Harvey and pending Hurricane Irma, which would enact several provisions for recent years.

The bill (H.R. 3679) included a provision to increase the low-income housing tax credit (LIHTC) ceiling by the greater of $8 multiplied by the population of the qualified disaster area or 50 percent of the state housing credit ceiling for federally declared disaster areas during calendar years 2012 to 2015. It also called for a special new markets tax credit (NMTC) annual allocation increase of $500 million to community development entities (CDEs) serving any covered federally declared disaster area for each calendar year of 2012 to 2015. Furthermore, it would provide a special $10 billion allocation of tax-exempt

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bonds for affected areas for disaster during 2012-2015. Meanwhile, the federal historic tax credit (HTC) would jump to a 13 percent credit for rehabilitation of non-historic buildings placed in service before 1936 and a 26 percent credit for certified rehabilitations of a certified historic structure, respectively, within federally declared disaster areas during 2012 to 2015. That's a 30 percent increase in the rate for each.

If those provisions sound familiar, it's because they mirror what Congress issued in response to hurricanes Katrina, Rita and Wilma in 2005. In that legislative example, disaster-affected areas received increases in the allocation of LIHTCs, HTCs and NMTCs, in addition to other tax benefits. That arrangement has since repeated. Similar legislation was enacted to address the Midwestern floods in 2008. However, the use of tax credit allocation increases isn't automatic. Famously, although it provided disaster recovery grants, Congress didn't enact disaster tax credit relief to areas hit by Hurricane Sandy in 2012.

Hurricane Katrina and the GO Zone

Hurricane Katrina, which made landfall in southeastern Louisiana Aug. 29, 2005, killed more than 1,800 people and was the costliest natural disaster in the United States. It also prompted dramatic changes in how the government uses tax credit programs to spur incentives.

Along with other recovery provisions, Congress increased tax credit allocations–specifically the federal LIHTC, NMTC and HTC–in areas affected by hurricanes Katrina, Rita and Wilma to encourage development. Four months after the disaster, President George W. Bush signed H.R. 4440, the Gulf Opportunities Zone Act of 2005 (GO Zone), which provided a number of measures to encourage the cleanup and rebuilding of the areas devastated by the hurricanes.

The GO Zone legislation increased LIHTCs to an amount equal to $18 per capita (based on pre-disaster census data) for the presidentially declared disaster areas for each year from 2006 to 2008, granting Louisiana an extra $1.7 billion, Mississippi an extra $1.06 billion and Alabama an extra $470 million in LIHTCs. Texas and Florida also received an additional $35 million in LIHTCs. The GO Zone areas were also designated as difficult development areas (DDAs), which meant they were able to receive a 30 percent boost of eligible basis, but were not included in the 20 percent cap on designated DDAs nationwide. The act also contained extra tax-exempt bond authority and incentives for bonus depreciation.

The bank regulators were also helpful in promulgating guidance making clear to financial institutions without deposits in the metropolitan areas affected by Katrina that they would be able to receive special Community Reinvestment Act (CRA) consideration for LIHTC and NMTC investments. That helped sustain CRA investment interest in the disaster area.

The HTC percentage jumped from 10 percent and 20 percent to 13 percent and 26 percent, and an additional $600 million in NMTC allocations were granted to the GO Zone for 2005 and 2006, with a $400 million jump for 2007.

The GO Zone was used as a model for The Emergency Economic Stabilization Act of 2008, which featured similar provisions to provide tax relief for the victims of the Midwestern flood disaster in Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska and Wisconsin, as well as areas in Texas and Louisiana that were affected by Hurricane Ike.

Now we're back at it, following the first major hurricanes (Category 3 or above) to make landfall in the U.S. in 12 years.

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Wider Tax Code Issues

The fact that the disasters hit in August and September left some suggesting that permanence for disaster relief provisions could be tied to comprehensive tax reform. That's not necessarily true and a separation of the issues would likely increase the chances of passage of the disaster provisions. That's because of the increasing possibility that comprehensive tax reform could get bogged down in Congress, delaying permanent disaster provision implementation.

By the way, the idea to make provisions permanent didn't come simply in response to Hurricane Harvey and Hurricane Irma. In July, well before Harvey and Irma hit, the American Institute of CPAs asked Congress to make 10 tax provisions permanent to help disaster victims. They included extending the net carryback period for net operating losses attributable to a disaster event to five years, increasing the Section 179 expensing limits, waiving the penalty for early retirement withdrawal up to $100,000 from individual retirement accounts if it's repaid within five years, and more. Tax credits weren't included in the 10-item list, but there is plenty of momentum to add them.

With a massive disaster bill price tag, tax reform and more, Congress has a lot to consider. Whether or not the tax-credit provisions for disaster relief become a permanent part of the tax code, one thing is clear: Since 2005, Congress has repeatedly turned to tax credit programs in an effort to encourage investment in storm-ravaged areas.

Other Provisions Affecting Tax Credits

New legislation isn't the only way disaster victims get relief: the Internal Revenue Code has some permanent regulatory provisions related to disasters, such as not taxing individuals on disaster relief payments. The IRS also regularly offers filing extensions after disasters, as it did following Hurricane Harvey and Hurricane Irma. And it's more than that. In 2005, the Internal Revenue Service (IRS) allowed those displaced by Hurricane Katrina eligibility to reside in LIHTC properties nationwide, which meant that thousands of households were able to quickly find a new home. Subsequently, Revenue Procedures 2014-49 and 2014-50 provided guidelines for LIHTC and bond-financed properties in response to natural disasters.

Opening LIHTC properties to house affected residents impacts such properties in the immediate geographical area of the disaster, but that's not all. After Hurricane Katrina, New Orleans residents relocated all over the country. IRS regulations permit any LIHTC apartment to be used for housing those displaced by a presidentially declared natural disaster.

What's Coming

The high profiles of Hurricane Harvey and Hurricane Irma are expected to provide momentum for relief, perhaps including the permanent provisions. The fact that Texas and Florida each have large Congressional delegations, especially with influential Republicans, provides plenty of political support to including disaster relief provisions, although they would likely receive help anyway.

The widespread media coverage of the victims added to pressure on Congress. In the days following Harvey's landfall, the tax credit world was quick to promote the allocation of additional tax credits to areas hit by the storm. The New Markets Tax Credit Coalition circulated a letter in early September calling on Congress and the Trump administration to propose legislation similar to the GO Zone legislation of 2005.

Effective Tool

In a dozen years since the nightmare of Hurricane Katrina, America was hit by a series of natural disasters and the greatest national recession since the 1930s. Out

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of those events came the recognition that tax credit programs can be used to efficiently address recovery by bringing private capital into the affected areas. In short, the government doesn't need a new program, it can expand existing programs.

While the move toward permanent disaster tax credit provisions gained steam, it wasn't unanimous. Some insiders insist that the government needs flexibility to respond to different disasters and to standardize the response would be restrictive. Maybe that's true, maybe not. But this is clear: As Hurricane Katrina taught us and subsequent events reinforced, one of the best ways to encourage recovery is to use something that already works well.

Tax credits are a great tool for rebuilding after disasters. ❖

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