

POST-DISASTER TAX LEGISLATION: A SERIES OF UNFORTUNATE EVENTS

ELLEN P. APRILL[†]

RICHARD SCHMALBECK^{††}

ABSTRACT

When a disaster strikes the United States, Congress typically feels heavy pressure to enact legislation, including tax legislation, to provide relief. This Article discusses features of two tax legislative initiatives, which responded to two quite different disasters: first, the response to the devastation of the fall 2005 hurricane season and, then, the response to the earlier terrorist attacks on the World Trade Center and Pentagon of September 11, 2001. The Article first raises the possibility that some of the provisions of these acts may be vulnerable to indirect constitutional challenge under the Uniformity Clause. In examining some of the problems inherent in post-disaster tax legislation, it discusses the role, usually unfortunate, of sympathy in tax legislation. It goes on to consider how, despite the fact that the targets of relief legislation are generally thought to be people in need, it nevertheless seems to be the case that a good deal of the benefits of disaster legislation in the tax area goes to relatively high-income and high-wealth taxpayers. It asks whether a better approach can be institutionalized. It suggests that Congress identify those provisions enacted in response to the recent disasters that make sense generally, such as five-year carryback of net operating losses, and amend the tax code to adopt these rules generally. It further recommends that

Copyright © 2006 by Ellen P. Aprill and Richard Schmalbeck.

[†] Associate Dean for Academic Programs and John E. Anderson Professor in Tax Law, Loyola Law School, Los Angeles.

^{††} Professor of Law, Duke University School of Law.

The authors would like to thank Lawrence Zelenak and other participants in the *Duke Law Journal* Administrative Law Conference, Katherine Pratt, and Professor Pratt's Tax Policy class at Loyola Law School. We are also grateful for the insightful editorial suggestions of Stacey McGavin and Christopher Montville of the *Duke Law Journal* staff, and for the valuable research assistance provided by Jennifer Dupuy.

Congress identify those provisions needed in particular when a whole area is devastated—a five-year period for replacing destroyed property, credit for wages to pre-disaster employees, and routine extensions of filing deadlines—and make them available to any declared disaster area. It urges as well two kinds of longer-term approaches. One is to consider and evaluate disaster tax relief provisions as a kind of national insurance against disasters that the private market does not supply. The other is to develop off-the-shelf provisions to be activated when a disaster strikes.

INTRODUCTION

In recent years, when a disaster strikes the United States, whether a natural disaster such as Hurricane Katrina in 2005 or an unnatural disaster such as the attacks on the World Trade Center and the Pentagon in 2001, Congress typically feels heavy pressure to enact legislation to provide relief. Among the tools available to Congress in discharging these perceived obligations is the Internal Revenue Code (I.R.C.). But there are substantial problems with the tax legislative solutions Congress typically crafts under these circumstances.

First, any relief comes slowly, for the federal legislative process is not built for speed. Congress must be in session, or called into one if it is not. Bills must be drafted, considered, and approved by the relevant committees—in the case of tax legislation, the House Ways and Means Committee and the Senate Finance Committee. Care must be taken to comply with special rules that apply to tax legislation.¹ After debate and vote in each house, the bills must ordinarily be considered by a conference committee to resolve differences between the House and Senate versions, and then each house must separately approve the conference version of the bill.² Finally, the president must find a free moment in the Rose Garden for the signing ceremony, at which

1. For example, the Constitution requires that revenue legislation originate in the House of Representatives. U.S. CONST. art. I, § 7, cl. 1. Also, the Senate has imposed supermajority requirements on legislation that would permanently lose revenue under the so-called “Byrd Rule,” which was incorporated into the Congressional Budget Act of 1974 as section 313 and made permanent in 1990. Pub. L. No. 101-508, § 13214, 104 Stat. 1388-621, 1388-621 to 1388-622 (1990) (codified at 2 U.S.C. § 644 (2000)).

2. See JURISDICTION OF THE COMM. ON WAYS AND MEANS AND HISTORICAL NOTE, H.R. REP. NO. 108-810, § C (2005), available at <http://waysandmeans.house.gov/About.asp?section=23> (“The committee on Ways and Means has responsibility for raising the revenue required to finance the federal government. This includes individual and corporate income taxes, excise taxes, estate taxes, gift taxes, and other miscellaneous taxes.”).

point the congressional work is finished, except perhaps for the technical corrections bill that will follow to fix the errors that seem unavoidably to infect the process, especially when done in haste.³

Second, when Congress does eventually take action, it tends to overreact. There appears to be a legislative imperative, a felt need to be seen by constituents as engaged actively in providing whatever relief or succor within the imagination of Congress, and within fairly elastic budgetary constraints. In such an atmosphere, the powerful House Ways and Means and Senate Finance Committees are likely to assert their role, involving tax benefits as an element of any disaster relief package. Moreover, indirect relief through special tax provisions, known as tax expenditures,⁴ may be perceived, however inaccurately, as both self-executing and less costly than direct governmental grants.

This congressional imperative is encouraged by the fact that the IRS, at least in its own view, lacks statutory authority to provide certain types of relief, no matter how much such relief seems merited by the circumstances. Finally, because post-disaster tax legislation is

3. For example, just prior to passage, the Gulf Opportunity Zone Act was amended to include a large technical corrections title. Pub. L. No. 109-135, §§ 401–413, 119 Stat. 2577 (2005) (codified as amended in scattered sections of I.R.C.). Section 403 clarifies key rules relating to alternative minimum tax elections and effective dates for nondeferred compensation plans, provides technical corrections to the U.S. production activities deduction, and spells out other technical corrections related to the American Jobs Creation Act of 2004 (an act which was corrected prior in the Tax Technical Corrections Act of 2004).

4. Tax expenditures are “revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.” Congressional Budget and Impoundment Control Act of 1974, Pub. L. No. 93-344, § 3(3), 88 Stat. 297 (1974). *See generally* STANLEY S. SURREY & PAUL R. MCDANIEL, *TAX EXPENDITURES* (1985). The Joint Committee on Taxation has explained, “[s]pecial income tax provisions are referred to as tax expenditures because they may be considered to be analogous to direct outlay programs, and the two can be considered as alternative means of accomplishing similar budget policy objectives.” STAFF OF THE JOINT COMM. ON TAXATION, 109TH CONG., *ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2006-2010*, at 2 (Comm. Print 2006). The Government Accountability Office recently undertook a study of tax expenditures and found that “[s]ince 1974, the number of tax expenditures more than doubled and the sum of tax expenditure revenue loss estimates tripled in real terms to nearly \$730 billion in 2004.” U.S. GOV’T. ACCOUNTABILITY OFFICE, *TAX EXPENDITURES REPRESENT A SUBSTANTIAL FEDERAL COMMITMENT AND NEED TO BE REEXAMINED*, at first unnumbered page (2005), available at <http://www.gao.gov/new.items/d05690.pdf>. For 2006, the Joint Committee on Taxation estimated the cost of the mortgage interest deduction at \$69.4 billion and the exclusion from income for employer contributions for health insurance premiums and related exclusions at \$90.6 billion. STAFF OF THE JOINT COMM. ON TAXATION, 109TH CONG., *ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2006-2010*, at 33, 39 (Comm. Print 2006).

typically viewed as something that will almost certainly pass Congress by wide margins, it can be an attractive place to put provisions that an individual legislator or interest group wants enacted, but which would be controversial if offered in any other context.

But while the forces inclining Congress to enact post-disaster tax legislation are compelling, the legislative output that results (we will argue) has been disappointing, and largely inconsistent with sound tax policy. Curiously, the usual explanations of why legislation may be inconsistent with optimal public policy do not seem to apply in this situation. Conventional public-choice analysis—a currently popular and usually reliable source of why legislation goes bad—emphasizes self-interest as the moving force in political processes. Elected officials seek first and foremost to assure their own reelection.⁵ That may involve actions that appeal to their constituents,⁶ but even when it does, that is simply viewed as a case in which the self-interests of the constituents achieve congruence with those of the legislator, more or less accidentally.⁷

Ironically, disaster-relief legislation typically embodies a large and undeniable element of genuine altruism, at least on the part of the general public. A legislator representing South Dakota knows—as do her constituents—that South Dakota is unlikely to be devastated by a hurricane,⁸ and unlikely as well to be a prime target of terrorist attacks. The legislator also knows, however, that her support of relief measures for disasters of those types will be popular with her constituents. Unfortunately, the temporary displacement of self-interest by altruism does not seem to produce better legislation; it just produces legislation that is bad in different ways.

5. As Professors Farber and Frickey have put it, legislators are portrayed in this literature as “single-minded seekers of reelection.” DANIEL A. FARBER & PHILIP P. FRICKEY, *LAW AND PUBLIC CHOICE: A CRITICAL INTRODUCTION* 20 (1991) (quoting D. MAYHEW, *CONGRESS: THE ELECTORAL CONNECTION* 5 (1974)).

6. Or, equally relevant, the legislators’ actions may appeal to their campaign contributors, who may or may not be among their constituents.

7. FARBER & FRICKEY, *supra* note 5, at 22–23.

8. No state is completely free from natural disaster risks, but the risks faced by South Dakota are probably largely from tornadoes, whose damage can be intense, but never approaches the scale of major hurricanes, and thus never receives the degree of legislative attention under discussion here. See Allen Kenney, *JCT Staff Member Suggests Automatic Provisions for Disaster Relief*, *TAX NOTES TODAY*, Nov. 2, 2005, LEXIS, 2005 TNT 211-6 (citing Thomas Barthold of the Joint Committee on Taxation, who noted in a speech that recent tornadoes in Missouri caused intense devastation, but no legislation).

Although altruism may play a refreshing role in motivating Congress to enact post-disaster tax legislation, such legislation nonetheless needs to be tested against the standard criteria for good tax policy: horizontal equity, vertical equity, and economic efficiency.⁹ Horizontal equity requires treating those similarly situated in the same way so “those with equal ability to pay taxes should pay equal amounts of tax.”¹⁰ Vertical equity requires treating those differently situated differently so that “people with greater income . . . pay greater amounts of that income in tax.”¹¹ Efficiency “requires that a tax interfere as little as possible with people’s economic behavior.”¹² These tax criteria demand that, whatever the role of the federal government in expressing sympathy to victims on behalf of the nation, any expression should be designed not to burden the poor, favor the rich, or fail to achieve its economic goals.

We begin in Part I by discussing features of two tax legislative initiatives, which responded to two quite different disasters: first, the response to the devastation of the fall 2005 hurricane season and, then, the response to the earlier terrorist attacks on the World Trade Center and Pentagon of September 11, 2001. In Part II, we explore the possibility that some of the provisions of these acts may be vulnerable to indirect constitutional challenge under the Uniformity Clause.¹³ Part III examines some of the problems inherent in post-disaster tax legislation. This Part first discusses the role, usually unfortunate, of sympathy in tax legislation. It goes on to consider how, despite the fact that the targets of relief legislation are generally thought to be people in need, it nevertheless seems that a sizable share of the benefits of disaster legislation in the tax area goes to relatively high-income and high-wealth taxpayers. Part IV suggests

9. See MICHAEL J. GRAETZ & DEBORAH H. SCHENK, *FEDERAL INCOME TAXATION: PRINCIPLES AND POLICIES* 27–29 (5th ed. 2005).

10. *Id.* at 27. The scholarly debate about the validity and usefulness of these criteria is beyond the scope of this paper.

11. *Id.* at 28.

12. *Id.* Professors Graetz and Schenk continue:

A tax often is said to be efficient when it promotes economic growth and inefficient when it inhibits such growth. Finally, efficiency sometimes refers to the extent to which incentive provisions provide benefits to taxpayers other than the intended beneficiaries. Where, for example, an unintended third party receives a benefit, or where the intended beneficiary receives less than the government loses in tax revenue, the tax provision is said to be inefficient.

Id. at 29.

13. See U.S. CONST. art. I, § 8, cl. 1 (“All Duties, Imposts, and Excises shall be uniform throughout the United States.”).

that a better approach can be institutionalized by incorporating some of the legislative and administrative measures that we think have proven appropriate and helpful. We conclude by offering our speculation regarding ways in which the incentive structure might be altered to encourage only relief actions that seem likely to promote good policy, both in terms of disaster relief and tax policy.

I. LEGISLATIVE RESPONSE TO RECENT DISASTERS

Much can be learned from the congressional response to two recent disasters: the 2005 hurricane season (including Hurricane Katrina) and the terrorist attacks of September 11, 2001. We do not attempt a comprehensive analysis here of the several tax enactments spawned by these two disasters. Rather, we have chosen a few representative features of each that illustrate Congress's unfortunate tendency to disregard sound tax policy criteria when responding to disasters.

With respect to hurricane relief, the shortcomings primarily implicate horizontal equity concerns between taxpayers within and without the designated geographic zones. With respect to the terrorist-attack response, the primary problem relates to a confused application of the special tax rules designed for military personnel to civilian disaster victims. In both cases, other concerns are identified as well.

A. *The Three Sisters: Hurricanes Katrina, Rita, and Wilma*

1. *Catastrophe and Response.* The congressional reaction to the devastation wreaked by the 2005 hurricane season illustrates several of the troublesome tendencies noted in the introduction. The immense scale of the damage done by Hurricane Katrina created an urgency that presumably led Congress to move on legislative relief as quickly as it reasonably could; nevertheless, the legislative process was glacial in comparison to the dire needs developing on the ground. Hurricane Katrina hit the Louisiana and Mississippi coastline on August 29, 2005.¹⁴ Two weeks passed without legislative action; the Senate then slightly beat the House to the draw, introducing S. 1696

14. Transcript of *Anderson Cooper 360* (CNN television broadcast Aug. 29, 2005), available at <http://transcripts.cnn.com/TRANSCRIPTS/0508/29/acd.01.html>.

on September 13.¹⁵ The following day, H.R. 3768 was introduced.¹⁶ Two days later, both bills passed their respective houses.¹⁷ To shorten the process, however, the Senate later that day voted to adopt the House bill, but with some amendments. Further amendments followed, but without formal conference committee consideration.¹⁸ Both the House and the Senate passed resolutions on September 21 adopting the final provisions of the Katrina Emergency Tax Relief Act (KETRA).¹⁹ The enormous strength of the legislative imperative mentioned above is demonstrated by the fact that, though this bill was in many ways ill-considered, it passed both houses unanimously.²⁰ Apparently, even the most maverick legislators, from the safest seats, did not want to arm their next opponents with the charge that they tried to block assistance to the victims of this horrific disaster.

The bill was signed by the president two days later, on September 23. Less than a month thus passed between the disaster and the tax Act designed to address it. This is remarkably swift by the standards of tax legislation; still, it demonstrates that tax legislation can never be much of a first responder in a crisis.

As it happened, however, the hurricane season was far from over. Even as Congress finally approved, and the president signed, KETRA, Hurricane Rita was approaching the Gulf Coast, making landfall in Texas and Louisiana on September 24.²¹ And a month after that, Hurricane Wilma—which at times carried the National Weather Service’s highest hurricane designation, Category Five—circled the Gulf, eventually hitting the west coast of Florida, where it caused extensive damage. Congress went back to work—again, at a pace that one would say was quick for legislation, but slow for disaster relief—and passed (through both houses) the Gulf Opportunity Zone Act of

15. S. 1696, 109th Cong. (2005).

16. H.R. 3768, 109th Cong. (2005).

17. S. 1696 (as passed by Senate); H.R. 3768 (as passed by House of Representatives).

18. *E.g.*, S. 1728, 109th Cong. (2005).

19. Katrina Emergency Tax Relief Act (KETRA) of 2005, Pub. L. No. 109-73, 119 Stat. 2016 (2005).

20. 151 Cong. Rec. H8197 (daily ed. Sept. 21, 2005); 151 Cong. Rec. S10320 (daily ed. Sept. 21, 2005).

21. RICHARD D. KNABB ET AL., NATIONAL HURRICANE CENTER, TROPICAL CYCLONE REPORT: HURRICANE RITA 2 (2005), http://www.nhc.noaa.gov/pdf/TCR-AL182005_Rita.pdf (last visited Sept. 9, 2006).

2005 (GOZA)²² on December 16, 2005. The president signed it on December 21.²³

GOZA accomplished several things: it expanded the geographical reach of the KETRA provisions to areas damaged by the two subsequent hurricanes;²⁴ it added several important investment incentive provisions that had apparently not occurred to Congress when it passed KETRA;²⁵ and it offered technical corrections to several earlier tax bills, including the Growth Tax Relief Reconciliation Act of 2003,²⁶ the American Jobs Creation Act of 2004,²⁷ and the Energy Policy Act of 2005.²⁸

KETRA and GOZA certainly deserve to be called disaster acts, but the adjective should be understood to refer more to the Acts themselves than to the hurricanes that spawned them. As can be seen from the description below, the provisions of the two Acts are, with only a few exceptions, a sad combination of ineffective disaster relief and poor tax policy.

2. *Provisions of the Acts.*

a. *Qualified Plan Withdrawals.* KETRA's section 101, the first substantive section of the first Act, seems a logical place to begin.²⁹ It allows an individual who, on August 28, 2005, lived in the Hurricane

22. The accepted style of shorthand references to this Act seems to be "GO Zone Act," but we have used the shorter acronym because it is shorter, and because it sounds more like a piece of legislation and less like a cheerleader's exhortation.

23. Gulf Opportunity Zone Act (GOZA), Pub. L. No. 109-135, 119 Stat. 2577 (2005).

24. Some provisions apply variously to areas hit by each storm, a technical choice that has spawned a bewildering variety of zone names, including "Gulf Opportunity Zone," "Hurricane Katrina disaster area," "Rita GO Zone," "Hurricane Rita disaster area," "Wilma GO Zone," and "Hurricane Wilma disaster area." In all cases, the boundaries of these areas or zones were to be defined essentially by presidential proclamation. STAFF OF THE JOINT COMM. ON TAXATION, 109TH CONG., TECHNICAL EXPLANATION OF THE REVENUE PROVISIONS OF H.R. 4440, THE "GULF OPPORTUNITY ZONE ACT OF 2005," AS PASSED BY THE HOUSE OF REPRESENTATIVES AND THE SENATE (Comm. Print 2005).

25. See *infra* Part I.A.2.e. Technically, GOZA extends several of KETRA's provisions by repealing them as of December 21, 2005 (GOZA's effective date) and reenacting them as part of GOZA. To be as clear as possible about what Congress did, and when it did it, however, we will refer to the KETRA provisions when discussing the provisions first introduced into law by that Act.

26. GOZA § 405 (amending the Growth Tax Relief Reconciliation Act of 2003).

27. GOZA § 403 (amending the American Jobs Creation Act of 2004).

28. GOZA § 402 (amending the Energy Policy Act of 2005).

29. As is typically true, the Act begins with sections giving the Act its name, and providing definitions. Section 101 is the first section that effects any changes to the prevailing tax rules.

Katrina disaster area to make withdrawals from various retirement accounts, such as plans established under I.R.C. sections 401(k), 403(b), or 457, under favorable terms. First, the usual 10 percent penalty on premature withdrawals would be waived.³⁰ Second, any income produced by the withdrawals (which are ordinarily taxable in full) would be included ratably over a three-year period (rather than fully includible in the year of distribution, as is generally the rule).³¹ Finally, any amounts withdrawn pursuant to this provision could be recontributed to the plan at any time within three years of the distributions (which is not normally allowed with respect to any distributions, much less premature ones).³² The Act imposes a few limits: no more than \$100,000 could be withdrawn under this provision; and only withdrawals between August 25, 2005, and December 31, 2006 could qualify.

As an emergency relief provision, the provision was unlikely to be helpful. Many of the victims, including those whose situations were most desperate, (1) would not have such accounts; (2) could not find their financial institutions even if they did have such accounts during the weeks and months following the disaster; and (3) likely did not have the specter of modest premature withdrawal penalties at the top of their list of worries at any time.

But as time passed, some progress was made in dealing with the disaster. People presumably began to be able to locate their various accounts (if they had them), and may well have found one or more of the KETRA provisions useful. But, though that was Congress's clear intention, it raises an unavoidable horizontal equity question: Why should taxpayers whose losses resulted from this particular hurricane be more favorably treated than those whose losses resulted from a different catastrophe?

b. Casualty Loss Deductions. Before making a head-to-head comparison between hypothetical victims inside and outside the favored zones, consider another provision of KETRA: section 402, which suspends, for losses attributable to Hurricane Katrina, the limits on casualty loss deductions. These deductions normally allow deduction of losses only to the extent that such losses exceed ten

30. Katrina Emergency Tax Relief Act (KETRA) of 2005, Pub. L. No. 109-73, § 101(b)(2), 119 Stat. 2016 (2005).

31. KETRA § 101(c)(1).

32. KETRA § 101(c)(2)–(3).

percent of the taxpayer's adjusted gross income (AGI) in the year of the casualty.³³ This limitation has had the effect of virtually eliminating eligibility to claim casualty loss deductions for most taxpayers since its inception in 1983.³⁴

Again, there is reason to question the effectiveness of this provision as disaster relief. First, casualty loss deductions are only available to those who itemize their deductions, a group which consists of only about a third of all taxpayers,³⁵ and probably a smaller percentage of Katrina victims, because they were disproportionately poor, while itemizers are disproportionately well-off.³⁶ Second, there was not much need to worry about deductions on an emergency basis, because taxpayers would generally not even be thinking about tax filings until six months or more after the disaster.³⁷ Finally, the ten percent limitation was generally less important for Katrina victims, because their losses were of such a magnitude that they likely would greatly exceed ten percent of AGI in many cases, especially among those that seem most deserving of special relief.³⁸

33. KETRA also suspended an apparently trivial limitation allowing deduction only of losses exceeding \$100 per casualty event. KETRA § 402. For personal casualty losses and theft losses attributed to Hurricane Katrina there is no \$100 minimum or 10 percent AGI limitation under section 402 of KETRA (excluding restrictions in paragraphs (1) and (2)(A) of section 165(h)). *Id.*

34. In 1982, the last year preceding introduction of this limit, about 2.2 million taxpayers claimed casualty loss deductions. In the following year, when taxpayers were subject to the 10 percent limitation, only about 200,000 taxpayers claimed such deductions. Susan Hostetter & Dan Holik, *Preliminary Income and Tax Statistics for 1983 Individual Income Tax Returns*, INTERNAL REVENUE SERV. STATISTICS OF INCOME BULLETIN, Winter 1984–1985, at 19, 21.

35. Itemized deductions were claimed on 33.7 percent of all returns filed in 2003. Internal Revenue Service, *Tax Stats at a Glance*, <http://www.irs.gov/taxstats/article/0,,id=102886,00.html> (last visited Aug. 21, 2006).

36. It is true, of course, that a deduction for a disaster loss of significant magnitude will alter a taxpayer's decision on the question of whether or not to itemize deductions.

37. See KETRA § 403 (extending filing deadlines for victims of Hurricane Katrina).

38. The prototypical pre-1983 casualty was the loss due to collision involving a personal automobile. If a taxpayer with an AGI of \$80,000 totals a car worth \$10,000, the casualty loss limitation disallows the first \$8000 of that loss, permitting deduction of only the last \$2000, or 20 percent in this example. If a Katrina victim with the same income loses a \$150,000 house, \$50,000 of furnishings and personal effects, and a \$10,000 automobile, the \$210,000 total losses would have been mostly allowable even without the changes effected by section 402. Only the same \$8000 would have been disallowed, with the balance of \$202,000 being allowed, or 96 percent in this example. In the latter case, the effect of the casualty losses in excess of income would be to allow carryovers of the losses to subsequent years, subject to the rules of I.R.C. § 172.

c. Illustrating the Inequity. But, at least for a taxpayer who was reasonably well-off, having perhaps both a substantial section 401(k) balance, and an income high enough to justify itemizing his deductions, this pair of KETRA provisions could produce some significant benefits. Imagine, for example, a single taxpayer with an income of \$90,000, who was perhaps at the periphery of the Katrina disaster area, and sustained only \$10,000 of damage to his house from a wind-blown tree. He would be allowed to deduct the entire \$10,000 of damages, and would be able to withdraw from his section 401(k) plan the \$10,000 necessary to repair the damage. This withdrawal would be subject to no penalty tax, and would produce no net taxable income if the individual were able to recontribute the amount back to his section 401(k) plan within three years. Even if he does not recontribute, his withdrawal would result in no more than \$3333 of income in the year of distribution.

One must wonder why the benefits—if appropriate in this case—are not more broadly available to others who are similarly situated. In the extreme case, imagine another taxpayer identically situated in every respect except his choice of residence—a taxpayer, perhaps, who lived in Minnesota, nowhere near the disaster area, and had a weakened tree blow over on her house, causing an identical \$10,000 of damage. This taxpayer will find that if she withdraws \$10,000 from her section 401(k) plan, that amount will be included in her income in the year of the distribution; and she will pay an additional excise tax of \$1000 for violating the rules discouraging premature withdrawals. She will also find that, because her income (including the amount of the premature distribution) is \$100,000, all of the \$10,000 casualty loss will be absorbed by the statutory nondeductible floor of ten percent of AGI. The combination of the extra \$10,000 of income, the absence of the \$10,000 casualty-loss deduction, and the premature withdrawal penalty tax will mean that the Minnesota taxpayer will pay about \$6000 more tax in 2005 than the taxpayer who lived in the Katrina area³⁹—an amount that results in, under reasonable assumptions, about a 76 percent larger tax bill than the Louisiana taxpayer faced.⁴⁰

39. Married taxpayers with an AGI of \$100,000 would be in the 25 percent tax bracket. I.R.C. § 1(a)(1) (2000) (as adjusted for inflation). The extra \$20,000 of income would thus be associated with an additional tax of \$5000. This, plus the \$1000 early withdrawal penalty, equals \$6000.

40. Married taxpayers with two children would have paid a federal income tax of \$7850 if their AGI was \$100,000, they had \$20,000 of non-casualty itemized deductions, and a \$10,000 casualty deduction. \$6000 is 76.4 percent of \$7850.

The two taxpayers suffered precisely the same damage during 2005—\$10,000 of structural damage to their homes due to a wind-blown tree. One has to ask: Why should their tax treatment be so dramatically different?

It is possible to justify the KETRA provisions as to casualty losses and emergency withdrawals from retirement accounts, in the sense that they do not seem, by themselves, outrageous rules: If one's house is suddenly damaged by a storm, perhaps rules allowing full deductibility of the damages, and tax-free borrowing from one's retirement account to cover the repairs, are merciful, even sensible. On the other hand, it is possible to justify, on different grounds, the more stringent background rules as to casualty losses and premature withdrawals that would apply to the Minnesota taxpayer: rules imposing nondeductible floors on casualty loss deductions expand the tax base without gross injustice to those suffering modest losses, and penalizing premature withdrawals from retirement accounts serves to protect those accounts for later achievement of their intended purposes. But it is virtually impossible to justify treating two so nearly identically situated taxpayers so differently.

d. Other KETRA Provisions. Although too numerous to examine individually, most of the other KETRA provisions also seem rather capriciously limited to the Katrina disaster zone. They are rules that either make sense everywhere, or make sense nowhere. They are not, for the most part, provisions that make sense only because of some unique characteristic of the Katrina disaster. Two more abbreviated examples will illustrate this point.

First, KETRA provides an especially favorable mileage rate for purposes of deductions related to charitable uses of a personal automobile.⁴¹ The general mileage rate that taxpayers may deduct for use of a personal automobile for charitable purposes is set by statute at 14 cents per mile.⁴² In contrast, the rate for business use of a personal automobile is permitted by regulation to vary according to prevailing costs of fuel, oil, and other commodities, and is set by periodic announcement by the IRS.⁴³ For roughly the period covered by KETRA, the mileage rate allowed for business use of a personal

41. Katrina Emergency Tax Relief Act (KETRA) of 2005, Pub. L. No. 109-73, § 303, 119 Stat. 2016 (2005).

42. I.R.C. § 170(i) (2000).

43. Treas. Reg. § 1.274-5(g) (as amended in 2003).

automobile was 48.5 cents per mile.⁴⁴ Congress's explanation of the difference is that business use of the automobile should be fully compensated through a deduction of all costs, including maintenance, depreciation, and the like, while only out-of-pocket costs, such as the cost of gasoline, are appropriate charitable deductions.⁴⁵ Why this should be so is not self-evident, but justification could perhaps be found in the income-defining properties of business-expense deductions. Charitable contribution deductions, in contrast, may be more properly a matter of legislative grace.

Whatever the reasons for distinguishing business from charitable uses of an automobile for purposes of deducting the vehicle costs, KETRA blatantly disregards them by allowing a deduction for charitable use of a personal automobile—but only within the disaster zone—at a rate equal to 70 percent of the applicable business rate prevailing at the time—amounting to about 34 cents per mile during the fall of 2005.⁴⁶ If charitable contributions are indeed a matter of legislative grace, then perhaps one should accept grace when and how one finds it.⁴⁷ Still, it is difficult to understand how someone who drives from Cincinnati to help rebuild a flooded church in southern Mississippi deserves a more generous deduction than if that person had driven to Alabama to help rebuild a church destroyed by fire.⁴⁸

44. Rev. Proc. 2005-78, 2005-51 I.R.B. 1177. This rate was in effect from September 1, 2005, through December 30, 2005; KETRA was in effect from August 25, 2005, until it was superseded by GOZA (with this provision intact) on December 21, 2005.

45. STAFF OF THE JOINT COMM. ON TAXATION, 109TH CONG., TECHNICAL EXPLANATION OF H.R. 3768, THE "KATRINA EMERGENCY TAX RELIEF ACT OF 2005," AS PASSED BY THE HOUSE AND THE SENATE ON SEPT. 21, 2005 (Comm. Print 2005) (addressing section 303 of KETRA).

46. KETRA § 303. The section following allows exclusion of any reimbursement of mileage costs in excess of 14 cents, which, under ordinarily applicable provisions, would be included in income.

47. Recall here the parable of the laborers in the vineyards, who are paid the same, regardless of how long they had worked; grace is thus within the discretion of He who bestows it. *Matthew* 20:1–16.

48. One might argue that Congress is simply trying to provide particularly powerful incentives to rebuild the hurricane disaster area because of the extent of the devastation. That may be an accurate description of congressional motives in enacting this provision, but it is contrary to the nearly universal refusal to use variable charitable deductions to create hierarchies among objects of charity. A dollar given to an opera company, for example, is deductible on precisely the same terms as a dollar given to a soup kitchen, even though relief of hunger for food would presumably take precedence over relief of hunger for arias in the minds of most members of Congress (and most voters). The focus of I.R.C. § 170 (which allows charitable contributions deductions) is on what the donor gives up, not on the worthiness of the

Second, KETRA adds another exception to the general tax rule requiring recognition of income from the discharge of indebtedness.⁴⁹ Even if the taxpayer is not insolvent (a usual requirement of the exception from debt discharge income rule in I.R.C. section 108), no recognition is required if the taxpayer resides within the Katrina disaster area.⁵⁰ Again, one can imagine broader exceptions to the rules regarding income from debt discharge, such as, hypothetically, allowing exclusion whenever the property securing indebtedness is destroyed by agents external to the taxpayer. It is, however, difficult to justify applying such a rule in only one geographical area. To any particular taxpayer, an uninsured loss of a major piece of property is likely a disaster, whether it happens in an officially designated disaster area or not.

e. GOZA Investment Incentives. Except for a few provisions allowing credits for wage payments, KETRA was not particularly generous with corporate entities, targeting most of its benefits at individuals instead.⁵¹ GOZA, in contrast, is loaded with provisions granting tax favors of a variety of sorts to business interests in a variety of industries. A cynic might conclude that this was due to

charity (as long as the donee meets the definitional standards for eligible recipients of deductible contributions).

49. I.R.C. § 61(a)(12) (2000). The idea behind income from discharge of indebtedness is that an increase in net worth generates income, and that net worth can be increased by a reduction of a taxpayer's liabilities, just as it would be by an increase in the taxpayer's assets.

50. But there is a nice exception-within-an-exception here: if the discharged debt relates to property outside the Katrina disaster area, then this exception does not apply. KETRA § 401.

51. Normally, the work opportunity tax credit provides to the employer a credit in the amount of 40 percent of the first \$6000 of qualified work wages per employee, amounting to a maximum credit of \$2400, for hiring individuals from various target groups, e.g., families eligible for Temporary Assistance for Needy Families, high-risk youths, ex-felons. Section 201 of KETRA extends this credit to employers who hire a Hurricane Katrina employee, defined as:

(1) any individual who on August 28, 2005, had a principal place of abode in the core disaster area and who is hired during the [two]-year period beginning on such date for a position[,] the principal place of employment of which is located in the core disaster area, and (2) any individual who on [August 28, 2005,] had a principal place of abode in the core disaster area, who [was] displaced from such abode by reason of Hurricane Katrina and who is hired during the period beginning on such date and ending on December 31, 2005 without regard to whether the new principal place of employment is in the core disaster area.

KETRA § 201.

In addition, section 202 of KETRA provides a credit of 40 percent of qualified wages (up to a maximum of \$6000 in qualified wages per employee) for the those employers who conducted a trade or business within the core disaster area who retained their employees that worked for them in their trade or business.

another source of delay inherent in the enactment of legislative solutions: it takes the lobbyists some time to figure out what they need, and how best to get it. Alliances must be formed, and compromises must be reached. But one need not be a cynic to recognize that crafting appropriate incentive structures to rebuild a completely devastated area takes some time. In any event, by December 2005, Congress had enacted in GOZA provisions to benefit a broad range of interests. Utilities, timber interests, oil and gas producers, and even colleges and universities all will benefit from one or more of the GOZA provisions.⁵² Some of those provisions have a retrospective quality, in the sense that they are intended to relieve the pain of the losses suffered; but some are primarily prospective, offering incentives for new investment to rebuild the areas affected by all three hurricanes.

These incentives take several forms. First, there is a special 50 percent depreciation allowance for qualifying investments to rehabilitate or reconstruct hurricane-damaged property.⁵³ This means that in addition to whatever depreciation deductions might be available for the particular type of property placed in service, the taxpayer may deduct an amount equal to fifty percent of the investment in the new or rehabilitated asset. Alternatively, if the taxpayer elects to expense (that is, to deduct immediately, in the year the cost was incurred) certain investments under I.R.C. section 179, he may expense up to \$200,000 of investment instead of the usual

52. I.R.C. § 1400N(j) (benefiting public utilities by stating that public utility property losses caused by Hurricane Katrina may, at taxpayer's election, be carried back ten years instead of two years); § 1400N(o) (benefiting public utilities by allowing the deduction of GO Zone public utility property losses from Hurricane Katrina in the fifth tax year before the year of the loss); § 1400N(i)(1) (benefiting timber interests by increasing the § 179 deduction limit of reforestation costs from \$10,000 to \$20,000 for small timber producers whose property was destroyed by Hurricane Katrina and whose property was located in the GO Zone region); § 1400N(i)(2) (benefiting timber interests by allowing net operating losses for small timber producers incurred prior to January 1, 2007, to be carried back for five years, rather than the two years previously allowed); § 1400N(g) (benefiting oil and gas producers by extending the deduction under § 198 for expenditures incurred to clean up qualified contaminated sites in the GO Zone through December 31, 2007, and defining petroleum products as hazardous substances); § 1400(O) (benefiting colleges and universities by doubling the Hope Credit to \$3000 and also doubling the Lifetime Learning Credit percentage from 20 percent to 40 percent of the first \$10,000 in qualified tuition and related expenses, for a maximum Lifetime Learning Credit of \$4000 for students attending undergraduate or graduate institutions in the GO Zone). These provisions apply to tax years 2005 and 2006. The same income phase out provisions still apply.

53. Gulf Opportunity Zone Act (GOZA), Pub. L. No. 109-135, § 101(a), 119 Stat. 2577 (codified in I.R.C. § 1400N(c) (West Supp. 2006)).

limit of \$100,000.⁵⁴ GOZA also allows expensing of certain cleanup and demolition costs within the favored zone.⁵⁵

GOZA also authorizes the issuance of “Gulf Opportunity Zone Bonds,” which allow states and political subdivisions within the “Gulf Opportunity Zone” to issue tax-exempt bonds to finance capital investments on generally favorable terms.⁵⁶ For example, the background I.R.C. provisions allow state and local governments to issue “qualified mortgage bonds” as a means of subsidizing the construction of housing units, as long as some of the financed units are reserved for residents who meet certain income limits.⁵⁷ GOZA does not eliminate these statistical tests, but rather relaxes them, making it easier for projects to qualify for favorable financing.

Some of these provisions may be justified by the scope of the disaster to which they respond, but that is by no means self-evident in most cases. In at least some cases, if the provision is justified in helping victims rebuild their businesses in the hurricane zone, it would be equally well-justified in a small Midwestern town devastated by a tornado. For example, GOZA’s rules allowing more remote net operating loss carrybacks (from the normal two years to five) would seem about equally beneficial, and equally justified, for any business that was destroyed by a catastrophe.⁵⁸

f. GOZA’s Provisions and Special Interests. GOZA’s provisions also demonstrate another problem of tax legislative responses to disasters: it contains many provisions that will benefit particular business interests that had invested or do invest within the designated areas. Lobbyists (and those who try to monitor them) sometimes refer to particular legislation as a “Christmas tree” bill—a piece of legislation that appears to have beneath its branches a nicely wrapped gift or two for every industry important enough to have a trade association. Because the concept is informal, nowhere defined, and inherently subjective, we do not assert that the disaster-relief bills

54. GOZA § 101(a) (codified in I.R.C. § 1400N(d) (West Supp. 2006)). Expensing under section 179 is an allowance typically used by small businesses in lieu of depreciation deductions. It is quite favorable to taxpayers, and its availability and scope are accordingly quite limited.

55. GOZA § 101(a) (codified in I.R.C. § 1400N(f) (West Supp. 2006)).

56. GOZA § 101(a) (codified in I.R.C. § 1400N(a)(2) (West Supp. 2006)).

57. I.R.C. § 143 (2000) (imposing the requirements necessary for favorable financing).

58. GOZA § 101(a) (codified in I.R.C. § 172, which provides the background rules on net operating loss carrybacks, and I.R.C. § 1400N(k), which extends the carrybacks for qualified losses).

can necessarily be characterized this way. And, although the term is certainly pejorative, bills with benefits distributed broadly among interest groups are not *necessarily* bad bills. Perhaps in this instance, one could say—if it does not push the metaphor too far—that after the catastrophes suffered in the fall, every industry with a stake in the Gulf coast region deserved to find a few delights under the tree at Christmas. Still, the profusion of industry-targeted benefits⁵⁹ suggests that legislators intended more than just a careful pursuit of optimal public policy. It suggests instead that the urgency to do something—almost anything—in response to a disaster that pulled at the nation's sympathies created an atmosphere in which Congress could not say no.

B. Legislative Response to the September 11 Attacks

1. *Chronology.* As was the case in the response to the hurricane season of 2005, the congressional approach to the terrorist attacks of four years earlier was performed in two Acts. The first, H.R. 2884, the Victims of Terrorism Tax Relief Act of 2001 (VTTRA), was introduced on September 13, 2001—a mere two days after the attack on the World Trade Center.⁶⁰ Bypassing normal procedures, House Ways and Means Committee Chair William Thomas and ranking Minority Member Charles Rangel sent the bill immediately to the floor, and the House passed the bill unanimously on September 13, 2001.⁶¹ Despite this nearly immediate response, however, the tax relief provisions did not win easy passage. Not until December 20, 2001 did both the House and Senate agree on the content of the Act.⁶² It ultimately garnered 129 cosponsors of which only 36 were Democrats.⁶³ President Bush signed the bill into law on

59. See *supra* note 52 and accompanying text.

60. Victims of Terrorism Tax Relief Act of 2001 (VTTRA), H.R. 2884, 107th Cong. (2001).

61. Patti Mohr & Warren Rojas, *House Passes Bipartisan Tax Relief for Terrorist Attack Victims*, TAX NOTES TODAY, Sept. 14, 2001, LEXIS, 2001 TNT 179-1.

62. Patti Mohr, *Congress Sends Victims' Tax Relief Bill to President Bush*, TAX NOTES TODAY, Dec. 21, 2001, LEXIS, 2001 TNT 246-1.

63. H.R. 2884, 107th Cong. (2001). It ultimately passed the House on a voice vote. Rep. William M. Thomas, *House Passes Victims of Terrorism Relief Act*, TAX NOTES TODAY, Jan. 11, 2002, LEXIS, 2002 TNT 8-37. The Democratic sponsors, however, included such liberal leaders as Richard Gephardt and Charles Rangel.

January 23, 2002, more than four months after the September 11 attacks.⁶⁴

The delay was due in large part to the Senate's desire to include a payroll tax exemption for victims out of a concern that the tax provisions would otherwise give little or no relief to poorer victims with little or no income tax liability.⁶⁵

Moreover, the House and Senate also postponed passage of tax incentives designed to help rebuild lower Manhattan.⁶⁶ Those stimulus provisions became part of the second act relating to September 11 tax changes, H.R. 3090, the Job Creation and Worker Assistance Act (JCWA). The president did not sign the act until March 9, 2002, nearly six months after the attack on the World Trade Center. We discuss the two acts in chronological order below. Like the hurricane provisions, these provisions raise questions about vertical equity, horizontal equity, and efficiency, particularly when the victims of September 11 are compared to soldiers who die in combat and the tax provisions addressing September 11 are compared to the provisions of the September 11th Victim Compensation Fund.

2. *VTTRA*. *VTTRA* extended income and estate tax benefits available to members of the armed forces killed in or as a result of combat⁶⁷ to three groups: those who died in the September 11 attacks, those who died in the Oklahoma City bombing of April 1995, and those who died from anthrax attacks following the September 11 attacks.⁶⁸ We see in this an interesting pattern—one that can also be discerned in favorable treatment of victims of lesser hurricanes such

64. Press Release, The White House, President Bush Signs Legislation to Help Victims of Terrorism (Jan. 23, 2002), available at <http://www.whitehouse.gov/news/releases/2002/01/20020123-20.html>.

65. The ultimate compromise was not to give payroll tax relief, but to guarantee each victim at least \$10,000 in income tax relief. Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, § 692(d)(2), 115 Stat. 2427 (2001). That is, lower-income victims who did not have income tax liability of \$10,000 would receive payments from the government so that the total relief equaled \$10,000. See Sen. Tom Daschle, *Senate Concurs with House Amendments to Victims of Terrorism Tax Relief Act*, TAX NOTES TODAY, Jan. 11, 2002, LEXIS, 2002 TNT 8-36 (“[I]nclud[ing] a provision that did not include payroll taxes but set a minimum of \$10,000 so lower income people would receive some tax refund.”).

66. See Daschle, *supra* note 65 (quoting Sen. Schumer as refusing “to stand in the way” and thus willing to permit removing from the bill the part intended to benefit lower Manhattan).

67. See I.R.C. §§ 692 and 2201 (West Supp. 2006).

68. Mohr & Rojas, *supra* note 61; Rep. Charles Rangel, *Rangel Bill to Aid Victims of Terrorist Attack*, TAX NOTES TODAY, Sept. 14, 2001, LEXIS, 2001 TNT 179-24.

as Rita and Wilma: when one disaster is so great that it seems to call for heavy congressional artillery, other, smaller but more or less similar disasters get caught up in the wave. This is an understandable response on the part of Congress: the Oklahoma City and anthrax tragedies were indeed similar enough to the September 11 attacks to justify similar treatment, just as Hurricanes Rita and Wilma were destructive storms similar to Katrina. Had they happened by themselves, however, they would not have been quite dramatic or intense enough to produce the response that the September 11 attacks, or, later, Hurricane Katrina, did. (We can only imagine that in the case of the anthrax terrorism; but we know from history that there was no immediate relief available for families affected by the Oklahoma City bombing on a scale that followed the September 11 attacks; similarly, each individual hurricane, even a fairly destructive one, does not produce its own tax bill.)

Smaller-scale disasters, it would appear, call for dramatic legislative responses only if they occur within some temporal proximity to bigger ones, and involve losses that are similar in type, if not in magnitude. Disasters, however, fall along a continuum of severity, and the individual victims of smaller disasters, while less numerous, may be just as deserving (or undeserving) of any special tax relief as victims of the disasters whose magnitude moves Congress into action. A more even response to taxpayers who are victimized in particular ways would be desirable from a tax policy viewpoint.

In the case of the September 11 attacks, the disaster type could be described as willful terrorist attacks on American soil, with American citizens as the targets. The September 11 attacks themselves, alone among the three episodes covered by VTTRA, were perpetrated by non-Americans, giving rise to a sense of attack that could be, and inevitably was, thought of as akin to warfare. In extolling the House bill, Representative Charles Rangel asserted on September 13 that the families of the terrorists' victims should be given at least "all of the benefits we have offered to the families killed in war zones in the past."⁶⁹ Representative William Thomas urged,

it is the least that we can do before we adjourn for this week to put on record that Members of the House of Representatives, in a bipartisan way, believe that those victims of those attacks on September 11 were in a combat zone and should be afforded the

69. Mohr & Rojas, *supra* note 61; accord Rangel, *supra* note 68.

privileges and protections that are in the code for military personnel and for civilian personnel because, clearly, this is the first, I believe, substantive reflection of the fact that we are at war.⁷⁰

The war metaphor, while moving and powerful, is nevertheless misleading. It has had mischievous results in the tax area, as well as many others. War is an armed conflict between or among nation-states. Terrorism is not ordinarily within this definition. One may speak loosely of a war on crime, a war on poverty, or a war on avian flu; but that usage is metaphorical. In the tax area, the metaphor is unhelpful at best and may have encouraged Congress to ignore principles of sound tax policy.

Promotion of these tax provisions as integral to a war may have assisted those who wish to make fundamental changes to our tax code. Under VTTRA, provisions designed to help lower-income military personnel, by supplementing military pay, were expanded in a way that produced large benefits for wealthy victims of disaster. At least one of these special provisions, relating to the estate tax, may have served as a pilot for controversial changes sought by some members, arguably a somewhat backdoor approach to tax reform. A closer examination of these provisions will make the sources of concern more evident.

Section 692 of the I.R.C. has long provided that income tax shall not apply to the income of any soldier who dies in or as a result of combat zone injury or disease for the year of death and “any taxable year ending on or after the first day” the soldier served in the combat zone.⁷¹ VTTRA amended this provision to give a similar benefit to the three specified groups of terrorist victims for both the year of their death and the preceding year.

VTTRA also gave the victims of terrorism the same estate tax relief as that extended to soldiers. In the course of consideration of

70. Rep. William M. Thomas, *House Passes Tax Relief for Terrorist Attack Victims*, TAX NOTES TODAY, Sept. 20, 2001, LEXIS, 2001 TNT 183-32. Of course, this belief was significantly less apt in the case of the Oklahoma City bombing, but that seems not to have troubled Congress—at least not enough to make distinctions among the remedies they crafted in the Act on this basis.

71. Section 692 of the Internal Revenue Act of 1954 is the descendant of section 421 of the Internal Revenue Code of 1939, as superseded by section 154 of the 1939 Code. *See* Rev. Rul. 56-323, 1956-2 C.B. 993. Originally, it was a provision enacted to grant tax relief to soldiers who died “on or after December 7, 1941, while in active service as a member of the military or naval forces of the United States.” The provision was to continue in force until “the termination of [World War II] as proclaimed by the President.” *Id.*

estate tax relief, however, Congress changed the nature of relief granted for the estate tax, both for soldiers and the terrorist victims. Prior to VTTRA, section 2201 of the I.R.C. had replaced the federal estate tax that would otherwise have been imposed for active members of the armed forces killed in action in a combat zone with a federal estate tax equal to 125 percent of the maximum state death tax credit.⁷² Needing to reconcile the provision with the phase-out of the credit for state estate tax liability that Congress enacted as part of estate tax reform in June of 2001,⁷³ VTTRA substituted a special estate tax rate structure for both such soldiers and for victims of terrorism. Under this special rate structure, the estate tax begins at a 1 percent rate for taxable estates over \$100,000 and reaches a maximum rate of 20 percent when the taxable estate exceeds \$10.1 million. (At the time, the general estate tax rates under section 2002 began at 18 percent for amounts over \$10,000 and went up to 50 percent for estates over \$2.5 million.⁷⁴)

Thus, VTTRA purported to treat the victims of September 11 in the same way as soldiers killed in combat for purposes of both the income and estate taxes. In fact, these income and estate tax provisions of VTTRA ignore key and relevant differences between soldiers and the victims of terrorism, particularly victims of the September 11 attack.

3. *Comparing the Victims of September 11 to Soldiers Killed in Combat.* The longstanding special tax provisions for members of the armed forces, including the special income and estate tax provisions for those killed in combat, are part of a package designed ex ante to attract and reward soldiers for a decision to serve voluntarily in the

72. I.R.C. § 2201 (2000) (before amendment by the Victims of Terrorism Tax Relief Act of 2001 (VTTRA), H.R. 2884, 107th Cong. (2001)); see STAFF OF THE JOINT COMM. ON TAXATION, 107TH CONG., TECHNICAL EXPLANATION OF VICTIMS OF TERRORISM RELIEF ACT OF 2001 (Comm. Print 2001) (“The Code also provides a reduction in Federal estate taxes for taxable estates of United States Citizens or residents who are killed in action while serving in a combat zone . . .”). After the estate tax liability is calculated, credits, including the unified credit of I.R.C. § 2010 and the state death tax credit of § 2011, are then applied to reduce or eliminate the amount of estate tax payable.

73. Economic Growth and Tax Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (2001).

74. Estate tax liability is satisfied up to limits established by Code by a unified credit under I.R.C. § 2010. Although soldiers and victims of terrorism were given special tax rates under VTTRA, they remained entitled to the I.R.C. § 2010 credit as determined under the standard tax rates, I.R.C. § 2201(d), thus further reducing out-of-pocket tax liability.

armed forces. The Department of Defense “views the federal tax advantage as part of service members’ cash compensation when it compares military pay with civilian pay.”⁷⁵ The military compensation package includes uniform benefits in the form of health plans, pension plans, death, and disability benefits.⁷⁶ The Department of Defense “relies heavily on noncash benefits because it views benefits as critical to morale, retention, and the quality of life for service members and their families.”⁷⁷ The Department of Defense recognizes that without such tax and benefit provisions, the United States government would need to compensate soldiers at a higher level.

For soldiers, then, these tax benefit provisions reflect a decision by Congress to use federal funds through tax benefits rather than through purely monetary compensation. Although these tax expenditures represent a choice to spend federal funds in one way rather than another, the cost of paying additional salary would equally be a cost to the government. Such is not the case for victims of terrorism who were unwitting casualties of a kind of combat, but whose income and wealth came from sources other than the federal treasury and whose employee benefits varied enormously.

Most significantly, these provisions ignore important economic differences between the two groups. Members of our armed forces do not constitute a highly paid segment of society. Indeed, our soldiers are often among the least affluent groups in our society. According to the Congressional Record, as of 2003 there were approximately 192,000 military families that earned only between \$10,000 and \$25,000 per year.⁷⁸

75. See Derek B. Stewart, *GAO Studies Effect of Combat Zone Exclusion*, TAX NOTES TODAY, May 14, 2004, LEXIS, 2004 TNT 94-27.

76. According to some press reports, part of the reason for the delay between House and Senate passage of the bill was the difficulty Senate staffers encountered in trying to provide civilian victims with the same tax treatment as military personnel when civilian benefit plans vary so widely. See Patti Mohr, *Senate Still Ironing Out Details of Victims’ Tax Relief Bill*, TAX NOTES TODAY, Oct. 12, 2001, LEXIS, 2001 TNT 198-07.

77. See Stewart, *supra* note 75.

78. 149 CONG. REC. S7449 (daily ed. June 05, 2003) (statement of Sen. Baucus). As a result of these low levels of salary, income exclusions can sometimes produce bizarre results. For example, section 112 of the Code excludes combat pay from income; however, the GAO in 2003 found that the surprising result of the exclusion was that between 5,000 and 10,000 soldiers lost some or all of two benefits designed to help poorer Americans: the earned income tax credit and the child tax credit. The exclusion of combat income lowered the amount of earned income below the amount necessary to make the military taxpayers in question eligible for the earned

Military cash compensation does not generally exhibit wide disparities, compared to those that might be expected in a similarly hierarchical civilian setting. The 2004 GAO memorandum explains that “a junior enlisted member with 3 years of service might earn around \$40,000 in cash compensation, while a senior officer with 22 years of service could earn cash compensation of about \$130,000.”⁷⁹ An enlisted member at grade 9 with 12 years of service would have basic pay of \$43,740 for fiscal year 2003.⁸⁰ Thus, soldiers, of whatever rank or seniority, are seldom highly paid. And those who die in combat are more often young, with low seniority and rank and thus with low pay.⁸¹

In contrast, the victims of terrorism under VTTRA span the full range of income and wealth possibilities. Indeed, a disproportionate number of them were people of higher income and wealth. According to the U.S. Census Bureau, the bottom income quintile of the U.S. population for 2000 had household income of no more than \$17,920; the top quintile of income for 2000 began at household income above \$81,766; and the top 5 percent of incomes started at \$145,220.⁸² The Final Report of The Special Master for the September 11th Victim Compensation Fund of 2001 reports that only a little more than 6 percent of the deceased victims who filed claims had individual income under \$25,000.⁸³ Almost 40 percent of the September 11th

income tax credit. This was not a completely consistent result; other, higher-income soldiers became eligible for the earned income tax credit because the exclusion lowered their incomes to a point that they no longer exceeded the ceiling for the credit. *See* Stewart, *supra* note 75. Exclusion of combat pay had similar mixed, and sometimes bizarre, effects on the child tax credit. *Id.*

79. *See* Stewart, *supra* note 75.

80. *Id.*

81. The youngest and lowest-ranking members of the military have accounted for a majority of the casualties during Operation Iraqi Freedom. As of September 2006, service members from pay grades E-1 to E-4 (the lowest-ranking pay grades) represented 50.7 percent of those killed in the Army, 76.7 percent of those killed in the Marines, and 46.6 percent of those killed in the Navy. Operation Iraqi Freedom Military Deaths: March 19, 2003, through September 30, 2006, *available at* <http://siadapp.dior.whs.mil/personnel/CASUALTY/castop.htm>. By age, across the branches of the military, 53.2 percent of those killed were less than 25 years old, and 77.8 percent were 30 or younger. *Id.*

82. *See* U.S. Census Bureau, Historic Income Tables—Households, <http://www.census.gov/hhes/income/histinc/h01.html> (last visited Sept. 25, 2006).

83. 1 U.S. DEP'T OF JUSTICE, FINAL REPORT OF THE SPECIAL MASTER FOR THE SEPTEMBER 11TH VICTIM COMPENSATION FUND OF 2001, at 52, 97 (2004), *available at* http://www.usdoj.gov/final_report.pdf [hereinafter FINAL REPORT]. The Census Bureau and the Final Report define income quite differently. The Special Master of the September 11th Fund included capital gains, employer-provided benefits, pensions, health insurance, etc. *Id.* at 30–33.

victims had income of \$100,000 or more.⁸⁴ Some of the victims were in fact extraordinarily well compensated, with 25 having had incomes of \$2,000,000 or more. Thus, applying provisions designed for soldiers to the victims of September 11 gives to the wealthy benefits intended for the middle class members of our society who have put themselves in harm's way.

VTTRA could have looked to an important distinction among the September 11 victims to make the Act a more reasonable response to the problem that gave rise to it. Congress could have distinguished two broad groups of victims: those who were merely in the wrong place at the wrong time; and those police and fire department officers whose volitional and selfless exposure to great risk was indeed heroic, and deserving of approbation and reward. If Congress had confined the military analogy, and the accompanying special relief, to those police and fire department personnel who entered the buildings in rescue efforts, it would have strayed less from the original intent and purpose of the relief. Although federal tax favors were not an explicit part of the compensation packages of the largely local officers involved, the relief would at least have been targeted at middle-income families of ordinary wealth. It would also have been sensible in such a case to think of the relief as an appropriate reward for public service of heroic proportions. Finally, it would have been much less costly in terms of foregone revenue, because the individuals and their families would likely have been in lower tax brackets than many of those inside the buildings, and would have little if any of their wealth transmission at death exposed to the estate tax, due to the much lower average sizes of their estates.

4. *Comparison of VTTRA and the September 11th Victim Compensation Fund.* The September 11 victims were injured and died for being Americans. The congressional desire to express

The Bureau of Census data, in contrast, defines income as “[m]oney income excluding capital gains before taxes.” U.S. Census Bureau, Current Population Survey (CPS)—Definitions and Explanations, <http://www.census.gov/population/www/cps/cpsdef.html> (last visited Sept. 25, 2006). Thus, if we were comparing individuals to individuals, the income levels reported by the Special Master would be higher than those for comparable individuals in the Census data. The Census Bureau, however, reports household income and the Special Master did not. If household incomes of September 11 victims were considered, the disparity between the income level of the general population and that of the September 11 victims would probably be even greater.

84. FINAL REPORT, *supra* note 83, at 97.

sympathy for these victims by compensating them in some way is one America as a nation shared. The nation, however, expressed this sympathy and offered compensation apart from and prior to VTTRA. It did so with the September 11th Victim Compensation Fund,⁸⁵ which was enacted, in the words of the Special Master chosen to administer it, as “a unique response to an unprecedented historical event” out of a “national sense of grief and compassion.”⁸⁶

The Air Transportation Safety and System Stabilization Act,⁸⁷ which established the September 11th Victim Compensation Fund, was signed into law by the president on September 22, 2001, and required that regulations be promulgated within ninety days.⁸⁸ Thus, by the time Congress passed VTTRA the following December, it was well aware that the victims of September 11 would be entitled to large, individualized awards funded by the Treasury, awards that themselves would be free of income tax liability.⁸⁹ The average award under the September 11th Victim Compensation Fund for families of victims killed in the attacks “exceeded \$2 million,” and the total amount awarded was more than \$7 billion.”⁹⁰

Awards under the Victim Compensation Fund varied with the victim’s economic situation so that the award from the fund increased as the victim’s income increased. In the Final Report, the Special Master queried the statutory approach mandating individualized awards: “The fireman’s widow would complain: ‘Why am I receiving less money than the stockbroker’s widow? My husband died a hero.

85. “[U]ltimately, 97% of eligible families who lost a loved one on September 11 voluntarily participated in the Program” *Id.* at 80. For discussion of the policy issues involved in the structure of the Victim Compensation Fund, see generally Stephen Landsman, *Symposium: After Disaster: The September 11th Compensation Fund and the Future of Civil Justice*, 53 DEPAUL L. REV. 205 (2003).

86. FINAL REPORT, *supra* note 83, at 83.

87. Air Transportation Safety and System Stabilization Act, Pub. L. No. 107-42, 115 Stat. 230 (2001).

88. FINAL REPORT, *supra* note 83, at 3–4.

89. Although the awards from the September 11th Victim Compensation Fund would surely have been amounts of damages received on account of physical injury, and thus deductible under I.R.C. § 104, a separate provision relating to disaster relief payments was added to the Code by VTTRA. VTTRA, H.R. 2884, 107th Cong., § 111 (2001) (codified in I.R.C. § 139 (West Supp. 2006)). This provision specifies that gross income shall not include “any amount received as payment under § 406 of the Air Transportation Safety and System Stabilization Act,” which established the September 11th Victim Compensation Fund. *Id.* Thus, VTTRA also excludes from income amounts received by victims’ families from that fund. *See* Rev. Rul. 2003-115, 2003-2 C.B. 1052.

90. FINAL REPORT, *supra* note 83, at 1.

Why are you demeaning the value of his life.”⁹¹ Even within a system of individualized awards, however, the Victim Compensation Fund had special rules for calculating the economic loss of for those with income levels above the 98th percentile. “For victims whose income exceeded the 98th percentile, the Fund calculated a ‘presumed’ economic loss using \$231,000 as the income level (*i.e.*, the 98th percentile income level in the year 2000).”⁹²

Unlike the Victim Compensation Fund, there is no cap, presumed or otherwise, to the income tax exclusion of VTTRA. In failing to enact a cap, Congress departed from the limited precedent regarding income tax relief for victims of terrorism. Congress provided income tax relief to victims of the terrorist bombing of Pan Am Flight 103 over Lockerbie, Scotland, in 1988, but with a very different result. In contrast with the unlimited income tax forgiveness under VTTRA, tax relief for victims of Pan Am Flight 103 was “limited to an amount equal to 28 percent of the annual rate of basic pay at Level V of the U.S. Executive Schedule as of December 21, 1988,” which provided tax relief equal “to that which was provided to personnel of the United States who were on Flight 103, thus providing equal relief to all of the victims. . . .”⁹³ VTTRA may have responded to a public need to express further sympathy for the victims of terrorism, but it did so in a way that favored the wealthy in ways unnecessary, and arguably counter, to the nature of the nation’s grief.

5. *The Incentives in JCWA.* The incentive provisions for New York in JCWA also favor the wealthier, those with capital to invest. This Act included provisions of the type often proposed for purposes of economic stimulus. They comprised six provisions: \$15 billion of tax-exempt bonds for property in the “Liberty Zone” of lower Manhattan; a 30 percent bonus depreciation for certain property in the zone; a reduced recovery period from fifteen years to five years for leasehold improvements made to commercial property in the zone; increased small business expensing for qualifying property used in the Liberty Zone; extending from two years to five years the period

91. *Id.* at 82.

92. *Id.* at 8. Families of high-income earners had the option of seeking a hearing to request a departure from this computation. *Id.* at 37.

93. STAFF OF THE JOINT COMM. ON TAXATION, 107TH CONG., TECHNICAL EXPLANATION OF THE “VICTIMS OF TERRORISM TAX RELIEF ACT OF 2001,” AS PASSED BY THE HOUSE AND THE SENATE ON DEC. 20, 2001, at 3 (Comm. Print 2001).

within which a taxpayer can replace destroyed property with similar property, without recognizing any gain on the destroyed property; and a new work opportunity credit for certain employees in New York City.⁹⁴

Our criticism of these provisions is that it would be difficult to find five square miles on earth less in need of enhanced development incentives than the southern tip of Manhattan, which has a credible claim to being the business and financial capital of the planet. Tax incentives of this sort tend to be relatively easily captured in the price of the real estate; but an artificial boost of the price of this real estate serves no clear public purpose. The case for conferring such a windfall on the owners of real estate in lower Manhattan is not obvious, and was certainly not made in the legislative history of the JCWA.⁹⁵

6. *Evaluation of September 11 Tax Relief.* The September 11 relief raises questions of both vertical and horizontal equity. As noted above, under VTTRA, the families of these victims of September 11 also receive awards from the Victim Compensation Fund free of income tax.⁹⁶ Such treatment parallels the exclusion under I.R.C. section 104 for compensation for physical injury, and can presumably be justified by arguments similar to those justifying the latter section. A troubling defect in the structure of section 104, however, is that while injury victims are allowed to exclude any recoveries they are able to achieve (on grounds that the recoveries simply offset earlier, undeducted losses⁹⁷), victims who achieve no compensation (because, for example, there was no tortfeasor, or the tortfeasor cannot be found), receive no deduction for the losses associated with the injury.⁹⁸ The VTTRA provision relieves one inequity at the expense

94. STAFF OF THE JOINT COMM. ON TAXATION, 107TH CONG., SUMMARY OF P.L. 107-147, THE "JOB CREATION AND WORKER ASSISTANCE ACT OF 2002" (Comm. Print 2002).

95. Similar provisions were enacted in GOZA: tax-exempt bond financing, I.R.C. § 1400N(a), additional first-year depreciation, § 1400N(d), increased expensing for qualified property, § 1400N(e), and a five-year rather than a two-year limit for replacement of property, § 1400N(k). They were not highlighted in the earlier section, in part because they seem arguably more defensible in the context of the widespread physical destruction in southern Louisiana and Mississippi.

96. See *supra* note 89 and accompanying text.

97. The prefatory language in I.R.C. § 104(a) makes clear that to the extent that a deduction was taken under the medical expense deduction provisions of I.R.C. § 213, no exclusion is allowable under I.R.C. § 104.

98. Of course, the losses that consist of medical expenses may be wholly or partly deductible under I.R.C. § 213, depending on the circumstances of the taxpayer.

of perpetrating another, by allowing the equivalent of such a deduction (through the exclusion of the award), but only for victims of the terrorist attacks.

One is left wondering why any victim of a tort or crime who cannot achieve a recovery through the justice system should not also be entitled to either excludible compensation, or, at the very least, a deduction for his uncompensated losses. As with many of the KETRA provisions, one searches in vain for an explanation of why some victims should be entitled to more favorable tax treatment than others. It would not be difficult to adopt a compensation scheme that would apply with greater generality, and it is difficult to find good policy justifications for limiting it to categories of victims that are set by Congress capriciously: If a taxpayer was a victim of the September 11 attacks, favorable tax treatment follows. If the taxpayer was instead the victim of an ordinary homicide, then no special relief is available. If a taxpayer's home was destroyed by Hurricane Katrina, favorable tax treatment follows. If it was destroyed instead by an ordinary, nameless tornado, then no special relief is available. But these categories make little or no sense to taxpayers that have lost their breadwinners or their homes.

The provisions noted earlier excluding regular income, and extending favorable estate tax treatment, go well beyond even the thin justifications of section 104, and seem especially jarring in the case of those victims who left behind very large estates. We assert that their families are no more deserving of special tax benefits than the family of any other victim of murder. Any family that loses a breadwinner to shocking acts of violence suffers immense damage, which no recompense can hope to repair. But all are in roughly the same situation. Special treatment of the September 11 victims can only be explained by sympathy, but sympathy of a sentimental and arbitrary form. It does not reflect sound policy analysis.

II. CONSTITUTIONAL QUESTIONS

Up to this point, the arguments in this Article have been framed largely in terms of what Congress should voluntarily eschew when it amends the tax laws in response to natural or man-made disasters. It may be useful to ask, if only for the novelty of doing so, whether the Constitution *allows* all of the things that Congress has done to the tax

laws in recent years in response to disasters.⁹⁹ This is not ordinarily a very productive inquiry in the case of federal tax questions, because the Supreme Court (and the lower federal courts, following its lead) has rarely managed to find constitutional shortcomings in the federal income tax laws as enacted by Congress. Even the most notable exception, *Eisner v. Macomber*,¹⁰⁰ is now generally thought to be something of a relic, with little continuing validity as a constitutional precedent.¹⁰¹

There is, however, a constitutional provision that should give Congress pause as it enacts tax legislation that applies depending on where a particular taxpayer lives, or where particular property is located. The Uniformity Clause of Section 8 of Article I, which, after conferring on Congress the power to “lay and collect Taxes, Duties, Imposts and Excises” adds: “but all Duties, Imposts and Excises shall be uniform throughout the United States,”¹⁰² might well have been included in the Constitution precisely to prevent legislation of the sort discussed in this Article. Tax rules that allow, for example, taxpayers who live in Louisiana to withdraw retirement account funds prematurely but without penalty to repair wind damage to their houses, but do not allow taxpayers who live in North Dakota to do the same, would seem vulnerable to judicial invalidation under this provision.

In its strongest form, it would seem that this clause would simply bar any tax enactments that depend on geographical qualifications. Even in its weakest form, this provision would obligate Congress to act only pursuant to a reasonable basis for using geographic

99. We are indebted to Larry Zelenak for suggesting that we explicitly consider this argument, which we had initially neglected, and for his helpful article, *Are Rifle Shot Transition Rules and Other Ad Hoc Tax Legislation Constitutional?*, 44 TAX L. REV. 563 (1989).

100. *Eisner v. Macomber*, 252 U.S. 189 (1920).

101. This seems to be so even within the Court itself. See, e.g., *Cottage Sav. Ass'n. v. Comm'r*, 499 U.S. 554 (1991), in which Justice Marshall describes the realization requirement—imposed by the *Macomber* Court as a matter of constitutional imperative in 1920—as being founded upon “administrative convenience.” *Id.* at 559.

102. U.S. CONST. art. I, § 8, cl. 1. This clause begins by granting Congress the power to “collect Taxes, Duties, Imposts, and Excises,” and concludes by imposing the Uniformity Clause quoted in the text on only the last three of these. This construction might be read to exclude “Taxes,” possibly including the federal income tax, from the constraints of the Uniformity Clause. In an early case following the imposition of our first modern income tax, however, the Supreme Court rejected this view: “[T]he contention that the [16th] Amendment treats a tax on income as a direct tax . . . and . . . therefore not subject to the rule of uniformity . . . is . . . wholly without foundation . . .” *Brushaber v. Union Pac. R.R.*, 240 U.S. 1, 18 (1916).

distinctions. Interpreted in this latter, weaker form, it would mandate precisely the process suggested to Congress by this Article: that it only make distinctions on geographic grounds when there is a clear and salient distinction between taxpayers within and without the boundaries of the geographic distinctions in question.

Thus, if a tax act grants a greater duration for replacement of damaged property to taxpayers living in areas where the infrastructure necessary to undertake replacements has suffered widespread damage, it would (or might) survive scrutiny under the uniformity provision.¹⁰³ In contrast, where no meaningful distinction in circumstances between taxpayers within and without the borders of a geographically-defined entitlement can be cited, the tax act would be subject to invalidation. Perhaps, if Congress cannot be persuaded to undertake this sort of evaluation on its own, this test can be imposed upon Congress by the courts, acting under the authority of the Uniformity Clause.

This argument seems far from frivolous; the limited case law on the Uniformity Clause, however, offers little encouragement to those who would advance it. The cases are few, presumably reflecting the fact that Congress ordinarily refrains from enacting tax rules of geographically limited scope. An influential nineteenth-century Supreme Court decision involving this question, denoted as the *Head Money Cases*,¹⁰⁴ related to a modest head tax imposed on owners of steam and sailing vessels for every passenger disembarking at a U.S. port who was not a U.S. citizen.¹⁰⁵ Cunard Lines (among others) refused to pay, on the ground (among others) that the tax did not apply uniformly because aliens entering by train or coach at inland points of entry were not subject to the tax.

The Court ultimately upheld the statute without conclusively addressing the Uniformity Clause constraints, finding that “the power exercised in this instance is not the taxing power. [It is] . . . the mere incident of the regulation of commerce.”¹⁰⁶ Along the way to that

103. See *infra* Part IV (discussing sensible geographic distinctions).

104. *Head Money Cases*, 112 U.S. 580 (1884). This decision was relied upon by the Supreme Court in two later cases: *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 160–61 (1974) (interpreting the parallel constitutional provision of Article I, Section 8, Clause 4 regarding uniformity in bankruptcy law); and *United States v. Ptasynski*, 462 U.S. 74, 82 (1983) (involving the tax Uniformity Clause itself, and discussed extensively below).

105. Act of Aug. 3, 1882, ch. 376, 23 Stat. 214 (repealed 1966) (imposing a tax of fifty cents per person).

106. *Head Money Cases*, 112 U.S. at 595.

conclusion, however, the Court also noted that a “tax is uniform when it operates with the same force and effect in every place where the subject of it is found.”¹⁰⁷ This suggests that the Court believed that if a tax that could be, and was, expressed in neutral terms, it would not fail on the ground that the tax had a disparate impact among taxpayers living in different states. An otherwise uniform tax on oil extraction, for example, would not fail simply because taxpayers in Texas extract a lot of oil, while taxpayers in Maine extract none.

Taxes on oil extraction were in fact the subject matter of the one Supreme Court decision most closely resembling the issues presented by post-disaster tax legislation.¹⁰⁸ Following a period of price controls in the late 1970s, Congress and the White House were about to deregulate the price of crude oil as a means of encouraging exploration for and development of new oil sources. There was concern, however, (which now seems rather quaint) about allowing producers of oil that would have come to the market in any event to receive the full benefit of the newly uncapped prices. The carefully engineered result of balancing these competing considerations was the Crude Oil Windfall Profit Tax Act of 1980.¹⁰⁹

One of several categories of oil favorably treated under the provisions of this act was “exempt Alaskan oil,” which was defined in section 4994(e) as:

any crude oil (other than Sadlerochit oil) which is produced—

- (1) from a reservoir from which oil has been produced in commercial quantities through a well located north of the Arctic Circle, or
- (2) from a well located on the northerly side of the divide of the Alaskan-Aleutian Range and at least 75 miles from the nearest point on the Trans-Alaska Pipeline System.¹¹⁰

Some producers that paid the windfall profit tax sued for refunds of taxes paid, and were successful in having the act declared

107. *Id.* at 594.

108. *United States v. Ptasynski*, 462 U.S. 74 (1983).

109. Crude Oil Windfall Profit Tax Act of 1980, Pub. L. No. 96-223, 94 Stat. 229 (temporarily adding I.R.C. §§ 4986–4990).

110. *Ptasynski*, 462 U.S. at 77 (quoting § 4994(e)).

unconstitutional in the Wyoming Federal District Court.¹¹¹ Direct appeal to the Supreme Court was allowed, setting the stage for the first Supreme Court consideration of the limitations imposed by the Uniformity Clause.

The Supreme Court in this case, *United States v. Ptasynski*,¹¹² accepted the dicta quoted above from *Head Money Cases* as something of a point of departure.¹¹³ But the rule under evaluation in *Ptasynski* was *not* one that had been stated in a geographically-neutral manner (as it had been in the *Head Money Cases*), but rather one that was quite specific about the extraction locations that would be favorably treated. The Court, however, explained that the *Head Money Cases* rule was essentially a one-way inference: while geographically-neutral language generally *would* insulate a tax provision from invalidation under the Uniformity Clause, geographically-specific language would not lead to automatic invalidity. Rather, the Court said, “where Congress does choose to frame a tax in geographic terms, we will examine the classification closely to see if there is actual geographic discrimination.”¹¹⁴

But not too closely, it would appear. Writing for the Court, Justice Powell also noted that: “The Uniformity Clause gives Congress wide latitude in deciding what to tax and does not prohibit it from considering geographically isolated problems.”¹¹⁵ The Court had already by this point in the opinion noted that the statutorily-defined term “exempt Alaskan oil” was by no means perfectly congruent with “oil produced in Alaska.”¹¹⁶ Indeed, the Court noted that less than 20 percent of then-current Alaskan oil production would be exempt from the tax under the § 4994(e) definition,¹¹⁷ and that certain offshore production, beyond the territorial limits of the state, would qualify for the exemption under that definition, despite

111. *Ptasynski v. United States*, 550 F. Supp. 549 (D. Wyo. 1982) (invalidating the Crude Oil Windfall Profit Tax Act in its entirety because the provisions exempting certain kinds of oil from the tax on impermissible grounds could not be severed from the other provisions of the Act).

112. *Ptasynski*, 462 U.S. at 74.

113. *Id.* at 82.

114. *Id.* at 85.

115. *Id.* at 84.

116. *Id.* at 77–78.

117. *Id.* at 77.

the fact that the oil in that situation could not be said to have come from Alaska.¹¹⁸

Perhaps of greater significance was the Court's view that Congress had made the findings necessary to justify the geographic distinctions embodied in the Act:

Congress clearly viewed "exempt Alaskan oil" as a unique class of oil that, consistent with the scheme of the Act, merited favorable treatment.¹¹⁹ It had before it ample evidence of the disproportionate costs and difficulties—the fragile ecology, the harsh environment, and the remote location—associated with extracting oil from this region.¹²⁰

And that, it appears, was sufficient. Although this examination of the classification seems more cursory than "close," it was nevertheless satisfactory to every member of the Court in this unanimous decision.

Although this certainly is not encouraging for taxpayers who might wish to challenge, on the basis of the Uniformity Clause, the narrowness of the disaster legislation's relief, it may not be hopeless. The Supreme Court's summary of the analysis behind the design of the Windfall Profits bill may have been excessively brief, but there was indeed a good deal of thought given to the categories created by that bill. The essential goal of that bill was to burden the production of oil that would have been brought to market even without price decontrol, without diminishing the incentives to bring to the market oil that could not have been feasibly produced under the then-existing price constraints. The discrimination among categories of oil in that tax bill, in other words, really was the centerpiece of that legislation, without which it could not have achieved its purposes.

That is much less self-evident in the case of many of the provisions of KETRA, GOZA, and VTTRA. Congress did not consider—or at least did not adequately explain—why it thought it necessary to allow better treatment for taxpayers in the defined

118. *Id.* at 78. The significance to the Court of these facts is not completely clear, because it was nevertheless the case that the geographic range of the favored category of oil was still quite limited. But the fact that the favorable provision was not confined to a single state, and was far from comprehensive within the state most favored, seemed to suggest that the category was not designed by means of political horse trading of the sort that the Court thought the Uniformity Clause was meant to prohibit.

119. The Court cited STAFF OF THE JOINT COMM. ON TAXATION, 96TH CONG., THE DESIGN OF A WINDFALL PROFIT TAX 20–23 (Comm. Print, 1979) in support of this proposition.

120. *Ptasynski*, 462 U.S. at 85 (internal citation added).

geographical zones than the background provisions of the I.R.C. permit to taxpayers who experience similar losses outside of the favored geographical zones. It would therefore seem that a constitutional objection based on the Uniformity Clause might still reasonably be raised.

There may be substantial practical difficulties in this approach, however, in addition to the uphill battle involved in distinguishing a recent, unanimous and contrary Supreme Court precedent: A challenge will necessarily require a taxpayer from a disfavored geographical area to bring the attack. But, generally, taxpayers lack standing to attack favorable treatment that Congress may have accorded to other taxpayers.¹²¹ Thus, acts like GOZA, which favor taxpayers in certain geographic areas but do not by their own terms specifically disfavor taxpayers elsewhere, are effectively immunized from judicial scrutiny by well-established standing principles: those who are favored by a particular provision have nothing to complain about, while those who are not favored are treated as complaining about favoritism shown to other taxpayers whose returns the complainant has no right to dispute. A child's complaint that her brother got one more cookie than she may have been allowed some salience in the court of their mother's kitchen, but similar claims relating to tax favoritism that Congress or the IRS bestows on other taxpayers have fared poorly in the federal courts.

Instead of attacking the GOZA rule directly, a taxpayer seeking to advance a Uniformity Clause complaint could argue instead that it is the background rules that have been made invalid by the disaster act provisions that extend more favorable treatment to certain taxpayers. But the need to seek that more aggressive remedy puts one more obstacle in the path of taxpayers seeking relief on a Uniformity Clause ground. One may reluctantly conclude that this avenue is not particularly promising, even if in a better, more constitutionally constrained tax world, it would be.

121. See, e.g., Nancy Staudt, *Taxpayers in Court: A Systematic Study of a (Misunderstood) Standing Doctrine*, 52 EMORY L.J. 771 (2003).

III. COMMON PROBLEMS IN ENACTING POST-DISASTER TAX LEGISLATION

A. *The Role of Sympathy in Tax*

Constitutional issues are not the only ones that complicate the tax response to disasters. The September 11 attacks and the Hurricanes Katrina, Wilma, and Rita unleashed the sympathy of the American public. For the most part, however, the tax code does not know what to make of widespread sympathy. A core background assumption of the code is that taxpayers will act rationally in their self-interest. The tax law counts on this self-interest to protect the integrity of the tax system when, for example, it assumes that property changes hands at fair market value, as long as the sale is between a willing buyer and willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.¹²²

The tax code, of course, does not assume self-interest prevails in all situations; in particular, the presumption of a certain amount of intrafamily altruism is more the rule than the exception. The government taxes husband and wife as a couple.¹²³ It gives exemptions for dependents¹²⁴ and credits for children.¹²⁵ It has established as well a number of antiavoidance provisions to prevent those for whom the assumption of self-interest does not hold from taking advantage of provisions that assume that parties to a transaction have opposing interests.¹²⁶

Other provisions make allowance for taxpayers who act in more broadly disinterested ways. The tax code allows, for example, charitable contribution deductions under section 170 for giving to the poor and needy, at least partly on grounds of efficiency—that

122. See Treas. Reg. § 25.2512-1 (2005).

123. I.R.C. § 1(a) (2000).

124. I.R.C. § 151(c) (2000).

125. I.R.C. § 24 (2000).

126. See, e.g., I.R.C. § 267(a)(1) (2000) (disallowing loss recognition on sales between related parties). See generally Theodore P. Seto, *The Assumption of Selfishness in the Internal Revenue Code: Reflections on the Unintended Tax Advantages of Gay Marriage* 4–5 (Loyola Law School Legal Studies Paper No. 2005-33), available at <http://ssrn.com/abstract=850645> (“Where [the] assumption of selfishness proves or is likely to prove incorrect, the code makes adjustments . . . [that] shut down avoidance techniques or otherwise enforce the policies of the Code.”).

“charitable organizations receive more in donations than the Treasury loses in revenue due to a tax policy change”¹²⁷ or “that the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds.”¹²⁸ Alternatively, it allows the deduction as a matter of income definition: the consumption opportunities represented by the gift may be viewed as having been transferred to others; if those others are appropriate objects of charitable beneficence, it is likely that their own incomes would make the consumption opportunities effectively nontaxable because of personal exemptions, standard deductions, and the like.¹²⁹

Whatever rationale is offered, the motive for provisions such as these may be the powerful pull of sympathy, a kind of golden rule for the tax code, that we should treat others in dire straits as we would wish to be treated if we found ourselves in the same situation. Consider our treatment of life insurance. Under section 101, the proceeds of life insurance are excluded from beneficiaries’ income, even though in the case of whole-life or endowment insurance policies, much of the amount received represents a return on the insured’s investment. Marvin Chirelstein, in questioning the policy rationale for this exclusion, has observed that “there is a heavy flavor of condolence about the whole affair.”¹³⁰

A flavor of sympathy and condolence surrounds the reaction to these recent disasters as well. The terrorist acts, for example, gave “rise to the largest wave of charitable giving in modern U.S. history.”¹³¹ Americans, wherever they lived, whatever their economic status, identified with the victims of these disasters, who themselves came from all income levels. Even the very rich were vulnerable. All of us, rather than being simply witnesses, became interested persons, and Congress responded with a startling number and variety of tax

127. Don Fullerton & Shira D. Goodman, *The Economic Recovery Act of 1981: Implications for Charitable Giving*, 16 TAX NOTES 1027, 1028 (1982).

128. J. S. SEIDMAN, SEIDMAN’S LEGISLATIVE HISTORY OF FEDERAL INCOME TAX LAWS 1938–1861, at 17 (1938).

129. William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309, 344–58 (1972).

130. MARVIN A. CHIRELSTEIN, FEDERAL INCOME TAXATION 42 (10th ed. 2005).

131. Kenneth S. Abraham & Kyle D. Logue, *The Genie and the Bottle: Collateral Sources Under the September 11th Compensation Fund*, 53 DEPAUL L. REV. 591, 594 (2003). Similarly, private charities raised \$3.27 billion to help the 2005 Hurricane victims. Jacqueline L. Salmon & Leef Smith, *Two-Thirds of Katrina Donations Exhausted*, WASH. POST, Feb. 27, 2006, at A1.

benefits, including benefits to the wealthy. But such sympathy fits uncomfortably within the tax code. “When we sympathize with the other, we open our hearts to his or her subjective predicament, rather than our minds to his or her behavioral choices and preferences.”¹³² Such sympathy distorts tax policy, by, for example, favoring the temporarily afflicted wealthy over the permanently poor. Sympathy, although a perfectly respectable sentiment, is probably not best expressed through financial benefits. Even when it is best so expressed, it probably should be done in the sort of direct ways that can more accurately target the benefits in the manner desired, rather than through the indirect means of tax favors, which can be more difficult to target accurately.

In the case of September 11 and the Gulf-region hurricanes, sympathy begat sympathy in a cycle of increasing tax benefits. Initially, in VTTRA, Congress treated the September 11 attacks as unique, involving heroes who made a sacrifice for their country—like our men and women in uniform, rather than as the victims of a manmade disaster.¹³³ The economic incentives enacted as part of JCWA, however, became only an opening bid in KETRA and was met and raised in GOZA.

In these two cases, moreover, sympathy had geographic limits. The American public did not generalize their concern to all victims of all crimes or disasters, large or small. When the Red Cross determined that the needs of the September 11 victims had been met and wished to put contributions to other purposes, it faced an enormous public outcry, investigations by governmental officials, and a forced retreat.¹³⁴ Americans identified with these particular victims, not victims generally.¹³⁵

132. Robin West, *Disciplines, Subjectivity, and Law*, in *THE FATE OF LAW* 119, 153 (Austin Sarat & Thomas R. Kearns eds., 1991). See generally ADAM SMITH, *THE THEORY OF MORAL SENTIMENTS* (Augustus M. Kelley Publ’rs 1965) (1759) (exploring the long history of the role of sympathy in the law).

133. See *supra* Part I.B.3 (noting that heroic designations do not seem out of place as applied to the police and fire personnel who willingly exposed themselves to mortal risk in the September 11 rescue efforts).

134. Corey Kilgannon, *Red Cross Offers to Refund Gifts for Sept. 11*, N.Y. TIMES, Nov. 12, 2001, at B10.

135. As a recent paper notes, we give “disproportionate sympathy and attention to identifiable as compared with statistical victims,” with the result that “debate about government spending and taxation is driven by vivid exemplars—*iconic* victims and perpetrators—rather than any rational calculation of costs and benefits.” George Loewenstein et al., *Statistical*,

Targeting tax benefits to impacted geographical areas is not new. But it is only rational if sympathy does not cloud judgment about whether the needs within a particular geographical area justify special treatment. Testifying before the Senate Finance Committee when it was considering Katrina relief,¹³⁶ George Yin, then Chief of Staff for the Joint Committee on Taxation, expressed skepticism about such geographically targeted benefits. Present law, he explained,

provides a model for location specific tax benefits, namely the provisions known as “enterprise zones,” which offer certain investment and employment incentives for geographically targeted areas that are chronically economically depressed. . . . In general, academic research has been inconclusive as to whether enterprise zones have significantly encouraged employment or investment.¹³⁷

Jane Gravelle, a Senior Specialist in Economic Policy at the Congressional Research Service, expressed stronger concerns during consideration of the hurricane legislation.¹³⁸ Even accepting the standard arguments for enterprise zones, she doubted that such arguments could be applied “to rebuilding areas that are not (at least in their entirety) chronically depressed, but have been destroyed by a natural disaster.”¹³⁹

Congress did not heed these warnings. The combined pressure of public sentiment and ability to benefit the wealthy as part of package to relieve the effects of a disaster apparently proved irresistible.

B. The Role of Wealth and Capital in Disaster Response

These disasters produced a perfect legislative storm. Not only did they provoke a public demand for congressional action, they permitted those who do not endorse strongly notions of vertical equity to enact provisions to their liking. Since President Bush’s

Identifiable and Iconic Victims and Perpetrators, 3–5 (Stanford Law Sch. Olin Program in Law & Econ., Working Paper No. 301, 2005), available at <http://ssrn.com/abstract=678281>.

136. George K. Yin, *JCT Chief Testifies on Tax Provisions for Disaster Relief*, TAX NOTES TODAY, Sept. 30, 2005, LEXIS, 2005 TNT 189-45.

137. *Id.*

138. See Jane G. Gravelle, *CRS Discusses Post-Hurricane Rebuilding Incentives*, TAX NOTES TODAY, Dec. 15, 2005, LEXIS, 2005 TNT 240-41 (suggesting that “the principal justification for intervention may be largely distributional—the desire to help people who have faced a significant loss to reclaim their lives”); see also Ellen P. Aprill, *Caution: Enterprise Zones*, 66 S. CAL. L. REV. 1341, 1362 (1993) (“If enterprise zones merely provide income tax incentives, they will do little to produce new business and new jobs.”).

139. Gravelle, *supra* note 138.

election, the tax policies of his administration and the Republican Congress have frequently been criticized for favoring the rich over the poor. In fact, the disaster relief provisions do the same. Because they are packaged as disaster relief and thus seen as a response to tragedies that hurt both rich and poor, they escaped the criticisms that have been directed at other tax legislation, such as tax rate cuts on capital gains and dividends.¹⁴⁰

We have discussed earlier how little good tax benefits do for those with little or no tax liability.¹⁴¹ Similarly, the geographical investment incentives introduced in JCWA, KETRA, and GOZA have not been effective in restoring blighted areas, but have been effective in helping those who have capital to invest. The estate tax relief provided to the victims of terrorism follows the same pattern. To extend estate tax relief to these victims distorts the progressivity of the tax code. As Michael Graetz has written, a primary justification for the estate tax is “its role in the distribution of the tax burden, in particular, its role in providing an important element of progressivity in the federal tax system.”¹⁴²

The desire of the Bush administration and the Republican party to eliminate the estate tax, which increases progressivity by taxing the wealthy, is reflected in the legislative history of VTTRA. Senator George Allen, Republican of Virginia, proposed exempting victims from “all Federal death taxes on the estates of any individual killed during, or as a result of injuries derived from, the September 11, 2001 terrorist attacks.”¹⁴³ The explanation he offered was that the family of the victims did not need “the added worry of filling out tax forms.”¹⁴⁴

140. See, e.g., Editorial, *Tax Cuts, Again*, WASH. POST, May 11, 2006, at A26; Editorial, *Tax Cut Showdown*, N.Y. TIMES, Dec. 9, 2005, at A36; Kevin Phillips, *A Tax Plan Rooted in the Bush Pedigree*, L.A. TIMES, Jan. 12, 2003, at M1.

141. And indeed, when, in connection with the hurricanes, Congress attempted to address a provision designed to help the working poor, the refundable earned income tax credit, it provided relief so complicated and impracticable as to boggle the mind. Francine Lipman, *KETRA and GOZA: Relief From the Rubble or Another Disaster Waiting to Happen to Low-Income Individuals?*, Presentation at the Am. Bar Ass'n Tax Section Meeting (Feb. 4, 2006) (materials on file with author). Former President Clinton has announced that his foundation is launching a major initiative to help Katrina victims determine whether they qualify for the credit. See Clinton Foundation Programs: EITC Awareness Program, <http://www.clintonfoundation.org/cf-pgm-ee-eitc.htm> (last visited Sept. 19, 2006).

142. Michael J. Graetz, *To Praise the Estate Tax, Not To Bury It*, 93 YALE L.J. 259, 270 (1983).

143. Sen. George Allen, *Allen Bill Would Fully Exempt Attack Victims from Estate Tax*, TAX NOTES TODAY, Sept. 27, 2001, LEXIS, 2001 TNT 188-42.

144. *Id.*

Given such a weak justification, his proposal, unsurprisingly, did not find its way into the legislation as passed. But President Bush used the opportunity to score rhetorical points in this ongoing wealth-transfer tax battle: when he signed VTTRA into law, the presidential release described the law as providing “Lower Death Tax Rates for Victims,” choosing the name adopted by opponents of the estate tax to describe it.¹⁴⁵ Similarly, the presidential release explains that VTTRA shields the first \$8.5 million of a victim’s estate from the “federal death tax.”¹⁴⁶

At least some of the compromise suggestions offered in “reform” of the estate tax remarkably resemble the estate tax provisions of VTTRA: current reports and predictions of possible compromises for the estate tax speculate on a maximum rate not unlike that in VTTRA.¹⁴⁷ Disaster relief again provided some in Congress with a means to advance its tax legislative agenda, but to do so with little if any attention or opposition.

IV. CAN A BETTER APPROACH BE INSTITUTIONALIZED?

The foregoing may suggest that the authors cannot imagine disaster-relief provisions that Congress ought not either generalize to a broader range of victims or eschew altogether. That is not the case, however. There are relief provisions that can be justified by the special circumstances that surround major disasters, and which vary somewhat, depending on the nature of the disaster.

KETRA again provides some useful examples. Among its many provisions are at least a few that seem reasonably tailored to special needs prevailing within the Katrina disaster area. For example, one provision extends from two years to five years the period within which a taxpayer can replace destroyed property with similar

145. See generally MICHAEL J. GRAETZ & IAN SHAPIRO, *DEATH BY A THOUSAND CUTS: THE FIGHT OVER TAXING INHERITED WEALTH* (2005).

146. Press Release, The White House, *supra* note 64.

147. Thus, for example, at the same time that then-Secretary of the Treasury John Snow stated that the White House would push for repeal of the “pernicious” estate tax, Senate Finance Committee Chair Charles Grassley commented that votes for full repeal were not there and that a compromise was much more likely, suggesting a compromise package of a \$5 million exemption and 15 percent rate. Emily Dagostino, *Snow Praises Tax Cuts, Looks Next to Estate Tax Repeal*, TAX NOTES TODAY, May 15, 2006, LEXIS, 2006 TNT 93-1.

property, without recognizing any gain on the destroyed property.¹⁴⁸ (Such gain can occur, for example, where appreciated property was insured for its replacement costs, which may exceed the taxpayer's basis in the property.) This rule seems to respond to a legitimate difference between property destroyed by a tornado in Missouri and similar property in Louisiana destroyed by Hurricane Katrina: in Missouri, a taxpayer whose property is destroyed may be able to find any number of similar properties by reference to the classified section of a local newspaper. But if a taxpayer would like to replace a destroyed shop in New Orleans with another that would continue the same business, with as much of the preexisting going concern value (good will among customers, suppliers, etc.), the taxpayer would not, for some extended period, even have been able to find a newspaper, much less advertisements for suitable properties in the area. One can never be sure that a five-year period rather than a two-year period captures the distinction in need precisely, but at least it is clear that a longer replacement period is reasonable under circumstances of widespread devastation.

Similarly, KETRA contains a provision that allows prehurricane employers a 40 percent credit for wages paid to prehurricane employees who are retained following the disaster.¹⁴⁹ This is strikingly generous in an absolute sense, but again seems arguably justified by the difficulties of continuing business in an area in which so much of the basic business infrastructure had been damaged or destroyed. One can reasonably debate whether some system of direct grants would have been preferable to the use of a tax credit, but at least this provision seems reasonably explicable by the special circumstances surrounding the Katrina disaster.

As we have indicated, it may be appropriate to allow taxpayers to make withdrawals from retirement accounts to enable them to afford repairs following disasters, and possibly to replenish those accounts within some time period following recovery from the

148. See I.R.C. § 1033 (2000) (listing background rules); see also Katrina Emergency Tax Relief Act (KETRA) of 2005, Pub. L. No. 109-73, § 405, 119 Stat. 2016 (2005) (listing modifications).

149. KETRA § 202. There was no background provision; as the Joint Committee explanation of the Act dryly notes in its description of present (pre-enactment) law: "There is no employer tax credit for wages paid solely by reason of such wages being paid by employers in connection with a disaster area." STAFF OF THE JOINT COMM. ON TAXATION, 109TH CONG., TECHNICAL EXPLANATION OF H.R. 3768, "THE HURRICANE KATRINA TAX RELIEF ACT OF 2005" AS AMENDED BY THE SENATE ON SEPT. 15, 2005, at 13 (Comm. Print 2005).

disaster. This special withdrawal rule might be tied to the current rules of section 165(h), which allows deduction of casualty losses to the extent that they exceed 10 percent of the taxpayer's adjusted gross income. The rule could thus be that if and to the extent that a taxpayer reasonably believes that repair costs will exceed 10 percent of her adjusted gross income, she may withdraw such sums from certain qualified retirement accounts without penalty. This approach would mean that a taxpayer could make such withdrawals whether the damage occurred due to a huge natural disaster, a terrorist attack, or a very localized and relatively unnewsworthy storm, as long as the amount of economic damage exceeded the stated threshold.

Similarly, not every provision of VTTRA is subject to the criticisms made in the previous section. Several provisions of that Act applied to disasters more generally and are, in part for that reason, somewhat more defensible than the provisions making the victims of terrorism into soldiers. They too, however, are not free of problematic aspects.

One important provision in VTTRA supplies a useful example: section 102 gave the Secretary of the Treasury expanded authority to postpone deadlines for filing returns, paying taxes, filing a claim for credit or refund of tax, and other procedural actions.¹⁵⁰ This provision expanded the suspension period from 120 days to one year. It included within the secretary's authority a number of filing requirements related to pension plans and gave authority to postpone requirements for any other act, such as the time requirement for a tax-free exchange under section 1031.¹⁵¹ It permitted the secretary to postpone actions in response to a terrorist or military action, regardless of whether a disaster area has been declared by the president in connection with the action. It allows the secretary to announce such extensions via a notice or other mechanism rather than requiring time-consuming regulations. This provision, particularly the longer period of time, proved its use when the hurricanes struck. It exemplifies a necessary and pragmatic response to a geographical disaster, where large numbers of taxpayers may be

150. Victims of Terrorism Tax Relief Act of 2001 (VTTRA), Pub. L. No. 107-134, § 102, 115 Stat. 2427 (2001), I.R.C. § 7508A, and new § 518 and § 4002 of the Employee Retirement Income Security Act of 1974.

151. See STAFF OF THE JOINT COMM. ON TAXATION, 107TH CONG., TECHNICAL EXPLANATION OF THE "VICTIMS OF TERRORISM TAX RELIEF ACT OF 2001" AS PASSED BY THE HOUSE AND THE SENATE ON DEC. 20, 2001, at 21 (Comm. Print 2001).

more or less similarly situated, and in need of administrative relief. Although it is true that individual taxpayers may in some circumstances also need filing extensions, and similar sorts of administrative relief, there are mechanisms for providing such relief,¹⁵² and it makes sense that such individual relief be handled on a case-by-case basis, rather than on the basis of residence within an area impacted by a disaster.

Another provision, codified as section 139, also applied to disasters more generally and expanded the Secretary of the Treasury's authority to declare a disaster. It excluded from income not only payments from the September 11th Victim Compensation Fund, but also all "qualified disaster relief payments."¹⁵³ These include payments for any reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster, as well as any payments for the repair or rehabilitation of a personal residence, or for the repair or replacement of its contents, to the extent that such repairs or replacements are not covered by insurance. A qualified disaster includes a presidentially-declared disaster, or any disaster which results from a terrorist or military action, an accident involving a common carrier, or from any other event which would be determined by the secretary to be of a catastrophic nature. For purposes of payments made by a federal, state, or local government, it also includes disasters designated by federal, state, or local authorities. Legislative history also clarified that employer-controlled foundations could make grants to their employees to relieve distress from a qualified disaster. So long as the grants are based on an "objective determination of need" using such procedures as an independent selection committee, they would not violate the tax law requirements, including the prohibition on self-dealing, applicable to section 501(c)(3) private foundations.¹⁵⁴

152. For example, individuals can routinely request extensions of filing deadlines due to extraordinary personal circumstances under I.R.C. § 6081, and the IRS routinely grants such relief. In addition, the IRS is authorized by I.R.C. § 7508A to prescribe periods of up to 120 days during which filing obligations may be suspended in the case of presidentially-declared disasters.

153. Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, § 111, 15 Stat. 2432 (2002); I.R.C. § 139 (2000).

154. See STAFF OF THE JOINT COMM. ON TAXATION, 107TH CONG., TECHNICAL EXPLANATION OF THE "VICTIMS OF TERRORISM TAX RELIEF ACT OF 2001" AS PASSED BY THE HOUSE AND THE SENATE ON DEC. 20, 2001, at 17-19 (Comm. Print 2001).

Section 139 codifies and thus clarifies the amorphous general welfare exception,¹⁵⁵ and Congress did well to think beyond the immediate terrorist attacks in enacting section 139 and in addressing problems exposed by the attacks. It makes clear, for example, that grants from FEMA are excluded from income. It has proven particularly useful in connection with employer-sponsored private foundations.¹⁵⁶ This sort of legislation represents exactly the sort of more generalized thinking about tax relief based on special circumstances that should be encouraged. Congress should consider all circumstances it can imagine that might deserve relief of particular sorts, and write rules that can be applied across a range of circumstances that are similar in salient ways.

Further, these provisions, by allowing administrative invocation of the predicate for relief rather than requiring congressional action in each new instance, accomplish two important objectives: First, they permit relief to be granted within a much shorter response time. As soon as Treasury officials verify the nature of the disaster, the relief provisions can be put in place.¹⁵⁷ Second, they permit an administrative process to unfold, under which Treasury can impose on itself standards and guidelines that will make it more likely that the relief will be granted in ways that are appropriate to each situation.

Nonetheless, aspects of section 139 are troubling. By not excluding from income payments for any expenses compensated for by insurance or otherwise, it gives an incentive for taxpayers not to insure for replacement value. By itself, this might be a minor quibble, in light of the fact that the casualty loss deduction provisions embody the same moral hazard.¹⁵⁸ But the provisions of section 139 go a bit

155. See Rev. Rul. 98-19, 1998-1 C.B. 840; Rev. Rul. 76-144, 1976-1 C.B. 17. In Rev. Rul. 2005-46, 2005-30 I.R.B. 1, however, the Service ruled that disaster grants to businesses from a state program were not excluded from income as a gift, under the general welfare exception or under § 139.

156. See Internal Revenue Service, *IRS Designates South Asia Earthquake as Qualified Disaster*, TAX NOTES TODAY, Oct. 26, 2005, LEXIS, 2005 TNT 206-8; see also Internal Revenue Service, *Tsunami Deemed 'Qualified Disaster' for Tax Purposes*, TAX NOTES TODAY, Feb. 28, 2005, LEXIS, 2005 TNT 38-6.

157. See *supra* note 156.

158. I.R.C. § 165(c)(3) generally allows deductions for damages, whether repaired or not, that arise from “fire, storm, shipwreck, or other casualty” or from theft. The deduction is subject to a floor equal to ten percent of the taxpayer’s adjusted gross income, which bars deduction of relatively small losses. In the disaster scenario, however, the ten percent limitation may be less significant, in light of the large losses that individuals tend to sustain in those cases.

beyond the casualty loss deduction rules, leveraging the moral hazard into new ranges. Although it does not exclude payments in the nature of income replacement, the legislative history provides that “in light of the extraordinary circumstances surrounding a qualified disaster, it is anticipated that individuals will not be required to account for actual expenses in order to qualify for the exclusion, provided that the amount of the payments can be reasonably expected to be commensurate with the expenses incurred.”¹⁵⁹ As a result, owner-employees could well use their corporations as a self-insurance mechanism for their personal disaster relief. That is, rather than purchasing insurance against natural disasters, owner-employees could instead make tax-free section 139 payments to themselves if and when a disaster occurs.

Limiting the exclusion to qualified disasters is also troubling. Should an employer or an employer-sponsored foundation choose to provide assistance to an individual employee who lost a home to fire or storm, section 139 will not protect such payments, because the disaster would not be a qualified disaster. In sum, in enacting section 139, Congress looked beyond the particular major disaster facing the country, but did not extend its vision to consider the relevance of its relief to the individualized disasters that occur each and every day.

Contemplating future disasters, however, leads us to suggest a procedural change for section 139. Section 139 delegates to the president or the Secretary of the Treasury the authority to declare disasters. In an ideal world, this would be sensible, because the executive branch can act more quickly than Congress ever can. In the real world, however, Congress will likely always feel that it needs to act when disaster strikes. In order to preserve a role for Congress, section 139 and other special disaster provisions should require that Congress invoke those provisions by adoption of a joint resolution declaring a disaster. Joint resolutions can be passed quickly in the face of disaster, and if the substantive provisions so invoked have been carefully considered in advance, sound tax policy need not be sacrificed to achieve a quick and dramatic result.

We further urge policymakers to consider a different kind of justification for disaster aid and thus to develop a different set of

159. STAFF OF THE JOINT COMM. ON TAXATION, 107TH CONG., TECHNICAL EXPLANATION OF THE “VICTIMS OF TERRORISM TAX RELIEF ACT OF 2001” AS PASSED BY THE HOUSE AND THE SENATE ON DEC. 20, 2001, at 16 (Comm. Print 2001).

business tax incentives for areas hit by disasters. The Congressional Research Service has suggested that

aid to devastated areas by the federal government may be viewed as an implicit form of insurance—the country as a whole acts to spread the risk of the cost of natural disasters. . . . In particular, the cost to businesses in a catastrophe exceeds the loss of property (which can be covered by insurance) because the business also loses its customer base and work force, and it is difficult for private insurance markets to provide coverage for this type of loss.¹⁶⁰

The credit for wages to pre-disaster employees we endorse provides exactly this sort of aid. We recommend that Congress consider other similar sorts of tax provisions—perhaps a credit for advertising expenses for some period after a disaster, or accelerated amortization of section 197 intangibles for preexisting businesses in the disaster area. Designing tax relief in such a way, rather than enacting a laundry list of business tax incentives, will help to match the irresistible congressional impulse to respond to disasters with tax provisions more directly targeted at the disaster.

More generally, there may be actions that can be taken to restrain the tendency of Congress toward uneven and somewhat excessive tax relief in response to disasters. One possible model would be the one that Congress has, in effect, already adopted with respect to the costly problem of lost revenue due to inter-company pricing schemes between and among related taxpayers engaged in international trade.¹⁶¹ Congress has enacted a very simple and general rule, only a few sentences long, granting the commissioner authority in his discretion to restate a taxpayer's income and expense items "in order to prevent evasion of taxes or clearly to reflect the income [of

160. Gravelle, *supra* note 138; see also Terrence Chorvat & Elizabeth Chorvat, *Income Tax as Implicit Insurance Against Losses from Terrorism*, 36 IND. L. REV. 425, 425–26 (2003) (“[T]he income tax system provides a certain level of implicit insurance, which emanates from provisions that allow for deduction of losses and, in some instances, deduction of insurance payments, as well as the exclusion of recoveries from insurance companies or the tortfeasors themselves.”). Some of the provisions Congress has enacted, such as requiring reduction of tax-free disaster payments to the extent a disaster-related expense is compensated by insurance, may well be best explained on such a basis.

161. For example, if X Corporation is a U.S. multinational corporation with a subsidiary in Ireland (which has generally lower corporate income tax rates), it may find that it can advantageously sell its products to its Irish subsidiary at prices that barely cover its costs, allowing the Irish subsidiary to resell the products in Europe at higher prices. The profits derived from the sale of these goods would then appear on the Irish subsidiary's income statement rather than the income statement of the U.S. parent.

the taxpayer].”¹⁶² The Treasury regulations, in contrast, are voluminous.¹⁶³ The control achieved over tax avoidance through inter-company pricing arrangements is less than perfect, but one imagines that it is far better than could be achieved through the more cumbersome legislative process.

Something similar could be done with respect to tax relief in response to all disasters. That is, Congress could expand the kind of authority it has already given to the commissioner to postpone filing deadlines under section 518 or declare disasters under section 139. It could delegate to the commissioner not only authority to suspend filing burdens, but also to toll the running of limitations on reinvestment of insurance proceeds in similar property, excuse the imposition of penalty taxes on withdrawals from retirement accounts, and so on. The Treasury could then promulgate regulations that would achieve the sort of consistency that the piecemeal legislative approach to disasters has not, and cannot.

As a general solution, however, this approach seems unrealistic. The problem exists at least in part because of the “legislative imperative” discussed at the outset of this Article. Congress apparently feels vulnerable to possible charges that it has “done nothing” in the face of a national disaster, and it is institutionally unable—and increasingly so, it would appear—to resist defending itself in anticipation of those charges by enacting tax relief provisions, including ones of types that we have criticized.

A more promising alternative might be to create a panel involving the staff of the several tax-policy agents within the executive and legislative branches: in particular, the Internal Revenue Service, the Treasury Department’s Office of Tax Policy, and the Joint Committee on Taxation of the U.S. Congress. The panel, in consultation with the non-tax federal agencies and Congressional committees with disaster-relief responsibilities, could be charged with providing guidelines for tax relief measures that Congress may choose to consider in response to future major disasters. In particular, we suggest that such a panel might identify three categories of relief provisions, more or less along the lines we have indicated in this Article.

162. I.R.C. § 482.

163. Treas. Reg. §§ 1.482-0 to 1.482-9, including proposed regulations, run to more than 200 pages in length in 8 U.S. Tax Rep. (RIA).

The first category would consist of provisions that should probably be available for all disasters, large and small, on an equitable basis. As discussed, one such example would be special IRA withdrawal rules in the case of a disaster and five-year carryback of net operating losses. The panel would undoubtedly come up with other possible provisions.

The second category would consist of those provisions that should rarely if ever be invoked in response to a disaster. An example of such a provision might be those that effectively exempt estates from all estate tax liability, regardless of the size of the estate. As we have explained, there is simply no policy justification for the idea that the estates of very wealthy decedents should be immune to the usual estate tax liabilities simply because the decedent died in a particular sort of disaster.

The third category would consist of things that should be to some degree customized to fit the particular disaster, but within guidelines that the panel could develop. For example, we concur with Congress that the scope of some disasters is such that longer periods may be necessary for reinvestment of insurance proceeds in property similar to property that may have been destroyed, because the damaged infrastructure and heightened local demand for materials and labor make the standard periods inadequate.¹⁶⁴ The panel could develop guidelines for such customization. For example, it might suggest that if less than five percent of the housing units within an affected county or metropolitan area were damaged or destroyed in the particular disaster, the reinvestment window should not exceed the four years already allowed in the case of presidentially-declared disasters.¹⁶⁵ If more than five percent but less than ten percent of the housing units were damaged or destroyed, then the reinvestment period could be as long as five years.¹⁶⁶ Similar rules could be developed for wage credits, credits for advertising expenses, and section 197 amortization.

164. I.R.C. § 1033 generally allows taxpayers to defer recognition of gain on recoveries (through insurance or otherwise) with respect to damaged or destroyed property if those recovered amounts are reinvested in property that is similar to the property that was damaged or destroyed. The baseline period for such reinvestments is two years under § 1033(a)(2)(B), but a four-year period is available in the case of presidentially-declared disasters under § 1033(h).

165. § 1033(h).

166. We have no expertise in disaster relief, and so we offer these examples with great diffidence, as purely hypothetical possibilities that might emerge from the panel process.

Guidelines of this sort obviously produce no more than soft constraints; Congress would be free to disregard them when it chose, and it might choose to do so with some frequency. But if even some constraint is achieved through this process, it would be better than none at all. Guidelines of this sort would establish presumptions, obligating a member of Congress who proposes to disregard them to offer compelling explanations of why it would be appropriate to do so. The guidelines would also provide some cover for members who may wish to protect the integrity of the fisc, without undue fear that they will be portrayed as heartless and uncaring in their next campaigns for resisting their colleagues' efforts to create tax expenditures unwisely. Finally, creation of the panel would by itself draw some attention to the problem of excessive use of tax relief measures as a response to disasters, which may have salutary effects at least in the short run.

CONCLUSION

In our view, the nature of the problem presented explains the public response. The disasters were vividly, unceasingly presented in the media day and night; they were easy for the public to understand, and difficult to put out of mind. The entire nation identified with the victims and resonated with fear that a manmade or natural disaster would afflict their own families and communities as well. Enormous sympathy and anxiety clouded public vision.

That Congress and the public may well have been acting altruistically—at least, mostly so—did not produce good tax policy. Citizens and members of Congress, eager and pressured to act, did not think—and, truly, did not want to think—about the efficacy in restoring destroyed neighborhoods or the equity of their actions in that tax benefits would favor the wealthier among those in the affected areas, rather than less wealthy taxpayers who suffer individual, isolated disasters. Sympathy, it would appear, systematically distorts tax policy in this way.

The nation has witnessed at least four major tax acts responding to disasters in the last five years. It seems reasonable to fear that Congress is likely to perpetuate this pattern with future disasters unless the institutional landscape is somehow altered. We have offered some ideas that we believe would alter that landscape. In order for Congress to inoculate itself against a distorting sympathy unleashed by a particular disaster, we urge Congress to take two

kinds of immediate actions. First, it should identify those provisions enacted in response to the recent disasters that make sense generally, such as five-year carryback of net operating losses, and amend the tax code to adopt these rules generally. Second, it should identify those provisions needed in particular when a whole area is devastated—a five-year period for replacing destroyed property, a credit for wages to pre-disaster employees, and routine extensions of filing deadlines—and, following the model of section 139, make them available to any declared disaster area.

We also urge two kinds of longer-term approaches. One is to consider and evaluate disaster tax relief provisions as a kind of national insurance against disasters that the private market does not supply. The other is to convene a panel to develop packages of tax relief for different kinds of disasters, for Congress to have available to invoke when needed. We urge Congress to consider these and other approaches immediately, before another disaster strikes, because they can be reasonably evaluated only outside the context of any particular disaster.