



**JOINT COMMITTEE ON TAXATION**  
**September 28, 2005**  
**JCX-70-05**

**TESTIMONY OF GEORGE K. YIN**  
**CHIEF OF STAFF**  
**OF THE**  
**JOINT COMMITTEE ON TAXATION**

**AT A HEARING OF THE SENATE COMMITTEE ON FINANCE ON**  
**“HURRICANE KATRINA: COMMUNITY REBUILDING NEEDS AND**  
**EFFECTIVENESS OF PAST PROPOSALS”**

**September 28, 2005**

Mr. Chairman, Senator Baucus, members of the Committee, thank you for inviting me to testify today. You have asked me to discuss the effectiveness of prior tax legislative responses to recent disasters affecting the United States. In this testimony, I provide some general observations about this type of legislation and then briefly describe the specific tax provisions that were enacted.<sup>1</sup>

**Tax provisions for Hurricane Katrina relief: some general observations**

The effectiveness of prior disaster-related tax provisions is very difficult to evaluate. The provisions are all of fairly recent vintage and there has not been sufficient time and data for research to emerge that specifically evaluates them. Furthermore, the problems presented by Hurricane Katrina are different in both nature and scope than those presented by, for example, the terrorist attack on 9/11. Thus, what may or may not have proven effective in New York City in 2001 may not be particularly useful in determining the appropriate approach to take for the Gulf region in 2005. In deciding whether to adopt any tax provisions in connection with Hurricane Katrina, the Committee might wish to consider the following general observations.

Disasters by their nature are location specific, and thus any tax measures to be considered as relief for those disasters will in general be location specific. Present law provides a model for location specific tax benefits, namely the provisions known as "enterprise zones," which offer

---

<sup>1</sup> In addition to the tax provisions described below, Congress recently passed and the President signed the Katrina Emergency Tax Relief Act of 2005, Pub. L. No. 109-73. For a complete description of the provisions in that Act, see Joint Committee on Taxation, Technical Explanation of H.R. 3768, the “Katrina Emergency Tax Relief Act of 2005,” as passed by the House and the Senate on September 21, 2005, (JCX-69-05), September 22, 2005.

certain investment and employment incentives for geographically targeted areas that are chronically economically depressed. As a general matter, economists are skeptical about attempts to alter the market's decision as to location of investment, although in the case of enterprise zones, rationales have been offered that they may potentially help to overcome mismatches between available labor supply and employment opportunities, or simply to help chronically depressed areas. In general, academic research has been inconclusive as to whether enterprise zones have significantly encouraged employment or investment. An important issue concerns whether any benefit to the targeted area merely comes at the expense of diminished investment or employment outside of the zone.

Because of the temporary nature of the shock, any relief for a disaster should presumably be short-lived. But short-lived tax relief may be problematic due to both lack of awareness of the relief on the part of taxpayers and limited enforcement incentives on the part of the IRS. As a result, we might expect above-average noncompliance with such provisions, both intentional and inadvertent, as well as below-average utilization. Tax provisions, especially short-lived ones, are also not well-suited to providing benefits to low-income beneficiaries, if that is the Committee's objective.

Among the possible investment incentives for the Gulf region are accelerated cost recovery deductions (for example, bonus depreciation or expensing). Such incentives reduce the after-tax cost of investing in eligible property and therefore encourage such investment. Moreover, such incentives may be attractive because they are relatively easy to tailor to specific geographic areas where investment is desired and to specific investment periods. Because similar provisions have been enacted in the past, taxpayers and the IRS are familiar with their operation, which may improve participation and compliance. A difficulty is knowing the appropriate level of incentive to spur the desired amount of investment.

Proposals to provide additional tax-exempt bond authority raise two separate questions. The first is whether the amount of a state's volume cap, which limits the aggregate issuance of tax-exempt private activity bonds, should be raised in view of increased government financing needs. A second and separate question is whether there should be an expansion of the permitted purposes for which tax-exempt financing may be provided. Congress has identified specific private activities that may be financed with tax-exempt bonds generally because such activities provide a degree of public benefit (e.g., multifamily and single family housing, solid waste facilities). Proposals to expand tax-exempt bond authority for broad, undefined purposes may permit financing for private activities that provide little or no public benefit.

A tax incentive that is something of a hybrid between a tax and grant program is the New Markets Tax Credit. This provision permits taxpayers to receive a tax credit over a seven-year period equal to 39 percent of the cost of qualified investments in designated Community Development Entities (CDEs). Substantially all of the qualified investment must in turn be used by the CDE to provide investments in low-income communities. Because the designation of qualifying CDEs is determined annually by the Treasury Department under a competitive application process, the program has both tax and grant characteristics. The tax program therefore has both the advantages (greater oversight and control) and disadvantages (slower response, insufficient reliance upon the market) of grant programs.

Finally, careful targeting of any tax incentives will ensure that they are available only to intended beneficiaries. In addition, if the Committee decides to adopt a package of provisions, it should consider the potential overlap of benefits as well as the effect multiple provisions may have on both participation and compliance.

### **Tax benefits included in recent disaster-related legislation**

The following summarizes very briefly the tax provisions included in recent disaster-related legislation.

#### **A. Capital Investment Incentives**

##### **1. Increase in expensing treatment for business property used in the New York Liberty zone**

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct (or “expense”) such costs. Present law (sec. 179) provides that the maximum amount a taxpayer may expense, for taxable years beginning in 2003 through 2007, is \$100,000 of the cost of qualifying property placed in service for the taxable year.<sup>2</sup> The \$100,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds \$400,000. The \$100,000 and \$400,000 amounts are indexed for inflation.

After the September 11, 2001, terrorist attacks, the Job Creation and Worker Assistance Act of 2002 (“JCWAA”) added a provision that increases the amount a taxpayer may deduct under section 179 for qualifying property used in the New York Liberty Zone. Specifically, the provision increases the maximum dollar amount that may be deducted under section 179 by the lesser of (1) \$35,000 or (2) the cost of qualifying property placed in service during the taxable year. This amount is in addition to the amount otherwise deductible under section 179.

Qualifying property means section 179 property purchased and placed in service by the taxpayer after September 10, 2001 and before January 1, 2007, if (1) substantially all of its use is in the New York Liberty Zone in the active conduct of a trade or business by the taxpayer in the zone, and (2) its original use in the New York Liberty Zone commences with the taxpayer after September 10, 2001.

The New York Liberty Zone expensing provision is effective for taxable years beginning on December 31, 2001 and before January 1, 2007.

##### **2. New York Liberty Zone depreciation**

In addition to the bonus depreciation provisions generally applicable, special rules are provided for property substantially all of the use of which is in the New York Liberty Zone.

---

<sup>2</sup> Additional section 179 incentives are provided with respect to a qualified property used by a business in the New York Liberty Zone (sec. 1400L(f)), which is discussed below, an empowerment zone (sec. 1397A), or a renewal community (sec. 1400J).

Generally, certain nonresidential real property and residential rental property in the New York Liberty Zone is eligible for the additional first-year depreciation deduction even though such property is not eligible if placed in service outside of the New York Zone. Also, the January 1, 2005 placed-in-service deadline applicable to property outside of the New York Liberty Zone is extended until January 1, 2007 for otherwise qualifying property in the New York Liberty Zone. For qualifying nonresidential real property and residential rental property the property must be placed in service on or before December 31, 2009.

A special rule precludes the additional first-year depreciation under this provision for qualified New York Liberty Zone leasehold improvement property because such property is eligible for a reduced recovery period under JCWAA as discussed below.

### **3. Treatment of New York Liberty Zone leasehold improvement property**

The JCWAA provides that qualified leasehold improvements placed in service in the New York Liberty Zone after September 10, 2001 and before January 1, 2007 are depreciable over five years (rather than the otherwise applicable recovery period of 39 years or 15 years) using the straight line method of depreciation. Liberty Zone leasehold improvements that are eligible for a five-year recovery period are not also eligible for any additional first-year bonus depreciation deduction.

#### **B. Employment Incentive**

##### **1. Work opportunity tax credit**

The JCWAA created a new targeted group for the work opportunity tax credit. Generally, the new targeted group was comprised of individuals who performed substantially all their services in the recovery zone for a business located in the New York Liberty Zone. This targeted group also included individuals who performed substantially all their services in New York City for a business that relocated from the New York Liberty Zone elsewhere within New York City due to the physical destruction or damage of their workplaces within the New York Liberty Zone by the September 11, 2001 terrorist attack.

For this category, the maximum credit was \$2,400 (40 percent of \$6,000 of qualified wages) per qualified employee in each taxable year.

#### **C. Tax Filing Relief**

##### **1. Administrative authority to postpone tax-related deadlines**

The Taxpayer Relief Act of 1997 (“the 1997 Act”) provided the Secretary authority to prescribe regulations providing a period of time that may be disregarded for performing various acts under the Internal Revenue Code, such as filing tax returns, paying taxes, or filing a claim for credit or refund of tax, for any taxpayer determined by the Secretary to be affected by a Presidentially declared disaster (sec. 7508A). The 1997 Act also required the Secretary to abate interest for any individual taxpayer for whom the Secretary extended the filing date for tax returns during the period of such extension.

The Victims of Terrorism Tax Relief Act of 2001 (“the 2001 Act”) expanded and clarified the Secretary’s authority under section 7508A. The 2001 Act clarified that the Secretary has authority to postpone actions in response to a terroristic or military action, regardless of whether a disaster area has been declared by the President in connection with the action. The 2001 Act also clarified that interest on underpayments may be waived or abated with respect to either a declared disaster or a terroristic or military action. In addition, the Secretary’s authority was expanded to permit the postponement of any action required by a pension or other employee benefit plan, or by a plan sponsor, administrator, participant, beneficiary or other person. The 2001 Act also permits the Secretary to suspend the period of time under section 7508A for up to one year (increased from up to 120 days under prior law) and facilitates the prompt issuance of guidance by the Secretary by removing the requirement that regulations be published listing the scope of actions that may be postponed, thus, permitting the Secretary to provide authoritative guidance via a notice or other mechanism that may be issued more rapidly.

#### **D. Tax Relief for Certain Property Transactions**

##### **1. Extension of replacement period for nonrecognition of gain for certain property involuntarily converted and special rules for livestock sold on account of drought, flood, or other weather-related conditions**

###### **In general**

Under section 1033, gain realized by a taxpayer from an involuntary conversion of property is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property within the applicable period. The taxpayer’s basis in the replacement property generally is the cost of such property, reduced by the amount of gain not recognized.

The applicable period for the taxpayer to replace the converted property begins with the date of the disposition of the converted property (or if earlier, the earliest date of the threat or imminence of requisition or condemnation of the converted property) and ends two years after the close of the first taxable year in which any part of the gain upon conversion is realized (the “replacement period”).

###### **Extended replacement period provisions**

Special rules enacted in Omnibus Budget Reconciliation Act of 1993 extend the replacement period for principal residences damaged by a Presidentially declared disaster to four years after the close of the first taxable year in which gain is realized. These rules also provide an exclusion from income for insurance proceeds received for property included in the contents of such a residence that was not scheduled property for purposes of the insurance. The Tax Reform Act of 1976 had previously provided that the replacement period for real property used in a trade or business or held for investment is extended from two to three years, in the event of an involuntary conversion by reason of seizure, requisition or condemnation.

The JCWAA provided that, in the case of property compulsorily or involuntarily converted as a result of the terrorist attacks on September 11, 2001, in the New York Liberty

Zone, the replacement period is extended from two years to five years, but only if substantially all of the use of the replacement property is in the city of New York (sec. 1400L(g)).

The sale of livestock (other than poultry) that is held for draft, breeding, or dairy purposes in excess of the number of livestock that would have been sold but for drought, flood, or other weather-related conditions is treated as an involuntary conversion. The AJCA provided that the replacement period for livestock sold on account of drought, flood, or other weather-related conditions is extended from two years to four years after the close of the first taxable year in which any part of the gain on conversion is realized. Treasury regulatory authority is provided to extend the replacement period for additional time on a regional basis if the weather-related conditions continue for more than three years.

### **Deferral of gain recognition**

Under another provision relating to livestock, section 451(e) provides that a cash-method taxpayer whose principal trade or business is farming who is forced to sell livestock due to drought, flood, or other weather related conditions may elect to include income from the sale of the livestock in the taxable year following the taxable year of the sale. This rule is generally intended to put taxpayers who receive an unusually high amount of income in one year in the position they would have been in absent the weather-related condition. Both this provision and the section 1033 rule relating to livestock are available only if the taxpayer establishes that, under the taxpayer's usual business practices, the sale would not have occurred but for drought, flood, or weather-related conditions that resulted in the area being designated as eligible for Federal assistance.

## **2. Exclusion for certain cancellations of indebtedness**

Gross income includes income that is realized by a debtor from the discharge of indebtedness, subject to certain exceptions for debtors in Title 11 bankruptcy cases, insolvent debtors, certain farm indebtedness, and certain real property business indebtedness.

The 2001 Act provided that gross income does not include any amount realized from the discharge (in whole or in part) of indebtedness if the indebtedness is discharged by reason of the death of an individual which occurred as a result of the September 11, 2001, attacks, or as a result of a terrorist attack involving anthrax occurring on or after September 11, 2001, and before January 1, 2002. In all cases, the provision applied only if the indebtedness is discharged because the individual died as a result of one the attacks. This provision applied to discharges made on or after September 11, 2001, and before January 1, 2002.

## **3. Use of appraisals to establish disaster relief losses**

In order to claim a disaster loss, a taxpayer must establish the amount of the loss. This may, for example, be done through the use of an appraisal. The 1997 Act provides that nothing in the Code should be construed to prohibit Treasury from issuing guidance providing that an appraisal for the purpose of obtaining a Federal loan or Federal loan guarantee as the result of a Presidentially declared disaster may be used to establish the amount of a disaster loss.

## **E. Tax Exempt Bond Incentives**

### **1. Mortgage bond financing**

Generally, interest paid on “qualified mortgage bonds” is excluded from gross income. Qualified mortgage bonds are bond issued to make mortgage loans to qualified mortgagors for the purchase, improvement, or rehabilitation of owner-occupied residences. The Code imposes several limitations on qualified mortgage bonds, including income limitations for homebuyers and purchase price limitations for the home financed with bond proceeds. In addition to these limitations, qualified mortgage bonds generally cannot be used to finance a mortgage for a homebuyer who had an ownership interest in a principal residence in the three years preceding the execution of the mortgage (the “first-time homebuyer” requirement). The first-time homebuyer requirement does not apply to targeted area residences. A targeted area residence is one located in either (1) a census tract in which at least 70 percent of the families have an income which is 80 percent or less of the state-wide median income or (2) an area of chronic economic distress.

Qualified mortgage bonds also may be used to finance qualified home-improvement loans. Qualified home-improvement loans are defined as loans to finance alterations, repairs, and improvements on an existing residence, but only if such alterations, repairs, and improvements substantially protect or improve the basic livability or energy efficiency of the property. Under present law, qualified home-improvement loans may not exceed \$15,000.

The 1997 Act waived the first-time homebuyer requirement for residences located in certain Presidentially declared disaster areas (sec. 143(k)(11)). In addition, residences located in such areas were treated as targeted area residences for purposes of the income and purchase price limitations. The special rule for residences located in Presidentially declared disaster areas does not apply to bonds issued after January 1, 1999.

### **2. Additional advance refunding of certain tax-exempt bonds**

Generally, the Code limits the number of times that tax-exempt governmental or qualified private activity bonds may be advanced refunded.<sup>3</sup> Governmental bonds and qualified 501(c)(3) bonds may be advance refunded one time.<sup>4</sup> Private activity bonds, other than qualified 501(c)(3) bonds, may not be advance refunded at all.<sup>5</sup>

Under the 2001 Act, certain bonds used to fund facilities located in New York City are permitted one additional advance refunding before January 1, 2006. In addition to satisfying other requirements, the bond refunded must be (1) a State or local bond that is a general

---

<sup>3</sup> An advance refunding bond is any bond issued more than 90 days before the redemption of the refunded bond.

<sup>4</sup> Sec. 149(d)(3). Bonds issued before 1986 and pursuant to certain transition rules contained in the Tax Reform Act of 1986 may be advance refunded more than one time in certain cases.

<sup>5</sup> Sec. 149(d)(2).

obligation of New York City, (2) a State or local bond issued by the New York Municipal Water Finance Authority or Metropolitan Transportation Authority of the City of New York, or (3) a qualified 501(c)(3) bond which is a qualified hospital bond issued by or on behalf of the State of New York or the City of New York. The maximum amount of advance refunding bonds is \$9 billion.

### **3. New York Liberty Zone bonds**

Interest paid on “qualified private activity bonds” generally is excluded from gross income. The definition of a qualified private activity bond includes an exempt facility bond, or qualified mortgage, veterans’ mortgage, small issue, redevelopment, 501(c)(3), or student loan bond.<sup>6</sup> Issuance of most qualified private activity bonds is subject (in whole or in part) to annual State volume limitations.<sup>7</sup> Exceptions are provided for bonds for certain governmentally owned facilities (e.g., airports, ports, high-speed intercity rail, and solid waste disposal) and bonds which are subject to separate local, State, or national volume limits (e.g., public/private educational facility bonds, enterprise zone facility bonds, qualified green building bonds, and qualified highway or surface freight transfer facility bonds).

The 2001 Act authorized an aggregate of \$8 billion in tax-exempt exempt facility bonds for the purpose of financing the construction and rehabilitation of nonresidential real property<sup>8</sup> and residential rental real property<sup>9</sup> in the New York Liberty Zone (“Liberty Zone Bonds”). Liberty Zone Bonds must be issued before January 1, 2010.

Issuance of New York Liberty Zone Bonds is limited to projects approved by the Mayor of New York City or the Governor of New York State, each of whom may designate up to \$4 billion of the aggregate bond authority. If the Mayor or the Governor determines that it is not feasible to use all of the authorized bonds that he is authorized to designate for property located in the New York Liberty Zone, up to \$2 billion of bonds may be designated by each to be used for the acquisition, construction, and rehabilitation of nonresidential real property (including fixed tenant improvements) located outside the New York Liberty Zone and within New York City. Bond-financed property located outside the New York Liberty Zone must meet the additional requirement that the project have at least 100,000 square feet of usable office or other commercial space in a single building or multiple adjacent buildings.

---

<sup>6</sup> Sec. 141(e).

<sup>7</sup> Sec. 146.

<sup>8</sup> No more than \$800 million of the authorized bond amount may be used to finance property used for retail sales of tangible property (e.g., department stores, restaurants, etc.) and functionally related and subordinate property. The term nonresidential real property includes structural components of such property if the taxpayer treats such components as part of the real property structure for all Federal income tax purposes (e.g., cost recovery). The \$800 million limit is divided equally between the Mayor and the Governor.

<sup>9</sup> No more than \$1.6 billion of the authorized bond amount may be used to finance residential rental property. The \$1.6 billion limit is divided equally between the Mayor and the Governor.



## **F. Individual Income, Trust and Estate Tax Relief**

### **1. Exclusion of qualified disaster relief payments**

Gross income includes all income from whatever source derived unless a specific exception applies. Under prior law, there was no specific statutory exclusion from income for disaster payments. Various types of disaster payments made to individuals had been excluded from gross income under a general welfare exception and under other provisions.

The 2001 Act provides that gross income does not include amounts received by individuals as qualified disaster relief payments. Qualified disaster relief payments include amounts paid to an individual: (1) to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster; (2) to reimburse or pay reasonable and necessary expenses incurred for the repair or rehabilitation of a personal residence or replacement of its contents to the extent that the need for such repair, rehabilitation, or replacement is attributable to a qualified disaster; (3) by a person engaged in the furnishing or sale of transportation as a common carrier by reason of death or personal injuries as a result of a qualified disaster; or (4) by a Federal, State, or local government, or agency or instrumentality thereof, in connection with a qualified disaster in order to promote the general welfare. Any amount received as payment under section 406 of the Air Transportation Safety and System Stabilization Act is also excludable from gross income.

### **2. Application of certain provisions to terroristic or military actions**

Gross income does not include amounts received by an individual as disability income attributable to injuries incurred as a direct result of a terrorist attack which occurred while the individual was performing official duties as an employee of the United States outside the United States. The 2001 Act expands the exclusion from gross income for disability income of U.S. civilian employees attributable to a terrorist attack outside the United States to apply to disability income received by any individual attributable to a terroristic or military action.

Military and civilian employees of the United States who die as a result of wounds or injury incurred outside the United States in a terroristic or military action are not subject to income tax for the year of death and for prior taxable years beginning with the taxable year prior to the taxable year in which the wounds or injury were incurred. The 2001 Act extends the income tax relief provided to U.S. military and civilian personnel who die as a result of terroristic activity or military action outside the United States to such personnel regardless of where the terroristic activity or military action occurred.

### **3. Exclusion of certain death benefits**

The 2001 Act provided an exclusion from gross income for amounts received if such amounts are paid by an employer by reason of the death of an employee who dies as a result of wounds or injury which were incurred as a result of the terrorist attacks that occurred on September 11, 2001, or April 19, 1995, or as a result of illness incurred due to an attack involving anthrax that occurs on or after September 11, 2001, and before January 1, 2002.

#### **4. Payments by charitable organizations treated as exempt payments**

In general, organizations described in section 501(c)(3) of the Code are exempt from Federal income taxation and must be organized and operated exclusively for exempt purposes. In general, payments by such organizations that result in private inurement or private benefit are considered as not being made for exempt purposes and are prohibited. In light of the extraordinary distress caused by the terrorist attacks of September 11, 2001, and the subsequent attacks involving anthrax, the Victims of Terrorism Tax Relief Act of 2001 provides that organizations described in section 501(c)(3) that make payments by reason of the death, injury, wounding, or illness of an individual incurred as a result of the September 11, 2001, attacks, or as a result of an attack involving anthrax, are not required to make a specific assessment of need for the payments to be related to the purpose or function constituting the basis for the organization's exemption, so long as the organization makes the payments in good faith using a reasonable and objective formula which is consistently applied.

#### **5. Income taxes of victims of terrorist attacks**

An individual in active service as a member of the Armed Forces who dies while serving in a combat zone (or as a result of wounds, disease, or injury received while serving in a combat zone) is not subject to income tax or self-employment tax for the year of death (as well as for any prior taxable year ending on or after the first day the individual served in the combat zone). Military and civilian employees of the United States are entitled to a similar exemption if they die as a result of wounds or injury which were incurred outside the United States in terrorist or military action.

The 2001 Act extended relief similar to the treatment of military or civilian employees of the United States who die as a result of terrorist or military activity outside the United States to individuals who die as a result of wounds or injury which were incurred as a result of the terrorist attacks that occurred on September 11, 2001, or April 19, 1995, and individuals who die as a result of illness incurred due to an attack involving anthrax that occurs on or after September 11, 2001, and before January 1, 2002. Such individuals generally are exempt from income tax for the year of death and for prior taxable years beginning with the taxable year prior to the taxable year in which the wounds or injury occurred. A minimum tax relief benefit of \$10,000 was provided to each eligible individual regardless of the income tax liability of the individual for the eligible tax years.

#### **6. Qualified disaster mitigation payments**

Public Law 109-7 provides an exclusion from gross income for amounts received as qualified disaster mitigation payments. Qualified disaster mitigation payments are amounts paid to or for the benefit of property owners for hazard mitigation pursuant to the Robert T. Stafford Disaster Relief and Emergency Assistance Act or the National Flood Insurance Act. Amounts received for the sale or disposition of property for the purpose of hazard mitigation are not eligible for the income exclusion. However, if property is sold or disposed to implement hazard mitigation, such sale or disposition is treated as an involuntary conversion, as defined by section 1033 of the Code.

## **7. Personal exemption deduction for certain disability trusts**

The 2001 Act provided that certain disability trusts may claim a personal exemption deduction in an amount that is based on the personal exemption provided for individuals under section 151(d), rather than the \$100 or \$300 exemption amounts otherwise available to trusts (excluding grantor trusts). The personal exemption available to qualified disability trusts is equal in amount to the section 151(d) personal exemption for unmarried individuals with no dependents (\$3,200 for 2005). The exemption is subject to a phaseout determined by reference to the phaseout of the personal exemption for such individuals under sec. 151(d)(3)(C)(iii).

A qualified disability trust is a trust described in 42 U.S.C. sec. 1396p(c)(2)(B)(iv) (relating to the treatment, for purposes of determining eligibility for medical assistance under the Social Security Act, of assets transferred to a trust established solely for the benefit of a disabled individual under 65 years of age). The increased personal exemption is only available to disability trusts the beneficiaries of which have been determined by the Commissioner of Social Security to be disabled (other than holders of a remainder or reversionary interest in the trust), within the meaning of 42 U.S.C. sec. 1382c(a)(3).

## **8. Estate tax reduction**

The law has long provided a reduction in Federal estate tax for the taxable estates of U.S. citizens or residents who are active members of the U.S. Armed Forces and who are killed in action while serving in a combat zone (Code sec. 2201). The 2001 Act extended the tax benefits of Code section 2201 to the taxable estates of individuals who died from wounds or injuries incurred as a result of the terrorist attacks of September 11, 2001, or April 19, 1995, or as a result of illness incurred due to an attack involving anthrax that occurred on or after September 11, 2001, and before January 1, 2002. In 2003 the Congress extended the tax benefits of Code section 2201 to the taxable estates of astronauts who die in the line of duty. Code section 2201 reduces the Federal estate tax liability of qualifying estates by subjecting these estates to a special, reduced rate schedule and by applying a larger effective exemption amount via the unified credit. Using the rates and unified credit in effect for 2005, the provision allows an effective exemption of more than \$5.4 million, with a maximum estate tax rate of 20 percent, compared to the generally applicable effective exemption of \$1.5 million and maximum estate tax rate of 47 percent.

\* \* \* \*

As always, the Joint Committee staff stands ready to assist the Committee in developing an appropriate tax legislative package. I am happy to answer any questions.