# HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** HM 539 Deepwater Horizon Oil Spill/Tax Relief
**SPONSOR(S):** Patronis and others
**TIED BILLS:** **IDEN./SIM. BILLS:** CS/SM 214

| REFERENCE | ACTION | ANALYST | STAFF DIRECTOR or BUDGET/POLICY CHIEF |
|---|---|---|---|
| 1) Federal Affairs Subcommittee | 13 Y, 0 N | Cyphers | Cyphers |
| 2) Economic Affairs Committee | | | |

## SUMMARY ANALYSIS


This memorial urges Congress to support certain tax-relief provisions of H.R. 5699 and S. 3934, introduced in the 111th Congress, or similar legislation relating to the Deepwater Horizon Oil Spill of 2010. Specifically, the memorial urges Congress to adopt the following provisions:

- Exempt from federal taxation as income, any insurance payouts arising from the oil spill, and payments for damages attributable to the oil spill under s. 1002 of the Oil Pollution Act of 1990, 33 U.S.C. 2702, which were reinvested in the Oil Spill Recovery Zone;
- Recognize any taxpayer who has a qualified oil-spill loss as eligible to use the federal 5-year net operating loss carryback for federal tax purposes;
- Exempt from federal taxation, the housing stipends paid to persons who are employed in the cleanup efforts, and award a tax credit to employers who paid the stipends;
- Award an Employee Retention Tax Credit to qualified employers in the affected Gulf Coast area;
- Waive the tax penalty on early withdrawals of certain retirement plans if the proceeds are used as specified;
- Relax the cap on federal deductions for charitable contributions dedicated to the cleanup efforts; and
- Award a Work Opportunity Tax Credit for the hiring of qualified recovery zone employees.


## FULL ANALYSIS

## I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

**Background**

On April 20, 2010 in the Gulf of Mexico, the Deepwater Horizon drilling rig experienced an explosion[1] that would take the lives of eleven people and mark the beginning of the largest environmental disaster in the history of the United States. By the end of April 22nd, eleven members of the crew of the Deepwater Horizon were missing and presumed deceased,[2] several other crew members were injured, the $350 million oil rig owned by Transocean[3] had sunk to the bottom of the Gulf of Mexico, and oil and natural gas were leaking from pipes attached to the failed blowout preventer at the well head.

[1] http://www.nytimes.com/2010/04/22/us/22rig.html?_r=1&scp=1&sq=oil+rig+explosion&st=nyt
[2] http://www.tampabay.com/incoming/as-oil-rig-sinks-hope-fades/1089672
[3] National Commission on the BP Deepwater Horizon Oil Spill and Offshore Drilling: Report to the President, January 2011

**Response and Aftermath**

The location of the leaking well site, known as the Macondo well, is approximately 45 miles southeast of Louisiana. As it became clear that the built-in measures to stop the leak had failed and that oil was beginning to spread away from the site of the leak, Governor Charlie Crist declared a state of emergency on April 30th for Escambia, Santa Rosa, Okaloosa, Walton, Bay, and Gulf counties.[4] On May 3rd, the Governor's executive order was amended to add Franklin, Wakulla, Jefferson, Taylor, Dixie, Citrus, Hernando, Pasco, Pinellas, Hillsborough, Manatee, and Sarasota counties.[5]

After several failed attempts to stop the leak from the well, including a failed "top kill" effort between May 26 through 29, 2010;[6] leaking from the well was finally stopped on July 15, 2010.[7] A new "static kill" was successfully completed on August 4, 2010[8], and on September 19, 2010, after the relief well was finished and the well was cemented from beneath, Admiral Thad Allen announced that the well was "effectively dead."[9]

The official government estimate regarding the spill places the amount of oil released from the Macondo well to be approximately 4.9 million barrels or 205.8 million gallons of oil.[10] While 17 percent of the oil was captured at the wellhead (833,000 barrels), according to official oil budget reports, the remaining oil (4.2 million barrels) escaped immediate retrieval.[11]

| Oil Budget (Released Aug. 4) | | Oil Budget Technical Report | | |
|---|---|---|---|---|
| **Category** | **% of Total** | **Category** | **% of Total** | **Change** |
| Direct Recovery | 17% | Direct Recovery | 17% | None |
| Burned | 5% | Burned | 5% | None |
| Skimmed | 3% | Skimmed | 3% | None |
| Chemically Dispersed | 8% | Chemically Dispersed | 16% | +8% |
| Naturally Dispersed | 16% | Naturally Dispersed | 13% | -3% |
| Evaporated or Dissolved | 25% | Evaporated or Dissolved | 23% | -2% |
| Other | 26% | Other | 23% | -3% |

According to a report by Secretary of the Navy Ray Mabus, at its peak, the response to oil spill included more than 47,000 personnel; 7,000 vessels; 120 aircraft; and many federal, state, and local agencies.[12] The final Situation Report by Florida's response team also noted the use of over 791,061 feet of boom, the removal of over 500,000 gallons of oil from Florida's shoreline, the deployment of 128 National Guardsmen; and the registration of 19,899 volunteers from all 50 states and 10 different countries.[13]

[4] Office of the Governor, Executive Order Number 10-99 (Emergency Management – Deepwater Horizon) April 30, 2010
[5] Office of the Governor, Executive Order Number 10-100 (Emergency Management – Deepwater Horizon) May 3, 2010
[6] http://www.nytimes.com/2010/05/30/us/30spill.html
[7] http://abcnews.go.com/WN/gulf-oil-spill-bps-cap-success-oil-stops/story?id=11173330
[8] http://www.nytimes.com/2010/08/05/us/05spill.html
[9] http://www.cbsnews.com/stories/2010/09/19/national/main6881308.shtml
[10] National Commission on the BP Deepwater Horizon Oil Spill and Offshore Drilling: Report to the President, January 2011
[11] http://www.noaanews.noaa.gov/stories2010/20101123_oilbudget.html

[12] America's Gulf Coast: A Long Term Recovery Plan after the Deepwater Horizon Oil Spill, September 2010
[13] Deepwater Horizon Response: Situation Report #114 (Final) August 26, 2010

**Responsible Parties**

On June 1, 2010, the United States Attorney General Eric Holder announced the federal government would pursue all legal remedies to the disaster, including civil and criminal penalties in order to ensure accountability on the part any responsible party.

Under the provisions of Oil Pollution Act of 1990 (OPA), all "responsible parties" are liable for recovery costs and other damages as the result of an unpermitted release of oil into the navigable waters of the United States. The OPA, however, limits the damages to be paid by responsible parties at $75 million per incident. However, according to a U.S. Coast Guard document on Oil Spill Liability Trust Fund Funding for Oil Spills, this limitation of liability disappears if the incident is found to have been caused by gross negligence; willful misconduct; or a violation of federal operating, construction, or safety regulations. BP has said that it would not claim protection under the $75 million limit under OPA.[14]

**Claims Process**

In June 2010, at the request of President Obama, BP announced that it would create a trust that would total $20 billion to pay all "legitimate claims".[15] The claims would include all recovery and damages related to individuals, governments and natural resources. Until August 23, 2010, BP administered the payment of claims out of the trust fund, but the process was subsequently turned over to an independent claims facility managed by Kenneth Feinberg with the opening of the Gulf Coast Claims Facility (GCCF).[16]

As of March 2, 2011, the total number of claimants to the GCCF reached 802,411. Of these claimants, 263,054 have been paid a total of $3.46 billion thus far. Florida makes up 32% of all claims (254,557 claims) and 35.6% of all claims paid to date (97,271 claims paid totaling $1.23 billion).[17]

**Historical Tax Relief Measures**

On several occasions, Congress has passed legislation aimed at providing tax relief to both businesses and individuals affected by natural disasters. One of the most recent instances relates to taxpayers affected by Hurricanes Katrina, Rita, and Wilma in 2005.[18] The other is related to individuals and businesses affected by the declared disaster areas of the Midwest in 2008.[19]

The subjects addressed by these historical tax relief measures include:[20]

- Charitable Giving Incentives;
- IRAs and Other Retirement Plans;
- Net Operating Losses;
- Specific Tax Relief for Individuals; and
- Specific Tax Relief for Businesses

[14] http://www.bloomberg.com/news/2010-05-21/bp-waiver-of-75-million-spill-damage-cap-may-recognize-liability-reality.html
[15] http://www.bp.com/genericarticle.do?categoryId=2012968&contentId=7062966
[16] http://www.gulfcoastclaimsfacility.com/
[17] Gulf Coast Claims Facility website; Overall Program Statistics; February 28, 2011
[18] Emergency Tax Relief Act of 2005 and the Gulf Opportunity Zone Act of 2005
[19] Heartland Disaster Tax Relief Act of 2008
[20] Internal Revenue Service Publication 4492 (January 2006) and 4492-B (January 2010)

In the summer of 2010, a similar effort to provide tax relief was begun in Congress in response to the Deepwater Horizon Oil Spill. In the House of Representatives, Representatives Miller, Bonner and Boyd sponsored the Gulf Oil Spill Recovery Act of 2010.[21] In the Senate, Senators Wicker and Vitter sponsored the Gulf Coast Oil Recovery Zone Tax Relief and Economic Recovery Act, or Senate Bill 3934.[22]

With the exception of the first area of tax relief listed below, each of the following seven tools to provide relief to taxpayers in areas affected by the Deepwater Horizon Oil Spill can be found in Katrina Relief Act of 2005, the Gulf Opportunity Act of 2005, and the Heartland Disaster Relief Act of 2008.[23]

## Effects

The memorial asks Congress to support and pass measures regarding relief in the following areas of federal taxes.

### 1. Exempting Payouts from Federal Taxation

Under current law, payouts from insurance payments, whether they are for damages or loss of income or wages, are not considered to be taxable income by the Internal Revenue Service.[24] However, damages for loss of income and profit, like those that are currently being paid by BP, are considered taxable income because they are considered a replacement of monies which would typically be taxed.[25] This form of tax relief is not found in the hurricane or Midwest disaster relief packages. However, it is provided for in the Senate bill that was introduced in the Senate in 2010.[26]

Senate Bill 3934 by Senators Wicker and Vitter would make all payouts, whether they are for damages or lost income and profits, non-taxable if the payout is related to the Deepwater Horizon Oil Spill. It should be noted that this provision is found only in the Senate relief package and is not found in the House's Gulf Oil Spill Recovery Act of 2010.

### 2. Net Operating Loss Carryback Period

Legislation proposed in the U.S. House of Representatives would allow any taxpayer who has a qualified oil-spill loss to use a federal 5-year net operating loss carryback for federal tax purposes.[27] Under current law, the net operating loss carryback period allows businesses to amend tax returns from the previous 2 years to account for losses and receive a refund for past taxes paid.

The Senate legisalation sought to enact law that would allow fishing and tourism-related businesses to carry back their losses from the oil spill for an additional 3 taxable years ("Gulf Coast net operating loss carryback").[28] The Gulf Coast net operating loss carryback would allow Gulf Coast fishing- and tourism-related businesses with $5 million or less in revenue to look back 5 years. Losses otherwise eligible for the carryback period would be reduced by any amounts the business receives from BP for lost profits and earning capacity.

Congress previously enacted a similar rule for businesses following Hurricane Katrina in 2005 and the Midwestern storms, tornadoes, and floods in 2008. Farming losses permanently qualify for a 5-year carryback period.

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[21] H.R. 5699; 111th Congress, July 1, 2010
[22] S. 3934; 111th Congress, September 29, 2010
[23] Internal Revenue Service Publication 4492 (January 2006) and 4492-B (January 2010)
[24] Internal Revenue Service Notice 1412, January 2011
[25] Internal Revenue Service Publication 4873, July 2010
[26] S. 3934; 111th Congress, September 29, 2010
[27] H.R. 5699; 111th Congress, July 1, 2010
[28] Senator Nelson introduced an amendment ot H.R. 4213 to achieve this purpose; see also, S. 3934; 111th Congress, September 29, 2010

### 3. Housing Stipends

Individuals employed in the cleanup efforts of the Deepwater Horizon Oil Spill were eligible for housing stipends to cover lodging expenses acquired during the course of their employment. Under Federal law, housing allowances are generally treated as taxable income, unless specifically excluded under the IRS Code (i.e. clergy, military).[29] Certain employers with a trade or business located in the Gulf Oil Spill Recovery Zone have paid housing stipends during the Deepwater Horizon Oil Spill cleanup process.

### 4. Employee Retention Tax Credit

This benefit has been historically applied to an employer who was actively involved in business in a named disaster area during the time of impact, and whose business was inoperable for some time after the time of impact. The credit is for 40% of all qualified wages for each employee, up to $6,000 per employee. Generally, an employer would have to reduce their deduction for salaries and wages by the amount of the credit being claimed. The wages paid to retained employees can be claimed for this credit, even if the employee performs no actual work during this period.[30]

### 5. Tax Penalties on Early Withdrawals of Retirement Plans

Most retirement distributions that are paid from a qualified retirement plan or nonqualified (deferred) annuity contract to a participant before he/she reaches the age 59½, are subject to a 10% additional tax penalty for early withdrawal.[31] This additional tax only applies to the portion of the distribution that the participant must include in his/her gross income, and does not apply to any portions of a distribution that are tax free, or for "corrective distributions of excess deferrals, excess contributions, or excess aggregate contributions."[32]

According to the Internal Revenue Service (IRS), a qualified retirement plan includes:

- A qualified employee plan, including a qualified cash or deferred arrangement (CDA) under the Internal Revenue Code section 401(k),
- A qualified employee annuity plan,
- A tax-sheltered annuity plan (403(b) plan), or
- An eligible state or local government section 457 deferred compensation plan, to the extent that any distribution is attributable to amounts the plan received in a direct transfer or rollover from one of the other plans listed here or an IRA.[33]

Deferred annuity contracts that are otherwise subject to the additional 10% tax penalty for early distributions may receive a 5% tax rate instead. "This 5% tax rate applies to distributions under a written election providing a specific schedule for the distribution of [the participant's] interest in the contract if, as of March 1, 1986, (the participant) had begun receiving payments under the election."[34]

[29] Internal Revenue Service Publication 517; See also IRS Publications 3 and 4
[30] Internal Revenue Service Publication 4492 and 4492-B
[31] Internal Revenue Service Publication 575
[32] *Id.*
[33] Id.
[34] Id. (alteration in original).

Both bills proposed by in the U.S. House of Representatives and the Senate allow for a withdrawal of $100,000 without penalty for those who live in the "Recovery Zone" and have been affected by the oil spill in the Gulf of Mexico.[35]

## 6. Federal Cap on Deductions for Charitable Contributions

Taxpayers are permitted to deduct the value of charitable contributions made to qualified organizations from their income taxes. The IRS outlines five types of organizations that can constitute a qualified organization:

Community chests, corporations, trusts, funds, or foundations that are organized under the laws of the United States, any state, or the District of Columbia that are organized and operated for the following purposes:

- Religion, charity, education, science, literary, and for the prevention of cruelty to children or animals.
- War veterans' organizations.
- Domestic fraternal societies, orders and associations operating under the lodge system.
- Certain nonprofit cemetery companies/corporations.
- The United States, any state, the District of Columbia, a U.S. possession or a political subdivision therein, or an Indian tribal government or subdivision performing governmental functions.[36]

The Federal Government limits the amount of charitable contributions certain taxpayers can deduct from their income taxes, depending upon the taxpayer and the type of charity or organization. As of 2009, this charitable contribution limit applies to taxpayers who have an adjusted gross income that is more than $166,800 for married, filing jointly or $83,400 for married taxpayers who file separately.[37]

Generally the federal cap on deductions for charitable contributions is 50%, meaning that the taxpayer's charitable contributions cannot exceed more than 50% of his or her gross income for that year.[38]

Charitable gifts to certain organizations such as "veterans' organizations, fraternal societies, nonprofit cemeteries and certain private non-operating foundations" have a lower deduction limit of 30%.[39]

Gifts of property that would otherwise be subject to capital gains taxes are treated differently by the IRS. Gifts of capital gains property that are provided to a 50% limit organization have a 30% cap, whereas gifts to non-50% limit organizations, have a 20% cap.[40]

Taxpayers that have provided charitable contributions that exceed the adjusted gross income limit for the year are permitted to "carryover" any excess contributions over the next 5 years until the excess amount is used up.[41]

House Resolution 5699, the Gulf Spill Recovery Act of 2010, suspends the limitation on the tax deduction for charitable contributions through 2012.

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[35] H.R. 5699; 111th Congress, July 1, 2010 and S. 3934; 111th Congress, September 29, 2010
[36] Internal Revenue Service, Publication 526
[37] Id.
[38] Id.
[39] Id.
[40] Id.
[41] Id.

### 7. Work Opportunity Tax Credit

The Work Opportunity Tax Credit (WOTC) is a federal income tax credit program administered by the U.S. Department of Labor and the state workforce agencies (in Florida, the state workforce agency is the Agency for Workforce Innovation). "The main objective of this program is to enable the targeted employees to gradually move from economic dependency into self-sufficiency as they earn a steady income and become contributing taxpayers, while the participating employers are compensated by being able to reduce their federal income tax liability."[42] The WOTC is intended to lower an employer's cost of doing business.

Employers must request and receive certification from the state workforce agency before claiming a WOTC on federal income tax returns. The state workforce agency is responsible for certifying that the employee is a new hire that is a member of one of the WOTC target groups consisting of individuals who have consistently faced significant barriers to employment.

For most target groups, the WOTC can be as much as $2,400, which is based on qualified wages paid to the new employee for the first year of employment. Generally, qualified wages are capped at $6,000. The credit is 25% of qualified first-year wages for those employed at least 120 hours and 40% for those employed 400 hours or more. To qualify employers for the WOTC, the new hire must begin work after

December 31, 2005, and before September 1, 2011.[43] There is no limit to the number of qualified employees for which an employer can take the credit.

Congress has enacted a special WOTC for certain impacted groups in the past. After Hurricane Katrina, hired employees that were victims of Hurricane Katrina were eligible for the WOTC.

**Other**

Copies of the memorial are to be sent to the President of the United States, the President of the United States Senate, the Speaker of the House of Representatives, and to each member of the Florida delegation to the United States Congress.

The legislation also includes whereas clauses in order to support the memorial. The whereas clauses include:

WHEREAS, on April 20, 2010, an explosion occurred on the Deepwater Horizon oil drilling platform, allowing millions of gallons of crude oil to contaminate the waters of the Gulf of Mexico and the beaches and coastline of Florida, and

WHEREAS, the oil spill forced the closure of many areas of the Gulf of Mexico to commercial fishing, creating financial hardship for Floridians engaged in fishing and the related industries of seafood processing, seafood packaging, and the wholesale and retail sales of seafood, and

WHEREAS, the oil spill forced the closure of many miles of pristine, white, sandy public beaches in Florida, depositing tar balls and oily sheen on the beaches and threatening tidal marshes and bays elsewhere in Florida, and

[42] U.S. Department of Labor – Work Opportunity Tax Credit, available at http://www.doleta.gov/business/incentives/opptax/

[43] U.S. Department of Labor – Work Opportunity Tax Credit Brochure, available at http://www.doleta.gov/business/incentives/opptax/

WHEREAS, closure of the beaches and Gulf waters created financial hardships for the state's hospitality industry, particularly in Northwest Florida, during its most profitable time of the year…

B. SECTION DIRECTORY:

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   None.

2. Expenditures:

   None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   None.

2. Expenditures:

   None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

None.

D. FISCAL COMMENTS:

## III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

   None.

2. Other:

   None.

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

## IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES