Abstract - Hurricanes Katrina and Rita battered the Gulf Coast in fall 2005, damaging homes, businesses, and public and nonprofit infrastructure, and disrupting the ongoing production process. US Congress passed and the President signed two tax bills regarding tax relief for victims of the hurricanes and tax incentives for the rebuilding and recovery of the Gulf Coast. This article discusses tax programs to provide relief and recovery and limitations in terms of economic factors targeted, deadlines for the tax programs to end, and geographical applicability of the tax provisions. This article is the first stage in evaluating tax programs to promote relief and recovery from natural disasters.

INTRODUCTION

On August 29, 2005, Hurricane Katrina battered the Gulf Coast region causing significant damage in Alabama, Mississippi and Louisiana and, two days after the hurricane, levees protecting New Orleans were topped/breached causing flooding in 80 percent of the city. Homes, businesses, public facilities, and infrastructure were destroyed. On September 23, 2005, Hurricane Rita battered the southwestern coast of Louisiana and the southeastern coast of Texas. Transmission lines were knocked down; roofs were blown off; health care facilities were evacuated. In less than one month, two major hurricanes came ashore in Louisiana. These two hurricanes left indelible marks on individuals, businesses, and state and local governments.

Once the storms had passed, the focus turned to recovery—levee enhancement, housing, infrastructure, social institutions such as schools and health care providers, and business recovery. The US Congress passed and the President signed two major tax relief and recovery measures with the purpose of providing tax relief for victims of the hurricanes and facilitating and stimulating the economic recovery of the Gulf Coast region. On September 26, 2005, the Katrina Emergency Tax Relief Act of 2005 (KETRA), a measure to provide immediate tax relief to individuals and businesses that were victims of Katrina, was signed. On December 21, 2005, the President signed the Gulf Opportunity Zone Act of 2005 (GO Zone), a public law that extended the tax provisions of KETRA to areas affected by Hurricanes Rita and Wilma.
and provided tax incentives designed to assist and encourage the economic recovery of areas damaged by Katrina, Rita, and Wilma. KETRA and GO Zone represent the use of the tax code to assist victims of a natural disaster and to encourage the economic recovery of the area damaged by the disaster.

This paper focuses on the economic conditions prevailing in the distressed areas, the general provisions of the tax relief and tax incentive bills; the provisions of the GO Zone Act that provide authority to Alabama, Louisiana, and Mississippi for approving private activity tax exempt bonds for businesses to replace damaged facilities or build new facilities within the counties and parishes declared to be eligible by the federal law; and the geographical description of the GO Zone.

**ECONOMIC CONDITIONS WITHIN THE GULF COAST, PRE AND POST KATRINA**

From 1996 to 2004, employment in the US economy grew by 10.1 percent, while employment growth over this time period in Alabama and in the Mobile Metropolitan Area was 4.0 and 2.8 percent, respectively; employment growth in Louisiana was 6.1 percent, in the New Orleans Metropolitan Area, 3.1 percent, and in the Lake Charles Metropolitan Area, 2.1 percent; and, employment growth in Mississippi was 3.3 percent, in the Biloxi–Gulfport Metropolitan Area, 19.5 percent, and in the Pascagoula Metropolitan Area, 4.9 percent. 1 Only Biloxi–Gulfport had a higher growth rate than the US average during this time period and this growth is related at first to the increase in the leisure and hospitality industry and then to the growth in professional and technical services. KETRA and GO Zone are not tax measures directed at correcting the economic lethargy in these three states; however, the prevailing economic structure in Alabama, Louisiana, and Mississippi may surely affect the possible success of tax measures in stimulating an economic recovery after Katrina and Rita.

Post–hurricane economic conditions can be summarized in terms of housing and employment gains or losses as illustrated in Table 1. Housing damage illustrates the issues with initiating an economic recovery. In Louisiana, 31 percent of the housing stock was damaged by Katrina or Rita; in Mississippi, 21.1 percent of the housing stock was damaged; and in Alabama, three percent of the housing stock was damaged. Louisiana has incurred a loss of 181,371 jobs since August 2005 and Mississippi has incurred a loss of 1,890 jobs. Alabama has gained almost 44,000 jobs during this same time period.

The housing damage was focused on certain regions of these states with the Lake Charles Metro and the New Orleans Metro in Louisiana absorbing 65.6 percent and 63.2 percent, respectively, of their housing stock being damaged in the storms. In Lake Charles, only 19 percent of the damaged housing units incurred major and severe damage, while in New Orleans, 56.5 percent of the damaged housing incurred major and severe damage. The housing stock major damage correlates with the employment loss with New Orleans showing a loss of 201,543 jobs since August 2005, or over 33 percent of its pre–Katrina employment level, while Lake Charles has actually improved its employment by over 1,500 jobs, or about a 1.74 percent growth rate. In Lake Charles, residents could return to their homes quickly, while in New Orleans—especially the City of New Orleans, St. Bernard Parish, and Plaquemines Parish—residents still cannot return to their homes.

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1 These are the metropolitan areas along the Gulf Coast and the regions that incurred the most damage from Katrina and Rita.
**TABLE 1**

**ECONOMIC COST ASSOCIATED WITH HURRICANES KATRINA AND RITA FOR ALABAMA, LOUISIANA, AND MISSISSIPPI**

<table>
<thead>
<tr>
<th>State/Metro*</th>
<th>Total Damaged Units</th>
<th>Major and Severe Damaged Units</th>
<th>Total Damaged Units as Percent of Housing Stock for Area</th>
<th>Average Gain or Loss of Employment from 9/2005 through 3/2006</th>
<th>Percent of Average Employment, first 8 months of 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>57,371</td>
<td>3,684</td>
<td>3.0%</td>
<td>43,090</td>
<td>2.24%</td>
</tr>
<tr>
<td>Mobile</td>
<td>44,869</td>
<td>3,177</td>
<td>29.7%</td>
<td>5,540</td>
<td>3.35%</td>
</tr>
<tr>
<td>Louisiana</td>
<td>915,249</td>
<td>204,737</td>
<td>31.0%</td>
<td>(181,371)</td>
<td>(9.42%)</td>
</tr>
<tr>
<td>Lake Charles</td>
<td>47,411</td>
<td>8,963</td>
<td>65.6%</td>
<td>1,530</td>
<td>1.74%</td>
</tr>
<tr>
<td>New Orleans</td>
<td>315,288</td>
<td>178,601</td>
<td>63.2%</td>
<td>(201,543)</td>
<td>(33.23%)</td>
</tr>
<tr>
<td>Mississippi</td>
<td>220,384</td>
<td>61,386</td>
<td>21.1%</td>
<td>(1,890)</td>
<td>(0.17%)</td>
</tr>
<tr>
<td>Biloxi–Gulfport</td>
<td>67,067</td>
<td>36,776</td>
<td>71.9%</td>
<td>(18,900)</td>
<td>(16.73%)</td>
</tr>
<tr>
<td>Pascagoula</td>
<td>34,288</td>
<td>16,743</td>
<td>63.2%</td>
<td>(1,340)</td>
<td>(2.46%)</td>
</tr>
</tbody>
</table>

*Mobile Metro is Mobile County; Lake Charles Metro is Calcasieu and Cameron parishes; New Orleans Metro is Jefferson, Orleans, Plaquemines, St. Bernard, St. Charles, St. John the Baptist, and St. Tammany parishes; Biloxi–Gulfport Metro is Hancock, Harrison, and Stone counties; and, Pascagoula Metro is George and Jackson counties.

**FEMA (2006).**

Biloxi–Gulfport had 71.9 percent of its housing stock damaged by Katrina, with 53.7 percent of its damaged housing incurring major and severe damage. Pascagoula had 63.2 percent of its housing stock damaged, with 47 percent of its damaged houses being listed as major and severe. The employment loss in Biloxi–Gulfport is a loss of 18,900 jobs, or 16.7 percent of its pre–Katrina employment level. Biloxi–Gulfport will have rising employment once the leisure and hospitality industry returns and this will happen over the next 12 to 24 months. Pascagoula has incurred a loss of 1,340 workers, or a 2.5 percent loss of its pre–Katrina employment level.

KETRA AND GO Zone tax provisions are being asked to assist in reviving state and regional economies, with the exception of Biloxi–Gulfport, growing slowly prior to Katrina and Rita and several metropolitan areas that incurred significant hurricane–related loss of housing and employment—an ultimate test for any tax restoration policy.

KETRA AND GO Zone Tax Provisions

The Katrina Emergency Tax Relief Act of 2005, signed on September 26, 2005, has twelve major provisions including: (1) a full deduction for personal casualty losses related to Katrina; (2) an extension of time to file and pay taxes for any returns due August 25, 2005 or thereafter until February 28, 2006; (3) relief for distributions from IRAs and qualified retirement programs up to $100,000 if they are made before the age of 59–1/2; (4) tax relief for taxpayers providing rent–free housing to dislocated persons for at least 60 days; (5) debt forgiveness of individuals not to be included in taxable income; (6) non–taxation of IRA distributions for first home buyers who could not purchase the first home because of Katrina if re–contributed within six months; (7) an extension of the Work Opportunity Tax Credits to a new target group called Hurricane Katrina Employees; (8) an employee retention tax credit of 40 percent of the first $6,000 of wages paid to each employee retained on the payroll of small businesses (200 or fewer employees) between August 28, 2005 and January 1, 2006; (9) an exemption of qualified cash charitable contributions by December 31, 2005 from the 50 percent AGI limitation and the AGI–based phaseout of itemized deductions; (10) an increase in the mileage rate for the use of vehicles for a charitable purpose from 14 cents per mile to 34 cents per mile; (11) use of 2004 income to calculate child credit and earned income credit on the 2005 tax returns for persons displaced from their principal residence by Katrina; and (12) non–taxation of insurance proceeds if they are reinvested within the disaster area within five years as opposed to the current two–year period (Internal Revenue Service, 2006).

These federal tax code changes made the federal system more compassionate to victims of the hurricanes, more relevant in terms of timing and use of funds, and more incentive–oriented for small businesses trying to retain employees during a major reduction in business activity. The Congressional Budget Office (2006) estimated KETRA will reduce federal revenues by approximately six billion dollars in 2006 and 2007. These estimates were derived from reports by the Joint Committee on Taxation of the U.S. Congress.

Persons receiving a tax break from the casualty loss provision may have to file an amended return once Mississippi and Louisiana have distributed housing relief based on Community Block Grants. Homeowners will get assistance from the block grant program, but this payment will have to be incorporated into the calculation of the casualty loss for tax purposes.
labor-intensive businesses, such as law offices, accounting firms, medical providers, and other professional services, are benefiting from the employee retention credit. A professional services firm with 100 employees will get a tax credit of close to $250,000. Individuals and companies will receive tax relief from KETRA.

States have a role to play in KETRA only if their tax codes supplement or diminish the federal tax relief. As an example, the Louisiana personal income tax allows federal taxes paid to be deducted from adjusted gross income subject to state income taxation. A reduction in a person’s federal income tax liability leads to an increase in the person’s Louisiana income tax liability. In an extraordinary session held in November 2005, the Louisiana Legislature passed and the Governor signed a law that does not permit KETRA reductions in federal tax liability to lead to an increase in Louisiana tax liability.

Key tax provisions of the Gulf Opportunity Zone Act of 2005 include: (1) a 50 percent bonus depreciation allowance for eligible property acquired after August 27, 2005 but before January 1, 2008 or before January 1, 2009 for real property; (2) an increase in Section 179 expensing for small businesses by $100,000 and an increase in the level of investment in which such expensing phases out for investments from August 27, 2005 through 2007; (3) partial expensing for demolition and clean-up costs from August 27, 2005 through 2007; (4) a doubling of expensing for qualified timber properties; (5) an extension of the Net Operating Loss carry–back period from two years to five years for losses associated with Hurricane Katrina; (6) an increase in rehabilitation credit for expenditures in the GO Zone between the August 27, 2005 and January 1, 2009; (7) a broadening of the employee retention credit as provided in KETRA to all companies without regard to size; (8) a doubling of the Hope Credit and the Lifetime Learning Credit; (9) creation of a New Markets Tax Credit for investments in qualified community developments; and (10) additional low–income housing credits (IRS, 2006) GO Zone tax incentives apply to businesses and individuals in 11 counties in Alabama, 37 parishes in Louisiana, and 49 counties in Mississippi.4

The Congressional Budget Office (2006) estimates that tax benefits related to GO Zone will amount to about $4 billion in 2006, $3 billion in 2007, and $2 billion over the years from 2008 to 2015.5 The major tax provisions will be the 50 percent bonus depreciation, the Section 179 expensing though this is limited by the fact that the small business must be profitable in order to gain the tax benefit, and the broadening of the employee retention tax credit to all companies regardless of size.

The tax incentives are aimed at the construction of new capital in the distressed area. The 50 percent bonus depreciation is aimed at capital improvements. A company cannot simply buy an existing structure in the affected area and apply the bonus depreciation. The 50 percent bonus depreciation applies only to improvements on that acquired property.

The limiting factor to these tax incentives is the timing. The 50 percent bonus depreciation is applicable to property placed in service before January 1, 2008 or for real property placed in service before January 1, 2009. The increase in expensing for small businesses applies to eligible property placed in service from August 27, 2005 through December 31, 2007. These tax deadlines encourage capital improvements to be completed more quickly. In fact, these tax deadlines compel the investment to be made within

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4 GO Zone tax incentives also apply to businesses and individuals in 22 counties in Texas and 13 counties in Florida.
5 These estimates were derived from reports by the Joint Committee on Taxation of the U.S. Congress.
the time period as defined by the tax code if the tax incentives are to be available. However, tax incentives, by themselves, will not dictate the economic recovery—a dependable customer base, available housing, and a skilled labor force are more important. The tax incentives may terminate before investments are feasible in the more heavily damaged areas. The tax incentives may be more effective in encouraging investment in the areas of Alabama, Louisiana, and Mississippi not severely damaged by the hurricanes but in which the tax incentives apply, rather than in areas that incurred the most damage.

GO ZONE TAX EXEMPT BONDS

Tax-exempt bonds issues have been restricted to governmental agencies, qualified private activity bonds, or not-for-profit organizations since 1986. GO Zone created private–activity tax–exempt bonds with Louisiana being granted the authority to issue $7.9 billion of tax–exempt bonds, Mississippi, $4.8 billion, and Alabama, $2.2 billion. GO Zone bonds, as illustrated in Figure 1, can be issued for business developments in 11 counties in Alabama, 31 parishes in Louisiana, and 49 counties in Mississippi (IRS, 2006). These counties and parishes were determined by the Federal Emergency Management Agency (FEMA) to be eligible for either individual only or both individual and public assistance from the federal government. Counties in Mississippi especially damaged by Katrina are illustrated on the map in white. Parishes in Louisiana especially damaged by Katrina and Rita based on the loss of housing are identified with markings with a white background. Parishes identified by the Louisiana Department of Economic Development to be granted favorable treatment in terms of how much of the bond proceeds will accrue to businesses in these parishes applying for GO Zone tax–exempt bonds are highlighted with markings with a shaded background. As illustrated on the map, the region that can take advantage of the tax–exempt bonds is much larger than the area that incurred severe damage from the hurricane.

Alabama, Louisiana, and Mississippi have the authority and responsibility to determine how these private activity tax–exempt bonds are allocated subject to federal guidelines. The states’ authority to issue these bonds expires as of December 31, 2010. These tax–exempt bonds can be used for projects with 95 percent of the proceeds being used in the GO Zone and for qualified mortgage bonds used for targeted area residences. These bonds are not financial obligations of the state. Companies are fully liable for the debt. The states have initiated different methods of deciding on the businesses that will get the reduced borrowing costs. Firms receiving tax–exempt financing must forego the 50 percent bonus depreciation tax incentive.

The Governor of Alabama stated the following criteria for determining the allocation of GO Zone Bonds: (1) replacing property damaged or destroyed by Hurricane Katrina; (2) rebuilding infrastructure of cities or counties damaged by Hurricane Katrina; (3) projects that substantially improve the quality of life for the area; and (4) new economic development projects (Riley, 2006). The Governor has stipulated the criteria for allocating the funds and has delegated the authority for making these decisions to the Director of Finance. Alabama has allocated $107.3 million for three projects as of May 1, 2005. The state is also considering a $160 million request by the Alabama Port Authority to provide...
Figure 1. GO Zone Tax Exempt Bond Regions
warehouses and other improvements at the Port of Mobile.  

GO Zone Bonds in Mississippi are issued through the Mississippi Business Finance Corporation with the approval of the Governor. The state will emphasize investments in manufacturing, distribution and warehousing, hotels, commercial office space, and medical providers. Mississippi will not grant any of the tax-exempt bond proceeds to ancillary activities associated with gaming facilities such as hotels and restaurants connected to gaming facilities. The state estimated that these gaming-related facilities will be built without any further tax inducement. Mississippi, as of April 28, 2006, had already approved 68 projects for about $1.4 billion of tax-exempt bond financing (Barry, 2006). The state has implemented the rule that any request for less than $20 million will be granted on a first come, first serve procedure subject to being fully compliant with federal and state guidelines. Mississippi has not received many applications from businesses in the counties along the Gulf Coast. The damage to businesses and to houses may delay the ability to recover in those counties. In addition, the casinos are primarily scattered along the Gulf Coast and the state has already decided that they will not get any financial assistance from this program.

Louisiana’s bond application process involves making application to the Louisiana Department of Economic Development and securing the approval of the Department of Economic Development, the Office of the Governor, and the State Bond Commission. The approval process always comes back to the Governor despite these other agencies involved.

The Louisiana Department of Economic Development has established several procedures to be followed in allocating the bond proceeds. First, it has been decided, at least as of May 2006, that about half of all bond issues will be granted to businesses in 13 parishes as identified by the markings in Figure 1 since these parishes were most affected by the hurricanes. Second, the Department puts a priority on projects that will assist the state in retaining companies with 500 or more employees or projects that will lead to 250 or more new employees. In Louisiana there are only 258 out of over 102,000 business establishments with more than 499 employees, and almost 25 percent of these are health care providers (County Business Partners, 2003). Economic Development also put a priority on businesses that had been damaged by Katrina or Rita and are returning to their original location. Businesses that pay wages above the local average are given a higher priority than businesses paying wages equal to the local average or lower than the local average. The Louisiana Department of Economic Development also compares applications for the bond proceeds on the basis of Regional Input–Output Multipliers computed by the U.S. Department of Commerce.

The Louisiana State Bond Commission has given final approval to a $65 million bond issuance to the Louisiana Local Government Environmental Facilities and Community Development Authority to make improvements at the Terrebonne Port. The Bond Commission has also given preliminary approval for a $20 million bond issuance for health care facilities in Vermilion Parish; a $17.5 million bond issuance to construct a pipeline to transport benzene between Dow Chemical in West Baton Rouge Parish and Total Petrochemicals, USA located in Iberville Parish.

8 Information from the Department of Finance in Alabama
9 Letter from Mr. Michael J. Olivier (2006), Secretary of the Louisiana Department of Economic Development, to Mr. John Neely Kennedy, the State Treasurer for Louisiana and the Chairman of the State Bond Commission. This letter also has attachments outlining economic development scorecard.
Katrina/Rita: The Ultimate Test for Tax Policy?

Parish; a $14 million bond issuance for the construction of a warehouse facility for storage of off-shore drilling equipment in Terrebonne Parish; a $60 million bond issuance for the construction of a downtown office complex and parking garage in Baton Rouge (East Baton Rouge Parish); a $20 million bond issuance to construct a limited service all-suite hotel in Lafayette Parish; a $160 million bond issuance for Cleco, an investor-owned utility, to reconstruct and renovate non-residential property in the GO Zone; and a $150 million bond issuance for the Industrial Development Board of the City of New Orleans for the acquisition, construction, and installation of a film studio and a digital media infrastructure. Louisiana has given final approval or preliminary approval to $489 million of bond issuances.

The tax-exempt bond issuances have received fanfare from the Departments of Economic Development in Alabama, Louisiana, and Mississippi. Businesses are lining up to get lower borrowing costs or they are comparing the benefit of lower borrowing costs to the benefits of using the 50 percent bonus depreciation. States do not want to appear that they are slowing down the economic recovery. The political pressure is to get the program working—only after 2010 will we be able to document fully the types of business endeavors that benefited from the lower borrowing costs and assess if the lower borrowing costs were essential for these business investments to occur.

SUMMARY AND CONCLUSIONS

Governments have been criticized for responding too slowly to Katrina. This criticism cannot be applied to the development and passage of KETRA and GO Zone. The federal government changed the tax laws to accommodate individuals and businesses that incurred damage because of Katrina and, eventually, Rita and Wilma, and then expanded the tax law to encourage the recovery of affected areas. The changes in the tax laws have to be viewed as one small part of an overall recovery process. The tax changes also encourage private investors to provide capital for the rebuilding of the Gulf Coast region, and the ultimate recovery of the region will be based on the willingness of private businesses to re-invest along the Gulf Coast.

One limitation to the effectiveness of the tax changes may be related to the expiration dates for certain provisions of the tax law such as deadlines of December 31, 2007, December 31, 2008, and December 31, 2009. These deadlines represent effective tax policy under normal conditions—the deadlines drive decisions to be made and accelerate the re-investment in a community. The City of New Orleans, St. Bernard Parish, and parts of Plaquemines Parish in Louisiana, as well as certain areas in Hancock and Harrison counties in Mississippi, may not be able to recover as quickly as other regions have recovered from other hurricanes because of the housing destruction. It is impossible to replace 200,000 homes in two to three years in the New Orleans Metropolitan Area and over 60,000 homes in the Mississippi Gulf Coast. Tax incentives complement a predictable customer base and a reliable and skilled work force.

A second limitation to the effectiveness of the tax incentives is to use FEMA guidelines in establishing regions subject to the tax incentives. The determination of a core disaster area by FEMA may be perfectly consistent with dealing with the day to day problems of a major disaster. It is not clear if the core disaster area is equally relevant for a region to be granted special tax incentives.

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10 A lawsuit over property rights is now proceeding in state court. A property owner is being sued so that the companies will have access to building the pipeline through his property.
A third limitation is the always present question of the effectiveness of tax policy to drive re-investment policy in a devastated area. Major catastrophes, once the event is over, typically offer enormous opportunities for individuals and businesses. The opportunities are limited not by the tax laws, assuming the tax laws were reasonable to start with, but by other factors, such as the economic lethargy of the region. Tax incentives may be one of the keys to encouraging persons to take advantage of the opportunities in the devastated area. KETRA and, especially, GO Zone give economists an opportunity to evaluate the effectiveness of tax policy within a devastated area.

Finally, the nation’s attention is focused on how to deal with mega-catastrophes. This might be a good time to ask how or even if tax policy should be structured to mitigate the economic losses associated with a major catastrophe and how should it be structured to facilitate an economic recovery from a devastating natural or man-made disaster. Can we structure a tax policy that would automatically kick in given a disaster or are all disasters sufficiently different that each disaster might require different decisions made by public officials?

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