

Legislation passed in response to Hurricane Katrina to provide relief and charitable incentives

The Katrina Emergency Tax Relief Act of 2005 was passed and signed into law providing relief for individuals affected by Hurricane Katrina (“the Hurricane”) and to provide incentives for charitable donations.

Legislation highlights

Incentives for individuals or businesses providing charitable donations:

- Cash donations by individuals to charities are exempt from the 50% of adjusted gross income limitation and phase-out of itemized deductions if made before Jan. 2006. Donations are not limited those charities providing relief related to the Hurricane however this does not apply to contributions to segregated funds or accounts like donor-advised funds.¹
- Cash donations by corporations for the Hurricane are exempt from the 10% of taxable income limitation if made before Jan. 2006.¹
- Mileage reimbursement rate for charitable driving related to the Hurricane is increased to 70% of the standard business mileage rate during the period of Aug. 25, 2005 through Dec. 31, 2006. The current standard is 48.5 cents per mile resulting in a charitable amount of 34 cents per mile. Also, no income tax is due for any reimbursement received for a substantiated volunteer use of a personal vehicle through the end of 2006.
- Provides tax deduction for individuals who provide rent-free housing to dislocated persons for at least 60 consecutive days in the year. The deduction is \$500 per dislocated person up to a maximum of \$2,000 and can be claimed in either 2005 or 2006.

Relief for individuals in the affected region:

- Waives 10% penalty tax on early distributions from IRAs, 403(b) and qualified retirement plans up to a maximum withdrawal of \$100,000 in the aggregate over a one-year period. The 20% mandatory withholding does not apply. Income tax on the distribution will be spread over a period of three years. The distribution may be re-contributed to the plan as a rollover distribution within three years from the date of the disaster. Any needed plan amendments can generally be made retroactively by the last day of the 2007 plan year.
- Re-contribution of a qualified distribution made between Feb. 28, 2005 and Aug.29, 2005 is permissible if the distribution was for the purpose of, but not used for, purchasing or building a home in the disaster area.
- Loan limit thresholds from qualified retirement plans are raised from the lesser of \$50,000 or 50% of the non-forfeitable balance of the account to \$100,000 or 100% of the non-forfeitable balance for individuals affected by the Hurricane.
- Loan repayments are extended and will not begin for one year for new loans for Hurricane victims. For Hurricane victims who have outstanding loans coming due between Aug. 25, 2005 and Dec. 31, 2006, the due date is delayed for one year.
- Insurance proceeds are generally treated as a sale of a personal residence for tax purposes unless reinvested into replacement property within four years. This legislation extends the time to replace damaged principal residences with insurance proceeds without incurring tax to five years as long as the replacement property is located within the disaster area.
- Extends deadlines for filing returns and paying income, estate, gift, excise and employment taxes to the federal government to Feb. 28, 2006.
- Allows full deductibility of personal casualty losses in the Hurricane disaster area by waiving the 10% of adjusted gross income and \$100 floor limitations.

¹ Contributions in excess of income less other contributions may be carried forward as under current rules.

- Allows for certain tax benefits such as the child tax and earned income credits to be claimed despite temporary relocations caused by the Hurricane.
- Ensures that individuals affected by the Hurricane are not taxed on personal debt forgiven by banks and other lending institutions before 2007.

Relief for businesses in the affected region and employers hiring workers from the affected region:

- Insurance proceeds are generally treated as a sale of business property unless reinvested into replacement property within two years. This legislation extends the time to replace damaged business property with insurance proceeds without incurring tax to five years as long as the replacement property is located within the disaster area.
- Extends the Work Opportunity Tax Credit (“WOTC”) to include a new target group called Hurricane Katrina employees.
 - Employers in the affected region may claim the WOTC with respect to Hurricane Katrina employees hired over the two-year period beginning Aug. 28, 2005.
 - Employers outside the area may claim the WOTC with respect to Hurricane Katrina employees hired between Aug. 29 and Dec. 31, 2005.
- Provides an Employee Retention Tax Credit through the end of 2005 for small employers who retain an eligible employee on their payroll during the time the business is inoperable as a result of the Hurricane.

Please consult your tax and/or legal advisor. See the Katrina Emergency Tax Relief Act of 2005 at www.irs.gov. Only federal law is addressed in this article, state law may vary.