

After reaching agreement on the Katrina Emergency Tax Relief Act (H.R. 3768), the House and Senate each passed the final measure on September 21, 2005, and President Bush signed it into law on September 23. The House passed the measure by a vote of 422 to 0 and the Senate passed it by unanimous consent. Please see the summary below.

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H.R. 3768, KATRINA EMERGENCY TAX RELIEF ACT OF 2005

Cash Flow Relief

1. Discharge of Indebtedness Related to Katrina: Gross income generally includes any amount realized from the discharge of indebtedness. The provision ensures that individuals are not taxed on personal debt that is discharged in response to damage suffered from Hurricane Katrina.
2. Early Withdrawals from Retirement Plans: Present law discourages distributions from tax-preferred retirement plans with penalties and other limitations. The provision waives the 10% penalty tax for premature distributions from IRAs and qualified retirement plans for individuals who suffered an economic loss because of Katrina and whose principal residence is the Katrina disaster area. Individuals eligible for this waiver would be permitted to pay income tax on such distributions ratably over a three-year period. Amounts distributed could be re-contributed to a qualified retirement plan over the three-year period following the distribution date and receive rollover treatment. The waiver of the 10% penalty, 3-year income averaging and re-contribution provisions for retirement plan withdrawals will be limited to \$100,000 per individual. Distributions for home purchases which were not finalized because of Hurricane Katrina could also be re-contributed to a qualified retirement plan or IRA. Limitations on loans from qualified employer plans would be increased for Hurricane Katrina victims by doubling the thresholds to the lesser of \$100,000 or 100% of the individual's account balance. Payments due from Katrina victims on qualified plan loans on or after August 25, 2005, and before January 1, 2007, could be deferred, and twelve months could be added to the maximum repayment period of affected loans.

3. Special Rule for Determining Earned Income: Hurricane Katrina has displaced hundreds of thousands of individuals. Under present law, a prolonged change in a family's living situation could affect its eligibility for various tax benefits. The provision gives Treasury authority to ensure taxpayers do not lose deductions, credits or filing status because of dislocations from Hurricane Katrina. The provision also allows low income working families an election to use their 2004 income for the refundable earned income credit and the refundable child tax credit.

4. Casualty Loss Provision: Under present law, non-business casualty losses are deductible by taxpayers who itemize only to the extent they exceed ten percent of adjusted gross income and a one-hundred dollar floor. In some circumstances, taxpayers are permitted to include a current-year casualty loss on an amended prior year return. The provision eliminates the ten percent and one-hundred dollar floor for casualty losses resulting from Hurricane Katrina and incurred in the disaster area, including those claimed on amended returns.

5. Extended Replacement Period for Damaged Property: Present law allows taxpayers not to recognize gain with respect to homes that are damaged or destroyed as a result of a presidentially declared disaster if the taxpayer replaces the property within a four-year period. Business property that is destroyed must be replaced within a two-year period to avoid gain recognition. The provision extends the replacement period to five years property that was damaged or destroyed within the presidentially declared disaster area for Katrina. The extended replacement period applies to principal residences and business property, and the replacement property must be located in the declared disaster area.

Employment

6. Extension of WOTC to Katrina Victims. Under current law, the Work Opportunity Tax Credit allows employers to claim a credit against wages paid to new workers that face barriers to employment. It applies to special groups such as residents of empowerment zones, TANF-eligible families, high-risk youth, veterans, SSI beneficiaries, and voc-rehab referrals. The credit maximum is \$2,400 (40% of first year wages up to \$6,000, or 25% of wages if less than 400 hours worked). The provision establishes an additional category of eligible new workers under the WOTC credit for Hurricane Katrina survivors, provided that the worker lived within the disaster zone.

- Employers outside the disaster area may hire qualifying employees from the disaster area through the end of 2005 (August 28, 2005, to December 31, 2005).

- Employers inside the disaster area may hire qualifying employees from the disaster area for two years (August 28, 2005, to August 28, 2007).

7. Employee Retention Credit for Small Businesses. Current law allows employers to deduct the cost of salaries paid to employees. This provision establishes a 40% tax credit for wages paid up to \$6,000 if paid after August 28, 2005, and before December 31, 2005, by employers located in the disaster zone. The credit only applies while the business is not operating. The

credit is available to small businesses (i.e., having an average of 200 or fewer employees in the taxable year) whose business is inoperable as a result of damage sustained by Hurricane Katrina. The employee's usual and principal place of work must have been in the disaster zone, but the credit is not affected if the employee reports to work at another location. Wages paid to relatives would be ineligible for the credit.

Housing

8. Tax Relief for Housing Assistance: Current law provides a personal exemption for taxpayers, their spouses, and dependents. The provision allows taxpayers who house dislocated persons from Hurricane Katrina for a minimum of sixty days in their principal residences an additional personal exemption of \$500 per dislocated person (maximum \$2,000 deduction). Family members (other than spouses and dependents) staying with the taxpayer may qualify, and the housing must be provided rent-free. This provision would not affect any deductions or exemptions due to the dislocated person on his or her tax return. The deduction can be claimed in 2005 and 2006 but cannot be claimed in both years with respect to the same person.

9. Relax Restrictions on Mortgage Revenue Bonds: Mortgage revenue bonds are tax-exempt bonds that state and local governments generally issue through housing finance agencies. The proceeds from the bonds are used to fund below-market interest rate mortgages for certain first-time homebuyers meeting income and purchase price restrictions. The provision allows greater access to mortgage revenue bond proceeds by lifting the first-time homeowner requirement through 2007 for homes in the area damaged by Katrina. In addition, the provision allows up to \$150,000 of the loan proceeds to be used for hurricane-related repairs to damaged homes.

Charitable Giving and Taxpayer Assistance

10. Encourage Food Donations by Businesses: The provision extends an enhanced deduction for donations of food inventory to all businesses through December 31, 2005. Under present law, a taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis (typically cost) in the inventory. However, for contributions of food inventory, C corporations may claim an enhanced deduction equal to the lesser of (1) basis plus one-half of the item's appreciated value (i.e., basis plus one half of fair market value in excess of basis) or (2) two times basis. The provision extends enhanced deduction for donations of food inventory to non-C corporation businesses.

11. Encourage Book Donations by Businesses: The provision establishes an enhanced deduction for donations of book inventory through December 31, 2005. Under present law, taxpayers may claim an enhanced deduction equal to the lesser of (1) basis plus one-half of the item's appreciated value (i.e., basis plus one half of fair market value in excess of basis) or (2) two times basis for donations of book inventory. The provision extends the enhanced charitable deduction to donations of educational books to public schools.

12. Corporate Charitable Contributions: The amount allowed as a charitable deduction for a corporation in any taxable year may not exceed ten percent of the corporation's taxable income. The provision temporarily waives limits regarding charitable cash contributions for Katrina relief. The provision is effective for contributions before January 1, 2006.

13. Individual Income Limits for Cash Contributions: The provision waives the individual income limits for cash contributions for tax years ending on or before December 31, 2005.

14. Increased Mileage Rate for Calculating Charitable Contribution Mileage Deduction: The mileage rate individuals may use to compute a tax deduction for personal vehicle expenses associated with charitable work is statutory and has not been increased since 1997. For a taxpayer providing relief related to Hurricane Katrina, the provision sets the charitable mileage rate at seventy percent of the standard business mileage rate through 2006.

15. Mileage Reimbursements to Charitable Volunteers Excluded from Gross Income: In general, reimbursements received for operating expenses of a personal vehicle used in connection with charitable work in excess of the statutory charitable mileage rate are taxable income to the recipient. However, reimbursements for charitable mileage attributable to Hurricane Katrina up to the amount of the standard business mileage rate will not be considered taxable income through December 31, 2006.

16. IRS Administrative Relief: The Internal Revenue Code authorizes the Secretary to extend deadlines for up to one year to file tax returns and to make payments and deposits for income, estate and gift taxes. Employment taxes are specifically excluded and excise taxes are not specifically included. The IRS issued a notice for victims of Katrina extending the time period until January 3, 2006, to file any returns, pay any taxes or make any deposits due. Although this is intended to apply to employment and excise taxes, it is unclear that the IRS has the authority to do so. This provision clarifies that the current IRS extension includes employment and excise taxes in addition to income, estate and gift taxes, and extends deadline relief for Katrina through February 28, 2006. Penalties and interest that would otherwise apply are waived. It also gives the Secretary authority to grant relief for employment and excise taxes in future combat and disaster situations.