

TAX SERVICES

KATRINA EMERGENCY TAX RELIEF ACT OF 2005



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THE KATRINA EMERGENCY TAX RELIEF ACT OF 2005 (KETRA) has been enacted to assist victims of Hurricane Katrina. Here are some provisions of the new act. (Note that many of the provisions are restricted to taxpayers living in defined areas. For brevity, we have necessarily omitted various details. Verify that a provision does apply to you before taking action. If you have any questions, contact us.)

FILING DATES - The IRS previously extended the deadline to file any return, pay any taxes, or perform any other time-sensitive acts to January 3, 2006. KETRA extends the deadline for filing returns and paying any tax related to excise, employment, income, estate and gift taxes to February 28, 2006.

BB Recommends: *Don't let February 28th be your deadline - by then, you should already be dealing with your 2005 income tax returns. The IRS will work with any taxpayer who resides elsewhere but whose books, records or tax professional is located in the areas affected by Hurricane Katrina. Thus, taxpayers residing outside the hurricane area, but whose returns are prepared by Bourgeois Bennett, will qualify for relief. Most states are also granting relief to hurricane victims.*

CASUALTY LOSSES - Casualty losses related to personal-use assets are itemized deductions and are generally deductible only to the extent they exceed the sum of \$100 and 10% of the individual's adjusted gross income (AGI). Katrina losses will not have to be reduced by the \$100 and the 10% of AGI.

CASUALTY GAINS - Sometimes taxpayers realize casualty gains when insurance and other proceeds exceed their basis (cost) in the damaged or destroyed asset. Subject to certain requirements, these gains are not taxable if the taxpayer replaces the lost asset with another asset of a like kind or repairs or rebuilds the damaged asset. Taxpayers in Katrina areas will have five years to replace the lost asset to avoid paying tax on any casualty gain, although the substantially all of the use of the replacement asset must be in the disaster area.

BB Recommends: *You can still avoid tax on a casualty gain by replacing the asset with one*

outside the disaster area - you just won't have five years to do so. How long you have depends upon what kind of asset was damaged or destroyed. Check with us for more information.

PENSION PROVISIONS - Many taxpayers will be looking for funds to rebuild or to cover other losses. The new act makes it easier to tap your pension funds for this purpose. Three provisions apply to qualified Katrina distributions from IRAs and certain qualified retirement plans made after August 25, 2005 and before January 1, 2007. First, qualified individuals can withdraw up to \$100,000 without paying the 10% penalty for withdrawals before age 59 1/2. The required 20% tax withholding will not apply to qualified Hurricane Katrina distributions. Second, there will be no income tax on withdrawals if the funds are recontributed to a qualified plan or IRA within three years of the withdrawal. Finally, for amounts that are not recontributed within the three-year period, only one-third will be taxed each year for three years. Note that the taxpayer's principal abode must have been in the Katrina disaster area on August 28, 2005, and the taxpayer must have sustained an economic loss by reason of Hurricane Katrina for the distribution to qualify for these rules.

If you withdrew funds from a plan or IRA after February 28, 2005 to purchase your first home and then couldn't complete the purchase because of Katrina, you can avoid income tax on the withdrawal if you recontribute the funds by February 28, 2006.

Effective for loans made on or after September 23, 2005 and before January 1, 2007, the act increases the maximum amount that can be borrowed from a qualified plan without paying tax to the lesser of (i) \$100,000, or (ii) 100% of the employee's accrued benefit.

CHARITABLE CONTRIBUTIONS - Several special rules have been created for charitable contributions related to Katrina.

Normally, cash donations made by an individual are not deductible to the extent they exceed 50% of the individual's adjusted gross income. Cash donations made after August 27, 2005 and before January 1, 2006 will not be subject to this limitation. In addition, such contributions are not part

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JANUARY 2006

KATRINA EMERGENCY TAX RELIEF ACT (CONT'D)

**MANY OF
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of the phase-out of itemized deductions as your income exceeds certain amounts. However, an individual's total donations are still limited to 100% of AGI.

Similarly, regular "C" corporation cash donations during this period will not be subject to the 10% of taxable income limit. However, in the case of C corporations, only cash donations specifically designated for hurricane relief qualify for the waiver. In addition, a corporation's total donations cannot exceed 100% of taxable income.

A regular corporation can deduct the lesser of (i) two times its basis (cost) or (ii) basis plus one-half the appreciated value when it donates inventory to certain charities. This rule has been extended, subject to one limitation, to donations by Subchapter S corporations, partnerships and sole proprietorships of "apparently wholesome food" (as defined in the Bill Emerson Good Samaritan Food Donation Act) effective for donations made after August 27, 2005 and before January 1, 2006. In addition, the special rule has been extended to the donation by regular C corporations of qualifying books to public schools during the same period.

The standard mileage rate for charitable driving related to hurricane relief during the period from August 29, 2005 through December 31, 2006 has been increased to 70% of the rate for business driving (the business rate is currently 48.5¢ per mile so the charitable driving deduction rate is 34¢ through December 31, 2005).

BUSINESS PROVISIONS - The Work Opportunity Tax Credit can be claimed for employees who had a principal place of abode in the core disaster area on August 28, 2005 and are hired over the next two years in the core disaster area. Employers outside the disaster area can claim the credit for such displaced employees hired through December 31, 2005.

Employers can claim a tax credit of 40% of the first \$6,000 in wages paid to employees after August 28, 2005 and before January 1, 2006. The wages must have been paid or incurred in the period during which the business was unable to perform significant activities at its principal place of employment as a result of the storm.

BB Recommends: *Thus, a qualifying employer should keep accurate records of the salaries paid or accrued from August 29, 2005 through the earlier of December 31, 2005 or the date the business is able to resume its activities in its principal date of employment.*

MISCELLANEOUS INDIVIDUAL PROVISIONS - Unless certain exceptions apply, you are taxed on the amount of any nonbusiness debt you owe that is discharged (i.e., forgiven). Individuals affected by Katrina will not have to pay tax on such debt forgiveness made on or after August 25, 2005 and before 2007.

Concerned that individuals displaced from their homes may lose valuable tax benefits or a favorable filing status, the act grants the IRS authority to issue

special rules to ensure this does not happen. In addition, such individuals may use their 2004 income to calculate their 2005 child credit and earned income credit.

Finally, individuals providing temporary rent-free housing to displaced Katrina evacuees have not been forgotten. They are allowed a \$500 exemption deduction per displaced person if they provide such housing for at least 60 days. The exemption can be claimed in both 2005 and 2006, but not for the same person, and the total exemption deduction cannot exceed \$2,000.

REMEMBER - As always, we can only provide a general summary of the new provisions. By necessity, we must omit important details. Get more information before acting on any of these changes. Contact Ted Stacey, Director of Tax Services, or your BB professional for more information. And look for more legislation to come.

