

The Katrina Emergency Tax Relief Act of 2005

- In general
- Provisions relating to the use of retirement funds
- Employment relief
- Charitable giving incentives
- Additional tax relief provisions

In general

On September 23, 2005, President Bush signed into law the Katrina Emergency Tax Relief Act of 2005 (HR 3768). The Act provides relief to individuals and businesses impacted by Hurricane Katrina, as well as to individuals and businesses helping in recovery efforts.

Provisions relating to the use of retirement funds

Withdrawals from retirement plans

- A qualified Hurricane Katrina distribution from a qualified retirement plan, a Section 403(b) annuity, a governmental Section 457 plan, or an IRA will not be subject to the additional 10 percent early withdrawal tax.
- Individuals who take a qualified Hurricane Katrina distribution can spread the resulting income ratably over three years.
- 20 percent mandatory withholding does not apply to a qualified Hurricane Katrina distribution.
- Individuals who take a qualified Hurricane Katrina distribution may re-contribute the distribution to an eligible retirement plan within three years. Any amount re-contributed within the three-year period is treated as a rollover, and is not includible in income (individuals may file amended returns to claim a refund of the tax attributable to amounts previously included in income).
- The total amount of qualified Hurricane Katrina distributions that an individual can receive from all plans, annuities, or IRAs is \$100,000.

Qualified Hurricane Katrina distribution—a distribution from an eligible retirement plan made on or after August 25, 2005, and before January 1, 2007, to an individual whose principal place of abode on August 28, 2005 is located in the Hurricane Katrina disaster area, and who has sustained an economic loss by reason of Hurricane Katrina.

Hurricane Katrina disaster area—an area with respect to which a major disaster has been declared by the President before September 14, 2005, under Section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of Hurricane Katrina. The States for which such a disaster has been declared are Alabama, Florida, Louisiana, and Mississippi.

Effective September 23, 2005

Re-contributions of withdrawals for home purchases

- Individuals who took qualified distributions from 401(k) plans, 403(b) annuities, or IRAs, to purchase a home in the Hurricane Katrina disaster area, may re-contribute their distributions.
- Any portion of a qualified distribution may be re-contributed to a plan, annuity or IRA during the period beginning on August 25, 2005 and ending on February 28, 2006.
- Any amount re-contributed is treated as a rollover, and is not includible in income (and also is not subject to the additional 10-percent early withdrawal tax).

Qualified distribution—a hardship distribution from a 401(k) plan or 403(b) annuity, or a qualified first-time homebuyer distribution from an IRA (1) that is received after February 28, 2005 and before August 29, 2005 and (2) that was to be used to purchase or construct a principal residence in the Hurricane Katrina disaster area, but the residence is not purchased or constructed on account of Hurricane Katrina.

Effective September 23, 2005

Loans from qualified plans

- Special qualified employer plan loan rules are established for loans made after September 23, 2005 and before January 1, 2007 to qualified individuals.
- For qualified individuals, the maximum amount of a qualified plan loan is increased to the lesser of (1) \$100,000 subject to certain reductions or (2) the greater of \$10,000 or the participant's accrued benefit under the plan. (Absent this provision, a qualified plan loan generally cannot exceed the lesser of (1) \$50,000 subject to certain reductions or (2) the greater of \$10,000 or 50 percent of a participant's accrued benefit.)
- Qualified individuals with outstanding qualified employer plan loans on or after August 25, 2005 can delay repayments due during the period of August 25, 2005 to December 31, 2006 for one year. Any subsequent repayments with respect to such loan shall be appropriately adjusted to reflect the delay in the due date and any interest accruing during such delay.

Qualified individuals— individuals who on August 28, 2005 had a principal place of abode in the Hurricane Katrina disaster area, and who have sustained economic loss as a result of Hurricane Katrina.

Effective September 23, 2005

Plan amendments

- Plan amendments made pursuant to the changes made by the Act will be effective retroactively. If the plan amendment meets the requirements of the provision, the plan will be treated as being operated in accordance with its terms.
- In order for this treatment to apply, the plan amendment is required to be made on or before the last day of the first plan year beginning on or after January 1, 2007, or such later date as provided by the Secretary of the Treasury.
- Governmental plans are given an additional two years in which to make required plan amendments.

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- If the amendment is required to be made to retain qualified status as a result of the changes made by the Act, the amendment is required to be made retroactively effective as of the date on which the change became effective with respect to the plan, and the plan is required to be operated in compliance until the amendment is made.
- Amendments that are not required to retain qualified status but are made pursuant to the changes made by the Act may be made retroactively effective as of the first day the plan is operated in accordance with the amendment.
- A plan amendment will not be considered to be pursuant to changes made by the Act if it has an effective date before the effective date of the provision under the Act to which it relates.

Effective September 23, 2005

Employment relief

Work Opportunity Tax Credit

- A Hurricane Katrina employee is treated as a member of a targeted group for purposes of the work opportunity tax credit.
- The present-law work opportunity tax credit certification requirement is waived for such individuals. In lieu of the certification requirement, an individual may provide to the employer reasonable evidence that the individual is a Hurricane Katrina employee.
- The present-law rule that denies the credit with respect to an individual who had been previously employed is waived unless the individual was employed by the employer on August 28, 2005.
- The present-law work opportunity tax credit expiration date is waived for purposes of Hurricane Katrina employees.

Hurricane Katrina employee—A Hurricane Katrina employee is (1) an individual who on August 28, 2005 had a principal place of abode in the core disaster area and is hired during the two-year period beginning on such date for a position, the principal place of employment of which is located in the core disaster area and (2) an individual who on August 28, 2005 had a principal place of abode in the core disaster area, who was displaced from such abode by reason of Hurricane Katrina, and is hired during the period beginning on such date and ending on December 31, 2005 without regard to whether the new principal place of employment is in the core disaster area.

Core disaster area—The term “core disaster area” means that portion of the Hurricane Katrina disaster area determined by the President to warrant individual or individual and public assistance from the federal government under such Act.

Effective September 23, 2005

Employee retention credit for employers

- A new tax credit is created equal to 40 percent of the qualified wages (up to a maximum of \$6,000 in qualified wages per employee) paid by an eligible employer to an eligible employee.

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- The credit is a part of the current year business credit under Section 38(b) and therefore is subject to the tax liability limitations of Section 38(c). Rules similar to Sections 280C(a), 51(i)(1) and Section 52 apply to the credit.

Eligible employer—any employer (1) that conducted an active trade or business on August 28, 2005, in the core disaster area, and (2) with respect to which the trade or business described in (1) is inoperable on any day after August 28, 2005 and before January 1, 2006 as a result of damage sustained by reason of Hurricane Katrina. An eligible employer shall not include any trade or business for any taxable year if such trade or business employed an average of more than 200 employees on business days during the taxable year.

Eligible employee—an eligible employee is an employee whose principal place of employment on August 28, 2005 with such eligible employer was in a core disaster area. An employee may not be treated as an eligible employee for any period with respect to an employer if such employer is allowed a credit under Section 51 with respect to the employee for the period.

Qualified wages—wages (as defined in Section 51(c)(1), but without regard to Section 3306(b)(2)(B)) paid or incurred by an eligible employer with respect to an eligible employee on any day after August 28, 2005 and before January 1, 2006 during the period (1) beginning on the date on which the trade or business first became inoperable at the principal place of employment of the employee immediately before Hurricane Katrina, and (2) ending on the date on which such trade or business has resumed significant operations at such principal place of employment. Qualified wages include wages paid without regard to whether the employee performs no services, performs services at a different place of employment than such principal place of employment, or performs services at such principal place of employment before significant operations have resumed.

Effective September 23, 2005

Charitable giving incentives

Temporary suspension of limitations on charitable contributions

- Normal limits on the deduction for charitable contributions will not apply to certain qualified contributions (generally, charitable contributions are limited to a percentage of an individual's contribution base, which is the individual's adjusted gross income computed without regard to any net operating loss carryback). Specifically, in the case of an individual, a deduction for qualified contributions is allowed up to the amount by which the taxpayer's contribution base exceeds the deduction for other charitable contributions.
- Contributions in excess of this amount are carried over to succeeding taxable years and treated as if they were contributions to churches, educational organizations, and other entities, generally allowed to the extent that the contributions do not exceed 50 percent of the individual's contribution base.
- In the case of a corporation, the deduction for qualified contributions is allowed up to the amount by which the corporation's taxable income (as computed under Section 170(b)(2)) exceeds the deduction for other charitable contributions. Contributions in excess of this amount are carried over to succeeding taxable years, subject to the limitations of Section 170(d)(2).
- Charitable contribution deductions up to the amount of qualified contributions paid during the year are not treated as itemized deductions for purposes of the overall limitation on itemized

deductions.

Qualified contributions—cash contributions made during the period beginning on August 28, 2005 and ending on December 31, 2005 to a charitable organization described in Section 170(b)(1)(A) (other than a supporting organization described in Section 509(a)(3)). Contributions of noncash property, such as securities, are not qualified contributions. Under the provision, qualified contributions must be to an organization described in Section 170(b)(1)(A). Thus, contributions to, for example, a charitable remainder trust generally are not qualified contributions unless the charitable remainder interest is paid in cash to an eligible charity during the applicable time period. In the case of a corporation, qualified contributions must be for relief efforts related to Hurricane Katrina. Corporate taxpayers must substantiate that the contribution is made for this purpose. A taxpayer must elect to have the contributions treated as qualified contributions. Qualified contributions do not include contributions for establishment of a new, or maintenance in an existing, segregated fund or account with respect to which the donor (or any person appointed or designated by such donor) has, or reasonably expects to have, advisory privileges with respect to distributions or investments by reason of the donor's status as a donor.

Effective September 23, 2005

Additional personal exemption for housing Hurricane Katrina displaced individuals

- An additional personal exemption of \$500 is allowed for each Hurricane Katrina displaced individual of the taxpayer.
- A taxpayer may claim the additional exemption for no more than four individuals. Thus, the maximum additional exemption amount is \$2,000.
- The exemption with respect to any Hurricane Katrina displaced individual may only be claimed one time for all taxable years.
- The additional exemption is not subject to the income-based phaseouts applicable to personal exemptions, and is allowed as a deduction in computing alternative minimum taxable income.

A Hurricane Katrina displaced individual—a person (1) whose principal place of abode on August 28, 2005 was in the Hurricane Katrina disaster area, (2) who is displaced from such abode, and (3) who is provided housing free of charge in the taxpayer's principal residence for a period of 60 consecutive days which ends in the taxable year in which the exemption is claimed. Additionally, in the case of a person whose principal place of abode on August 28, 2005 was located outside of the core disaster area, in order to qualify as a displaced individual, such person's abode must have been damaged by Hurricane Katrina, or such person must have been evacuated from such abode by reason of Hurricane Katrina. A Hurricane Katrina displaced individual may not be the spouse or dependent of the taxpayer. In order to claim the additional exemption, the taxpayer must provide the taxpayer identification number of the displaced individual. Additionally, the exemption is not allowed if the taxpayer receives any rent or other amount from any source in connection with the providing of housing for a displaced individual.

Effective for taxable years beginning in 2005 and 2006

Increase in standard mileage rate for charitable use of vehicle

- A taxpayer who uses a vehicle in providing donated services to charity solely for the provision of relief related to Hurricane Katrina may compute the charitable mileage

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deduction using a rate (rounded to the next highest cent) equal to 70 percent of the business mileage rate in effect on the date of the contribution, rather than the charitable standard mileage rate generally in effect under Section 170(i) (currently 14 cents per mile).

- For purposes of this provision, the term vehicle includes any vehicle manufactured primarily for use on the public streets, roads, and highways.
- As an alternative to determining the amount of the deduction using the mileage rate, a taxpayer may determine the amount of the deduction using actual out-of-pocket expenditures.
- It is intended that, in addition to the present law substantiation requirements for use of the statutory mileage rate, a taxpayer must substantiate that expenses are incurred in providing relief related to Hurricane Katrina. The present-law statutory rate applies if a taxpayer fails to substantiate that the expenses are incurred for the provision of relief related to Hurricane Katrina, assuming all other present-law requirements are met.

Effective for contributions made during the period beginning on August 25, 2005 and ending on December 31, 2006

Increase in standard mileage rate for charitable use of vehicle

- Reimbursement by an organization described in Section 170(c) (including public charities and private foundations) to a volunteer for the costs of using a passenger automobile in providing donated services to charity solely for the provision of relief related to Hurricane Katrina is excludable from the gross income of the volunteer up to an amount that does not exceed the business standard mileage rate prescribed for business use (as periodically adjusted), provided that recordkeeping requirements applicable to deductible business expenses are satisfied. The provision does not permit a volunteer to claim a deduction or credit with respect to amounts excluded under the provision. Effective for the use of an automobile during the period August 25, 2005 to December 31, 2006.
- Any taxpayer, whether or not a C corporation, engaged in a trade or business is eligible to claim an enhanced deduction for donations of food inventory. For taxpayers other than C corporations, the total deduction for donations of food inventory in a taxable year generally may not exceed 10 percent of the taxpayer's net income for such taxable year from all sole proprietorships, S corporations, or partnerships (or other entity that is not a C corporation) from which contributions of apparently wholesome food are made. Applies to contributions made after August 28, 2005 and before January 1, 2006.
- The present-law enhanced deduction for C corporations is extended to qualified book contributions. A qualified book contribution means a charitable contribution of books to a public school that provides elementary education or secondary education (kindergarten through grade 12), and is an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. Applies to contributions made after August 28, 2005 and before January 1, 2006.

Additional tax relief provisions

Exclusion of certain cancellations of indebtedness by reason of Hurricane Katrina

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- Amounts otherwise includible in gross income by reason of a discharge of nonbusiness debt (in whole or in part) are not includible in the gross income of a qualified individual if the indebtedness is discharged by an applicable entity.
- The discharge of indebtedness relief allowed under this provision does not apply to any indebtedness to the extent that real property constituting security for such indebtedness is located outside the Hurricane Katrina disaster area.
- As under the present-law rules, the amount excluded from gross income under this provision reduces the tax attributes of the taxpayer.

Qualified individual—any natural person if the principal place of abode of such person on August 25, 2005 was located (1) in the core disaster area or (2) in the Hurricane Katrina disaster area, and such person suffered economic loss by reason of Hurricane Katrina.

Applicable entity—The term “applicable entities” (as defined in Section 6050P(c)(1)) includes: (1) any financial institution (as described in Section 581 (relating to banks) or Section 591(a) (relating to savings institutions)), (2) any credit union, (3) any corporation that is a direct or indirect subsidiary of an entity described in (1) or (2) which, by virtue of being affiliated with such entity, is subject to supervision and examination by a federal or state agency regulating such entities, (4) the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, the National Credit Union Administration, certain other federal executive agencies, and any successor or subunit of any of them, (5) an executive, judicial, or legislative agency (as defined in 31 U.S.C. Section 3701(a)(4)), and (6) any other organization a significant trade or business of which is the lending of money.

Effective for discharges made on or after August 25, 2005 and before January 1, 2007

Suspension of limits on personal casualty losses

- Personal casualty or theft losses, to the extent those losses (1) arise in the Hurricane Katrina disaster area on or after August 25, 2005, and (2) are attributable to Hurricane Katrina, are not subject to the general per incident threshold or the general adjusted gross income limitation.
- Personal casualty or theft losses meeting the above requirements need not exceed \$100 per casualty or theft (the general per-incident threshold).
- Such losses are deductible without regard to whether aggregate net losses exceed 10 percent of a taxpayer’s adjusted gross income. For purposes of applying the 10 percent threshold to other personal casualty or theft losses, losses deductible under this provision are disregarded. Thus, the provision has the effect of treating personal casualty or theft losses from Hurricane Katrina as a deduction separate from all other casualty losses.

Effective on or after August 25, 2005

IRS administrative authority

- Employment and excise taxes are added to those items for which the Secretary may suspend filing and payment requirements for taxpayers serving in combat zones or contingency operations, as well as taxpayers affected by Presidentially declared disasters or terrorist or military actions (effective for any period for performing an act which has not expired by August 25, 2005).
- In the case of taxpayers determined to be affected by the Presidentially declared disaster relating to Hurricane Katrina, any administrative relief from required acts, such as filing tax

returns, paying taxes, or filing a claim for credit or refund of tax, shall be for a period ending not earlier than February 28, 2006.

- Any administrative relief provided to taxpayers affected by Hurricane Katrina prior to the date of enactment shall be treated as applying to the filing of returns relating to, and the payment of, employment and excise taxes (effective for any period for performing an act which has not expired by August 25, 2005).

Special rules for mortgage revenue bonds

- The first-time homebuyer requirement is waived for qualified Hurricane Katrina recovery residences, allowing qualified mortgage bonds to be used to finance a mortgage for a homebuyer who had an ownership interest in a principal residence in the preceding three years.
- This applies to residences financed before January 1, 2008.
- The permitted amount of a qualified home-improvement loan is increased from \$15,000 to \$150,000 with respect to residences located in the Hurricane Katrina disaster area to the extent such loan is for the repair of damage caused by Hurricane Katrina.

Qualified Hurricane Katrina recovery residence—(1) any residence located in the core disaster area and (2) any other residence if, on August 28, 2005 the mortgagor of such residence owned a principal residence in the Hurricane Katrina disaster area that was rendered uninhabitable by reason of Hurricane Katrina, and the residence being financed is located in the same state as the prior principal residence.

Effective September 23, 2005

Extension of replacement period for nonrecognition of gain

- In the case of property that is in the Hurricane Katrina disaster area and that is compulsorily or involuntarily converted on or after August 25, 2005 by reason of Hurricane Katrina, the replacement period in which a taxpayer may replace converted property is extended from two to five years.
- Substantially all of the use of the replacement property must be in the Hurricane Katrina disaster area.

Effective September 23, 2005

Earned income credit and refundable child credit

- Qualified individuals may elect to calculate their earned income credit and refundable child credit for the taxable year which includes August 25, 2005 using their earned income from the prior taxable year.
- Qualified individuals are permitted to make the election only if their earned income for the taxable year which includes August 25, 2005 is less than their earned income for the preceding taxable year.
- Any election to use the prior year's earned income under the provision applies with respect to both the earned income credit and refundable child credit.
- An election under this provision is disregarded for purposes of calculating gross income in the election year.

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Qualified individuals—qualified individuals are (1) individuals who on August 25, 2005, had their principal place of abode in the core disaster area or (2) individuals who on such date were not in the core disaster area but lived in the Hurricane Katrina disaster area and were displaced from their homes. For purposes of the provision, in the case of a joint return for a taxable year which includes August 25, 2005, the provision applies if either spouse is a qualified individual. In such cases, the earned income which is attributable to the taxpayer for the preceding taxable year is the sum of the earned income which is attributable to each spouse for such preceding taxable year.

Effective for taxable years that include August 25, 2005

Adjustments to be made regarding taxpayer and dependency status

- The Secretary is authorized to make such adjustments in the application of the federal tax laws as may be necessary to ensure that taxpayers do not lose any deduction or credit or experience a change of filing status by reason of temporary relocations caused by Hurricane Katrina.
- Such adjustments may include, for example, addressing the application of the residency requirements relating to dependency exemptions in the case of relocations due to Hurricane Katrina.
- Any adjustments made under this provision must insure that an individual is not taken into account by more than one taxpayer with respect to the same tax benefit.

Effective for taxable years beginning in 2005 or 2006

DISCLOSURE INFORMATION – IMPORTANT – PLEASE REVIEW

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