INTERNAL REVENUE SERVICE

IRS Fact Sheet

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Tax Law Changes Related to Hurricanes Katrina, Rita and Wilma

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The Gulf Opportunity Zone Act of 2005, in general, expands the provisions of the Katrina Emergency Tax Relief Act of 2005 to those affected by Hurricanes Rita and Wilma as well as Katrina. These two new laws provide certain tax breaks to help victims of the storms. The new laws alter the tax code to help individuals who suffered losses as a result of the hurricanes and to make it easier for individuals and companies to engage in charity to benefit those affected by the hurricanes.

The Internal Revenue Service will provide a full explanation of the new laws in Publication 4492, Information for Taxpayers Affected by Hurricanes Katrina, Rita and Wilma, which will be available on IRS.gov by February 2006.

The terms Gulf Opportunity Zone (GO Zone), Rita GO Zone, Wilma GO Zone, Hurricane Katrina Disaster Area, Hurricane Rita Disaster Area and Hurricane Wilma Disaster Area are defined at the end of this fact sheet. In total, five states – Alabama, Florida, Louisiana, Mississippi, and Texas are affected.

INDIVIDUALS AFFECTED BY HURRICANES KATRINA, RITA AND WILMA

In general, for individuals affected by Hurricanes Katrina, Rita and Wilma, recent legislation provides tax-favored early distributions and loans from retirement accounts, eliminates the limitations on claiming losses, and permits certain earned income tax credit (EITC) and refundable child tax credit recipients to choose either tax year 2005 or 2004 to determine their earned income and use the more beneficial result.

The Katrina Emergency Tax Relief Act of 2005 allows affected individuals to exclude from income certain cancellations of debt and extends, from two years to five years, the replacement period for converted properties.

The Gulf Opportunity Zone Act provides educational assistance by expanding the Hope and Lifetime Learning credits for students enrolled and paying tuition at eligible educational institutions in the GO Zone for tax years beginning in 2005 or 2006. Basically, it expands the educational credits in the following way:

- The Hope Credit is expanded from a maximum of $1,000 per student to 100 percent of the first $2,000 in eligible expenses plus 50 percent of the next $2,000 – for a maximum of $3,000.
- The Lifetime Learning Credit is expanded from 20 percent to 40 percent.

Removal of Loss Limitations

For taxpayers who suffered casualty or theft losses to property owned for personal use which are attributable to Hurricanes Katrina, Rita and Wilma, a recent change to the tax law removes certain loss limitations.

Ordinarily, to figure a deduction for a casualty or theft loss of personal-use property from a particular disaster, taxpayers must reduce the loss by $100 and also reduce their total casualty and theft losses by 10 percent of their adjusted gross income. Only the excess over these $100 and 10 percent limits is deductible. Recent legislation, however, removes these limits for Hurricanes Katrina, Rita and Wilma on losses of personal-use property, so that the entire amount of unreimbursed losses is deductible.

To qualify, a loss must arise in the Hurricane Katrina disaster area after August 24, 2005 and must be attributable to Hurricane Katrina, or arise in the Hurricane Rita disaster area after September 22, 2005 and must be attributable to Hurricane Rita, or arise in the Hurricane Wilma disaster area after Oct. 22, 2005 and must be attributable to Hurricane Wilma.

Cancellation of Debt

Individuals living in the Hurricane Katrina Disaster Area on August 25, 2005, will not include in income a non-business debt that is cancelled, provided that the debt is not secured by property outside the Hurricane Katrina Disaster Area. Usually, the cancellation of debt is treated as income by the person for whom the debt is forgiven.

Earned Income Tax Credit and Refundable Child Tax Credit

Eligible individuals may choose to calculate their earned income tax credit (EITC) or refundable child tax credit using their earned income from the prior tax year. An eligible individual is the following:

- One whose main home on August 25, 2005, was in the GO Zone or who was displaced from the home they lived in on August 25 in the Hurricane Katrina Disaster Area; or
- One whose taxable year included Sept. 23 and whose main home on Sept. 23 was in the Rita GO Zone or who was displaced from the home they lived in on Sept. 23 in the Hurricane Rita disaster area; or
- One whose taxable year included Oct. 23 and whose main home on Oct. 23 was in the Wilma GO Zone or who was displaced from their home in the Hurricane Wilma disaster area.

They may choose to use their prior year’s earned income in calculating the EITC and the refundable child tax credit if their 2004 earned income was higher than their 2005 earned income. Taxpayers eligible to make the choice should figure their EITC and refundable child tax credit using their earned income for each year before making the choice to see which gives them the higher credits.

Retirement Funds

To help victims of Hurricane Katrina, Rita and Wilma, the new law provides certain tax-favored treatment for early distributions, plan loans and recontributions.

Early Distributions from Retirement Plans

To qualify for tax-favored treatment, the distribution must be made on or after Aug. 25, 2005, and before Jan. 1, 2007, from an eligible retirement plan such as a qualified plan or an IRA, to an **eligible individual** –

- one whose main home was in the Hurricane Katrina disaster area on Aug. 28, 2005, and who sustained an economic loss from Hurricane Katrina;
- or for a distribution made on or after Sept. 23 and before Jan. 1, 2007, to an eligible individual whose main home was located in the Hurricane Rita disaster area on Sept 23, 2005 and who sustained an economic loss from Hurricane Rita;
- or for a distribution made on or after Oct.23, 2005 and before Jan. 1, 2007, to an eligible individual whose main home was located in the Hurricane Wilma disaster area on Oct. 23, 2005 and who sustained an economic loss from Hurricane Wilma.

The total amount of tax-favored distributions an individual can receive from all plans, annuities or IRAs is $100,000.

An individual who receives these qualified retirement distributions does not have to pay the 10-percent additional tax on early distributions. The distributions generally are included in income, ratably over a three-year period. However, if the individual recontributes a qualified distribution that is eligible for tax-free rollover treatment into an eligible retirement plan within three years, the distribution will be treated as though it were paid in a direct rollover.

For example, if an individual receives a qualified Hurricane Katrina distribution in 2005, that amount is includible in income, generally ratably over the year of the distribution and the following two years, but is not subject to the 10-percent additional tax on early distributions. If, in 2007, the amount of the qualified Hurricane Katrina distribution is recontributed to an eligible retirement plan, the individual may file an amended return (or returns) to claim a refund of the tax attributable to the amount of the distribution previously included in income.

Under the new law, qualified distributions are not subject to the mandatory 20-percent withholding.

Retirement Plan Loans

For an eligible individual, defined above, with an outstanding loan on or after Aug. 25, Sept. 23 or Oct. 23, as applicable, from a qualified employer plan, if the due date for any repayment on the loan occurs during the period beginning on Aug. 25, Sept 23, or Oct. 23, 2005, and ending on December 31, 2006, the due date shall be delayed for one year. Any payments after the suspension period will be appropriately adjusted to reflect the delay and any interest accruing during the delay.

Under the new law, the allowable loan amount for eligible individuals is increased from $50,000 to $100,000. To figure the dollar limit, an individual would start with (a) $100,000 and subtract the highest outstanding balance of loans from these plans during the prior year and compare that figure to (b) the individual's vested benefit under the plan. Whichever figure is less is the limit that the individual can borrow from the employer's plans without a tax consequence.

Recontributions to Retirement Plans

- In the case of Hurricane Katrina, a qualified individual who, after Feb. 28, 2005, and before Aug 29, 2005; took a distribution, such as a hardship distribution from a 401(k) plan or 403(b) annuity or a qualified first-time homebuyer distribution from an IRA, to purchase or construct a home in the Hurricane Katrina disaster area, but it was not purchased or constructed as a result of Hurricane Katrina, could recontribute the funds to an eligible retirement plan. Any amount recontributed is treated as having been paid in a direct rollover. To qualify for this treatment, the individual must recontribute the funds during the period beginning on Aug. 25, 2005 and ending on Feb. 28, 2006.

- In the case of Hurricane Rita, a qualified individual who after Feb. 28, 2005 and before Sept. 24, 2005, took a distribution, such as a hardship distribution from a 401(k) plan or 403(b) annuity or a qualified first-time homebuyer distribution from an IRA, to purchase or construct a home in the Hurricane Rita disaster area, but it was not purchased or constructed as a result of Hurricane Rita, could recontribute the funds to an eligible retirement plan. Any amount recontributed is treated as having been paid in a direct rollover. To qualify for this treatment, the individual must recontribute the funds during the period beginning on Sept 23, 2005 and ending on Feb. 28, 2006.

- In the case of Hurricane Wilma, a qualified individual, who after Feb. 28, 2005 and before Oct 24, 2005, took a distribution, such as a hardship distribution from a 401(k) plan or 403(b) annuity or a qualified first-time homebuyer distribution from an IRA, to purchase or construct a home in the Hurricane Wilma disaster area, but it was not purchased or constructed as a result of Hurricane Wilma, could recontribute the funds to an eligible retirement plan. Any amount recontributed is treated as having been paid in a direct rollover. To qualify for this treatment, the individual must recontribute the funds during the period beginning on Oct. 23, 2005 and ending on Feb. 28, 2006.

For example, on Aug. 28, 2005, a taxpayer received a qualified first-time homebuyer distribution from an IRA. The taxpayer is scheduled to close on the sale of a home that happens to be located in the Hurricane Katrina disaster area, and the home is destroyed by the storm. The taxpayer has until Feb. 28, 2006 to recontribute the funds to an eligible retirement plan.

The IRS issued on Nov. 30, 2005, Notice 2005-92, which provides guidance on the tax-favored treatment of distributions and plan loans as they apply to victims of Hurricane Katrina. The agency is drafting Form 8915, which taxpayers will use to report distributions, determine the amount included in income, and report any recontributions made during the taxable year.

CHARITY ENCOURAGED BY NEW LAW

To encourage charity, the new law suspends the limits on certain charitable contributions, creates an exemption for those housing Hurricane Katrina displaced individuals, increases the standard mileage rate for charitable use of vehicles and excludes from gross income mileage reimbursements to charitable volunteers.

Suspension of Charitable Limits for Certain Charitable Contributions

Under the provision, in the case of an individual, the deduction for qualified contributions is allowed up to the amount by which the taxpayer's contribution base – adjusted gross income – exceeds the deduction for other charitable contributions. Contributions in excess of this amount are generally carried over to succeeding taxable years.

In the case of a corporation, qualified contributions must be for relief efforts related to Hurricane Katrina, Rita or Wilma.

Qualified contributions are 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 non-cash property, such as securities, are not qualified contributions.

The charitable contribution deduction up to the amount of qualified contributions (as defined above) paid during the year is not treated as an itemized deduction for purposes of the overall limitation on itemized deductions.

Exemption for Those Housing Hurricane Katrina Displaced Individuals

The new law provides an additional exemption of $500 in taxable years 2005 and 2006 for each Hurricane Katrina displaced individual claimed by the taxpayer. The total additional exemption claimed for all years cannot exceed: $2,000 for married taxpayers filing jointly, $1,000 for married taxpayers filing separately, and $2,000 for all other taxpayers.

The exemption with respect to a specific Hurricane Katrina displaced individual may only be claimed one time by the same taxpayer for all taxable years. Additionally, if more than one taxpayer lives in the main home, only one of the taxpayers may claim the additional exemption. If more than one taxpayer from the main home claims an exemption for the same Hurricane Katrina displaced individual, the taxpayer with the highest adjusted gross income will be entitled to the exemption. In order to be eligible to claim the exemption, a taxpayer must have a legal interest in the main home where the displaced individual is housed.

A Hurricane Katrina displaced individual is a person (1) whose main home on Aug. 28, 2005 was in the Hurricane Katrina disaster area, (2) who is displaced from the home, and (3) who is provided housing free of charge in the taxpayer's main home 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 home on Aug. 28, 2005 was located in the

Hurricane Katrina disaster area but outside of the GO Zone, the person's home must have been damaged by Hurricane Katrina or the person must have been evacuated by reason of Hurricane Katrina in order to qualify as a displaced individual. A Hurricane Katrina displaced individual may not be the spouse or any dependent of the taxpayer claiming the exemption.

In order to claim the additional exemption, the taxpayer must provide the taxpayer identification number of the displaced individual. 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.

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.

Increase in the Standard Mileage Rate for Charitable Use of Vehicles

The new law allows a taxpayer who uses a vehicle in providing donated services to a charity solely to provide relief related to Hurricane Katrina to use a new mileage deduction. The rate is 70 percent of the standard mileage rate for business rounded up to the next cent. It also allows a taxpayer to exclude from income an amount computed at the business standard mileage rate received from a charity as reimbursement for the cost of operating an automobile for the provision of relief related to Hurricane Katrina.

For the period Aug. 25 to Aug. 31, 2005, the rate for miles driven for charities providing Hurricane Katrina relief is 29 cents, for deduction purposes, and 40.5 cents, for reimbursement purposes.

For the months of September through December 2005, the special Katrina-related rates are 34 cents for deductions and 48.5 cents for reimbursements.

For 2006, these Katrina-related charitable rates are 32 cents per mile for deduction purposes and 44.5 cents per mile for reimbursement purposes.

Definitions:

- **Gulf Opportunity Zone (GO Zone)** includes: **Alabama**, the following counties: Baldwin, Chocktaw, Clarke, Greene, Hale, Marengo, Mobile, Pickens, Sumter, Tuscaloosa, and Washington Counties; **Louisiana**, the following parishes: Acadia, Ascension, Assumption, Calcasieu, Cameron, East Baton Rouge, East Feliciana, Iberia, Iberville, Jefferson, Jefferson Davis, Lafayette, Lafourche, Livingston, Orleans, Pointe Coupee, Plaquemines, St. Bernard, St. Charles, St. Helena, St. James, St. John the Baptist, St. Mary, St. Martin, St. Tammany, Tangipahoa, Terrebonne, Vermilion, Washington, West Baton Rouge and West Feliciana, and **Mississippi**, the following counties: Adams, Amite, Attala, Claiborne, Choctaw, Clarke, Copiah, Covington, Forrest, Franklin, George, Greene, Hancock, Harrison, Hinds, Holmes, Humphreys, Jackson, Jasper, Jefferson, Jefferson Davis, Jones, Kemper, Lamar, Lauderdale, Lawrence, Leake, Lincoln, Lowndes, Madison, Marion, Neshoba, Newton, Noxubee, Oktibbeha, Pearl River, Perry, Pike, Rankin, Scott, Simpson, Smith, Stone, Walthall, Warren, Wayne, Wilkinson, Winston and Yazoo.

- **Hurricane Katrina Disaster Area**: Alabama, Florida, Louisiana and Mississippi.

- **Rita GO Zone: Louisiana**, parishes of Acadia, Allen, Ascension, Cameron, Calcasieu, Beauregard, Evangeline, Iberia, Jefferson, Jefferson Davies, Lafayette, Lafourche, Livingston, Plaquemines, Sabine, St. Landry, St. Martin, St. Mary, St. Tammany, Terrebonne, Vermilion, Vernon and West Baton Rouge; and **Texas** counties of Angelina, Brazoria, Chambers, Fort Bend, Galveston, Hardin, Harris, Jasper, Jefferson, Liberty, Montgomery, Nacogdoches, Newton, Orange, Polk, Sabine, San Augustine, San Jacinto, Shelby, Trinity, Tyler and Walker.

- **Hurricane Rita Disaster Area:** Texas and Louisiana.

- **Wilma GO Zone:** Florida counties: Brevard, Broward, Collier, Glades, Hendry, Indian River, Lee, Martin, Miami-Dade, Monroe, Okeechobee, Palm Beach and St. Lucie.

- **Hurricane Wilma Disaster Area:** Florida

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