TECHNICAL EXPLANATION OF H.R. 3768, "THE HURRICANE KATRINA TAX RELIEF ACT OF 2005" AS AMENDED BY THE SENATE ON SEPTEMBER 15, 2005

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INTRODUCTION

This document, prepared by the staff of the Joint Committee on Taxation, provides a Technical Explanation of H.R. 3768, the Hurricane Katrina Tax Relief Act of 2005 as amended by the Senate on September 15, 2005.

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TITLE I − PENALTY-FREE USE OF RETIREMENT FUNDS IN THE CASE OF HURRICANE KATRINA

A. Penalty-Free Withdrawals from Retirement Plans for Taxpayers Affected by Hurricane Katrina (sec. 101 of the bill and secs. 72(t), 401(k), 402(c), and 403(b) of the Code)

Present Law

Under present law, a distribution from a qualified retirement plan, a tax-sheltered annuity (a "403(b) annuity"), an eligible deferred compensation plan maintained by a State or local government (a "governmental 457 plan"), or an individual retirement arrangement (an "IRA") generally is included in income for the year distributed. In addition, a distribution from a qualified retirement plan, a 403(b) annuity, or an IRA received before age 59-½, death, or disability generally is subject to a 10-percent early withdrawal tax on the amount includible in income, unless an exception applies.

An eligible rollover distribution from a qualified retirement plan, a 403(b) annuity, or a governmental 457 plan, or a distribution from an IRA, generally can be rolled over within 60 days to another plan, annuity, or IRA. The IRS has the authority to waive the 60-day requirement if failure to waive the requirement would be against equity or good conscience, including cases of casualty, disaster, or other events beyond the reasonable control of the individual. Any amount rolled over is not includible in income (and thus also not subject to the 10-percent early withdrawal tax).

Distributions from a qualified retirement plan, 403(b) annuity, a governmental 457 plan, or an IRA are generally subject to income tax withholding unless the recipient elects otherwise. An eligible rollover distribution from a qualified retirement plan, 403(b) annuity, or governmental 457 plan is subject to income tax withholding at a 20-percent rate unless the distribution is rolled over to another plan, annuity or IRA by means of a direct transfer.

Certain amounts held in a qualified retirement plan that includes a qualified cash-or-deferred arrangement (a "401(k) plan") or in a 403(b) annuity may not be distributed before severance from employment, age 59-½, death, disability, or financial hardship of the employee. Amounts deferred under a governmental 457 plan may not be distributed before severance from employment, age 70-½, or an unforeseeable emergency of the employee.

Explanation of Provision

The provision provides an exception to the 10-percent early withdrawal tax in the case of a qualified disaster-relief distribution from a qualified retirement plan, a 403(b) annuity or an IRA. A qualified disaster-relief distribution is any distribution made: (1) to an individual who has sustained a loss as a result of a major disaster declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (the "Stafford Act") and who, immediately before the disaster declaration, has a principal place of abode in a qualified disaster area; and (2) during the one-year period beginning on the date of the disaster declaration. A qualified disaster area is an area: (1) with respect to which a major disaster has been declared by the President under section 401 of the Stafford Act before September 14, 2005, in connection

with Hurricane Katrina; and (2) which is determined by the President before such date to warrant assistance from the Federal Government under the Stafford Act. (This definition is the same as the definition of "Hurricane Katrina disaster area," which applies for purposes of the other provisions of the bill relating to retirement plans.) The total amount of qualified disaster-relief distributions that an individual can receive from all plans, annuities, or IRAs with respect to a disaster is the $100,000. The $100,000 limit applies to all distributions within the applicable one-year period, regardless of whether they are received in different taxable years. Thus, any distributions in excess of $100,000 during the applicable one-year period are not qualified disaster-relief distributions.

In addition, under the provision, any portion of a qualified disaster-relief distribution from a qualified retirement plan, a 403(b) annuity, a governmental 457 plan, or an IRA may, during the three-year period beginning the day after the date of the disaster declaration, be recontributed to a plan, annuity or IRA to which a rollover can be made. Any amount withdrawn pursuant to the provision is includible in gross income, except to the extent of recontributions, which are treated as a rollover. For example, if an individual receives a qualified disaster-relief distribution from a qualified retirement plan in 2005, that amount is included in income, but not subject to the 10-percent early withdrawal tax. (Under another provision of the bill, the amount required to be included in income may be spread over three years.) If the amount of the distribution is recontributed in 2007 to a qualified retirement plan, 403(b) annuity, governmental 457 plan, or IRA, the individual may file an amended return to claim a refund of the tax attributable to the amount previously included in income.

A qualified disaster-relief distribution is a permissible distribution from a 401(k) plan, 403(b) annuity, or governmental 457 plan, regardless of whether a distribution would otherwise be permissible. A plan is not treated as violating any Code requirement merely because it treats a distribution as a qualified disaster-relied distribution, provided that the aggregate amount of such distributions maintained by the employer and members of the employer's controlled group does not exceed $100,000. Thus, a plan is not treated as violating any Code requirement merely because an individual might receive total distributions in excess of $100,000, taking into account distributions from plans of other employers or IRAs.

Under the provision, qualified disaster-relief distributions are subject to the income tax withholding rules applicable to distributions other than eligible rollover distributions. Thus, 20-percent mandatory withholding does not apply.

Effective Date

The provision is effective for distributions received after August 28, 2005.

B. Income Averaging for Disaster-Relief Distributions Related to Hurricane Katrina (sec. 102 of the bill)

Present Law

Under present law, a distribution from a qualified retirement plan, a tax-sheltered annuity (a "403(b) annuity"), an eligible deferred compensation plan maintained by a State or local government (a "governmental 457 plan"), or an individual retirement arrangement (an "IRA") is generally included in income for the year distributed (secs. 402(a), 403(b), 408(d), 457(a)).

Explanation of Provision

Under the provision, an amount required to be included in income by a qualified individual as a result of a qualified disaster-relief distribution from a qualified retirement plan, a 403(b) annuity, a governmental 457 plan, or an IRA is included in income ratably over the three-year period beginning with the year of distribution unless the individual elects not to have the provision apply. A qualified disaster-relief distribution is defined as under the provision relating to penalty-free withdrawals by taxpayers affected by Hurricane Katrina and includes a distribution made to a qualified individual during the one-year period beginning on the date of the disaster declaration, subject to a limit of $100,000.

For this purpose, a qualified individual is an individual who has sustained a loss as a result of the major disaster declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (the "Stafford Act") in connection with Hurricane Katrina and who, immediately before the disaster declaration, has a principal place of abode in a Hurricane Katrina disaster area. A Hurricane Katrina disaster area is an area: (1) with respect to which a major disaster has been declared by the President under the Stafford Act before September 14, 2005, in connection with Hurricane Katrina; and (2) which is determined by the President before September 14, 2005, to warrant assistance from the Federal Government under the Stafford Act.

Certain rules apply for purposes of the provision. For example, the amount required to be included in income for any taxable year in the three-year period cannot exceed the total amount to be included in income with respect to the qualified disaster-relief distribution, reduced by amounts included in income for preceding years in the period.

Under the provision relating to penalty-free withdrawals, an individual who receives a qualified disaster-relief distribution may recontribute the amount of the distribution to a qualified retirement plan, a 403(b) annuity, a governmental 457 plan, or an IRA, and the recontribution is treated as a tax-free rollover. If such a recontribution is made before the full amount of the distribution has been included in income under this provision, any remaining amount is reduced by the amount of the recontribution.

Effective Date

The provision is effective on the date of enactment.

C. Recontributions of Withdrawals for Home Purchases Cancelled Due to Hurricane Katrina (sec. 103 of the bill)

Present Law

Under present law, a distribution from a qualified retirement plan, a tax-sheltered annuity (a "403(b) annuity"), or an individual retirement arrangement (an "IRA") generally is included in income for the year distributed (secs. 402(a), 403(b), and 408(d)). In addition, a distribution from a qualified retirement plan, a 403(b) annuity, or an IRA received before age 59-½, death, or disability generally is subject to a 10-percent early withdrawal tax on the amount includible in income, unless an exception applies (sec. 72(t)). An exception to the 10-percent tax applies in the case of a qualified first-time homebuyer distribution from an IRA, i.e., a distribution (not to exceed $10,000) used within 120 days for the purchase or construction of a principal residence of a first-time homebuyer.

An eligible rollover distribution from a qualified retirement plan or a 403(b) annuity or a distribution from an IRA generally can be rolled over within 60 days to another plan, annuity, or IRA. The IRS has the authority to waive the 60-day requirement if failure to waive the requirement would be against equity or good conscience, including cases of casualty, disaster, or other events beyond the reasonable control of the individual. Any amount rolled over is not includible in income (and thus also not subject to the 10-percent early withdrawal tax).

Certain amounts held in a qualified retirement plan that includes a qualified cash-or-deferred arrangement (a "401(k) plan") or a 403(b) annuity may not be distributed before severance from employment, age 59-½, death, disability, or financial hardship of the employee. For this purpose, subject to certain conditions, distributions for costs directly related to the purchase of a principal residence by an employee (excluding mortgage payments) are deemed to be distributions on account of financial hardship.

Explanation of Provision

In general, under the provision, a distribution received from a 401(k) plan, 403(b) annuity, or IRA in order to purchase a home in an area declared a disaster area in connection with Hurricane Katrina may be recontributed to such a plan, annuity, or IRA in certain circumstances.

The provision applies to an individual who receives a qualified distribution. A qualified distribution is 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 a Hurricane Katrina disaster area, but which is not used to purchase or construct the residence. A Hurricane Katrina disaster area is an area: (1) with respect to which a major disaster has been declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act before September 14, 2005, in connection with Hurricane Katrina; and (2) which is determined by the President before September 14, 2005, to warrant assistance from the Federal Government under the Stafford Act.

Under the provision, any portion of a qualified distribution may, within the six-month period beginning the day after the date of the disaster declaration, be recontributed to a plan, annuity or IRA to which a rollover is permitted. Any amount recontributed is treated as a rollover. Thus, that portion of the qualified distribution is not includible in income (and also is not subject to the 10-percent early withdrawal tax).

Effective Date

The provision is effective on the date of enactment.

D. Loans from Qualified Plans for Victims of Hurricane Katrina (sec. 104 of the bill)

Present Law

An individual is permitted to borrow from a qualified plan in which the individual participates (and to use his or her accrued benefit as security for the loan) provided the loan bears a reasonable rate of interest, is adequately secured, provides a reasonable repayment schedule, and is not made available on a basis that discriminates in favor of employees who are officers, shareholders, or highly compensated.

Subject to certain exceptions, a loan from a qualified employer plan to a plan participant is treated as a taxable distribution of plan benefits. A qualified employer plan includes a qualified retirement plan under section 401(a), a tax-deferred annuity under section 403(a) or section 403(b), and any plan that was (or was determined to be) a qualified employer plan or a governmental plan.

An exception to this general rule of income inclusion is provided to the extent that the loan (when added to the outstanding balance of all other loans to the participant from all plans maintained by the employer) does not exceed the lesser of (1) $50,000 reduced by the excess of the highest outstanding balance of loans from such plans during the one-year period ending on the day before the date the loan is made over the outstanding balance of loans from the plan on the date the loan is made or (2) the greater of $10,000 or one half of the participant's accrued benefit under the plan. This exception applies only if the loan is required, by its terms, to be repaid within five years. An extended repayment period is permitted for the purchase of the principal residence of the participant. Plan loan repayments (principal and interest) must be amortized in level payments and made not less frequently than quarterly, over the term of the loan.

Description of Proposal

The proposal provides special rules that in the case of a loan from a qualified employer plan to a qualified individual made after the date of enactment and before the date which is one year after the disaster declaration date. A qualified individual is an individual who has sustained a loss as a result of the major disaster declared under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act in connection with Hurricane Katrina and who has a principal place of abode immediately before the declaration in a Hurricane Katrina disaster area (as previously defined). The disaster declaration date is the date on which the President designated the area as a Hurricane Katrina disaster area.

Under the proposal, the exception to the general rule of income inclusion is provided to the extent that the loan (when added to the outstanding balance of all other loans to the participant from all plans maintained by the employer) does not exceed the lesser of (1) $100,000 reduced by the excess of the highest outstanding balance of loans from such plans during the one-year period ending on the day before the date the loan is made over the outstanding balance of loans from the plan on the date the loan is made or (2) the greater of $10,000 or the participant's accrued benefit under the plan.

Under the proposal, in the case of a qualified individual with an outstanding loan on or after August 26, 2005, from a qualified employer plan, if the due date for any repayment with respect to such loan occurs during the period beginning after August 29, 2005, and ending before August 30, 2006, such due date is delayed 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. The period during which required repayment is delayed is disregarded in complying with the requirements that the loan be repaid within five years and that level amortization payments be made.

Effective Date

The proposal is effective on the date of enactment.

E. Provisions Relating to Plan Amendments (sec. 105 of the bill)

Present Law

Present law provides a remedial amendment period during which, under certain circumstances, a plan may be amended retroactively in order to comply with the qualification requirements (sec. 401(b)). In general, plan amendments to reflect changes in the law generally must be made by the time prescribed by law for filing the income tax return of the employer for the employer's taxable year in which the change in law occurs. The Secretary of the Treasury may extend the time by which plan amendments need to be made.

Explanation of Provision

The provision permits certain plan amendments made pursuant to the changes made by the provisions of Title I of the bill, or regulations issued thereunder, to be retroactively effective. If the plan amendment meets the requirements of the provision, then 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. If the amendment is required to be made to retain qualified status as a result of the changes made by Title I of the bill (or regulations), 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 that are made pursuant to the changes made by Title I of the bill (or regulations) 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 Title I of the bill (or regulations) if it has an effective date before the effective date of the provision under the bill (or regulations) to which it relates.

Effective Date

The provision is effective on the date of enactment.

TITLE II – EMPLOYMENT RELIEF

A. Work Opportunity Tax Credit for Hurricane Katrina Employee Survivors (sec. 201 of the bill)

Present Law

Targeted groups eligible for the credit

The work opportunity tax credit is available on an elective basis for employers hiring individuals from one or more of eight targeted groups. The eight targeted groups are: (1) certain families eligible to receive benefits under the Temporary Assistance for Needy Families Program; (2) high-risk youth; (3) qualified ex-felons; (4) vocational rehabilitation referrals; (5) qualified summer youth employees; (6) qualified veterans; (7) families receiving food stamps; and (8) persons receiving certain Supplemental Security Income ("SSI") benefits.

A qualified ex-felon is an individual certified as: (1) having been convicted of a felony under State or Federal law; (2) being a member of an economically disadvantaged family; and (3) having a hiring date within one year of release from prison or conviction.

Qualified wages

Generally, qualified wages are defined as cash wages paid by the employer to a member of a targeted group. The employer's deduction for wages is reduced by the amount of the credit.

Calculation of the credit

The credit equals 40 percent (25 percent for employment of 400 hours or less) of qualified first-year wages. Generally, qualified first-year wages are qualified wages (not in excess of $6,000) attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $2,400 (40 percent of the first $6,000 of qualified first-year wages). With respect to qualified summer youth employees, the maximum credit is $1,200 (40 percent of the first $3,000 of qualified first-year wages).

Minimum employment period

No credit is allowed for qualified wages paid to employees who work less than 120 hours in the first year of employment.

Qualifying rehires

No credit is available for any individual if, prior to the hiring date of such individual, such individual had been employed by the employer at any time.

Coordination of the work opportunity tax credit and the welfare-to-work tax credit

An employer cannot claim the work opportunity tax credit with respect to wages of any employee for which the employer claims the welfare-to-work tax credit.

Other rules

The work opportunity tax credit is not allowed for wages paid to a relative or dependent of the taxpayer. Similarly, wages paid to replacement workers during a strike or lockout are not eligible for the work opportunity tax credit. Wages paid to any employee during any period for which the employer received on-the-job training program payments with respect to that employee are not eligible for the work opportunity tax credit. In addition, many other technical rules apply.

Expiration date

The work opportunity tax credit is effective for wages paid or incurred to a qualified individual who begins work for an employer before January 1, 2006.

Explanation of Provision

The provision provides that a Hurricane Katrina employee survivor is treated as a member of a targeted group for purposes of the work opportunity tax credit. A Hurricane Katrina employee survivor is an individual who is certified as an individual who: (1) on August 28, 2005, had a principal place of abode in the Hurricane Katrina disaster area; and (2) became unemployed as a result of Hurricane Katrina. The certification of a Hurricane Katrina employee survivor shall be made in such manner and at such time as determined by the Secretary of the Treasury, except that the certification shall be made by a person other than such employee survivor or the employer.

The provision shall only apply to wages (within the meaning of section 51(c) of the Code) paid or incurred to any individual who: (1) begins work for the employer during the six months period beginning on August 29, 2005, or (2) in the case of an individual who is being hired for a position, the principal place of employment of which is located in a Hurricane Katrina disaster area, during the two-year period beginning on such date. The Hurricane Katrina disaster area means the area determined by the President to warrant individual assistance or individual and public assistance from the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of Hurricane Katrina.

The present-law rule that denies the credit with respect to wages of employees who had been previously employed by the employer shall not apply with respect to the first hire of such employee survivor, unless such employee survivor was an employee on August 28, 2005.

The present-law work opportunity tax credit expiration date is waived for purposes of Hurricane Katrina survivor employees.

Effective Date

The provision is effective on the date of enactment.

B. Employee Retention Credit for Employers Affected by Hurricane Katrina (sec. 202 of the bill)

Present Law

There is no employer tax credit for wages paid solely by reason of such wages being paid by employers in connection with a disaster area.

Explanation of Provision

The provision provides a credit of 40% of the qualified wages (up to a maximum of $6000 in qualified wages per employee) paid by an eligible employer to an eligible employee.

An eligible employer is any employer (1) that conducted an active trade or business on August 28, 2005 in a Hurricane Katrina disaster area and (2) with respect to whom 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 in connection with Hurricane Katrina.

A Hurricane Katrina disaster area for the purposes of the employee retention credit is an area (1) with respect to which a major disaster was declared by the President before September 14, 2005, under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act in connection with Hurricane Katrina, and (2) which is determined by the President before such date to warrant individual assistance, or individual and public assistance, from the Federal government under such Act.

An eligible employee is, with respect to an eligible employer, (1) an employee whose principal place of employment on August 28, 2005 with such eligible employer was in a Hurricane Katrina disaster area, or (2) a Ready Reserve-National Guard employee of such eligible employer who is performing qualified active duty and whose principal place of employment immediately before the date on which such employee began performing such qualified active duty was in a Hurricane Katrina disaster area. A Ready Reserve-National Guard employee means an employee who is a member of the Ready Reserve of a reserve component of an Armed Force of the United States as described in sections 10142 and 10101 of title 10, United States Code and who is performing qualified active duty. Qualified active duty includes hospitalization incident to such duty, but excludes duty related to training requirements for the Ready Reserve and required drills and field exercises for the National Guard.

Qualified wages are wages (as defined in section 51(c)(1) of the Code, but without regard to section 3306(b)(2)(B) of the Code) 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.

The credit is a part of the general business credit. Rules similar to section 280C apply to deny a deduction for the amount of the credit.

Effective Date

The provision is effective on the date of enactment.

TITLE III − CHARITABLE GIVING INCENTIVES

A. Temporary Suspension of Limitations on Charitable Contributions (sec. 301 of the bill)

Present Law

In general

In general, an income tax deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization (sec. 170).

Charitable contributions of cash are deductible in the amount contributed. In general, contributions of capital gain property to a qualified charity are deductible at fair market value with certain exceptions. Capital gain property means any capital asset or property used in the taxpayer's trade or business the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Contributions of other appreciated property generally are deductible at the donor's basis in the property. Contributions of depreciated property generally are deductible at the fair market value of the property.

Percentage limitations

Contributions by individuals

For individuals, in any taxable year, the amount deductible as a charitable contribution is limited to a percentage of the taxpayer's contribution base. The applicable percentage of the contribution base varies depending on the type of donee organization and property contributed. The contribution base is defined as the taxpayer's adjusted gross income computed without regard to any net operating loss carryback.

Contributions by an individual taxpayer of property (other than appreciated capital gain property) to a charitable organization described in section 170(b)(1)(A) (e.g., public charities, private foundations other than private non-operating foundations, and certain governmental units) may not exceed 50 percent of the taxpayer's contribution base. Contributions of this type of property to private foundations and certain other organizations generally may be deducted up to 30 percent of the taxpayer's contribution base.

Contributions of appreciated capital gain property to charitable organizations described in section 170(b)(1)(A) generally are deductible up to 30 percent of the taxpayer's contribution base. An individual may elect, however, to bring all these contributions of appreciated capital gain property for a taxable year within the 50-percent limitation category by reducing the amount of the contribution deduction by the amount of the appreciation in the capital gain property. Contributions of appreciated capital gain property to charitable organizations described in section 170(b)(1)(B) (e.g., private non-operating foundations) are deductible up to 20 percent of the taxpayer's contribution base.

Contributions by corporations

For corporations, in any taxable year, charitable contributions are not deductible to the extent the aggregate contributions exceed 10 percent of the corporation's taxable income computed without regard to net operating loss or capital loss carrybacks.

For purposes of determining whether a corporation's aggregate charitable contributions in a taxable year exceed the applicable percentage limitation, contributions of capital gain property are taken into account after other charitable contributions.

Carryforward of excess contributions

Charitable contributions that exceed the applicable percentage limitation may be carried forward for up to five years (sec. 170(d)). The amount that may be carried forward from a taxable year ("contribution year") to a succeeding taxable year ("succeeding year") may not exceed the applicable percentage of the contribution base for the succeeding taxable year less the sum of contributions made in the succeeding taxable year plus contributions made in taxable years prior to the contribution year and treated as paid in the succeeding taxable year under this provision.

Overall limitation on itemized deductions ("Pease" limitation)

Under present law, the total amount of otherwise allowable itemized deductions (other than medical expenses, investment interest, and casualty, theft, or wagering losses) is reduced by three percent of the amount of the taxpayer's adjusted gross income in excess of a certain threshold. The otherwise allowable itemized deductions may not be reduced by more than 80 percent. For 2005, the adjusted gross income threshold is $145,950 ($72,975 for a married taxpayer filing a joint return). These dollar amounts are adjusted for inflation.

The otherwise applicable overall limitation on itemized deductions is reduced by one-third in taxable years beginning in 2006 and 2007, and by two-thirds in taxable years beginning in 2008 and 2009. The overall limitation is repealed for taxable years beginning after December 31, 2009, and reinstated for taxable years beginning after December 31, 2010.

Explanation of Provision

Increase in percentage limitations

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 exceeds the deduction for other charitable contributions. Contributions in excess of this amount is carried forward as contributions to which section 170(b)(1)(A) applies under the rules of section 170(d). Similar rules allow qualified contributions to offset the entire taxable income of a corporation.

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)). In the

case of a corporation, qualified contributions must be for relief efforts related to Hurricane Katrina. A taxpayer must elect to have the contributions treated as qualified contributions.

Except as provided above, subsections (b) and (d) of section 170 are applied by not taking into account qualified contributions.

Below are examples illustrating the operation of this provision. (The examples assume the taxpayer makes an election to have this provision apply.)

Example 1.−Assume individual A's contribution base for 2005 is $100,000; aggregate qualified contributions are $70,000; and other charitable contributions to which section 170(b)(1)(A) applies are $60,000. Under the provision, A is allowed a deduction of $100,000 for 2005 ($50,000 determined without regard to qualified contributions plus $50,000 for the qualified contributions). $30,000 is treated as a contribution described in section 170(b)(1)(A) paid in each of the five succeeding taxable years (subject to the limitations of section 170(d)(1)(A)(i) and (ii)). $30,000 is the sum of the $10,000 excess referred to in section 170(d)(1)(A) (the excess of $60,000 over $50,000) and the $20,000 excess referred to in paragraph (b)(1)(B) of this provision (the excess of $70,000 over $50,000).

Example 2.–For calendar year 2005, B, an individual, has a contribution base of $100,000. On January 10, 2005, B makes a $7,000 cash contribution to an organization described in section 170(b)(1)(A) and a $65,000 cash contribution to an organization not so described. On October 10, 2005, B makes a $70,000 qualified contribution. In 2004, B made cash charitable contributions to organizations described in section 170(b)(1)(A) that exceeded 50% of the contribution base by $5,000.

First, subsections (b) and (d) of section 170 are applied by disregarding the qualified contribution. For 2005, a $12,000 deduction is allowed under section 170(b)(1)(A)–the $7,000 current year contribution and the $5,000 carryover from 2004. For 2005, a $30,000 deduction for the contribution to the organization not described in section 170(b)(1)(A) also is allowed. This amount is the lesser of (i) $38,000 ($50,000 (50% of B's contribution base) less the $12,000 allowed under section 170(b)(1)(A)) or (ii) $30,000 (30 percent of B's contribution base). The remaining contribution amount of $35,000 is carried over as a contribution to an organization which is not described in section 170(b)(1)(A). Thus, without regard to the qualified contribution, B is allowed a total contribution deduction of $42,000 in 2005.

In addition, B may deduct $58,000 of the qualified contribution in 2005 (the lesser of (i) the $70,000 amount of the qualified contribution or (ii) the $58,000 excess of B's $100,000 contribution base over the $42,000 amount otherwise deductible). $12,000 is treated as a contribution described in section 170(b)(1)(A) paid in each of the five succeeding taxable years (subject to the limitations of section 170(d)(1)(A)(i) and (ii)).

In summary, B's deduction for 2005 is $100,000; $12,000 may be carried over as a contribution to an organization described in section 170(b)(1)(A) (subject to the limitations of section 170(d)(1)(A)(i) and (ii)); and $35,000 may be carried over as a contribution to an organization not so described (subject to similar limitations).

Example 3.–Assume corporation X's taxable income (as defined in section 170(b)(2)) for 2005 is $100,000; aggregate qualified contributions (which, in the case of a corporation, must be related to Hurricane Katrina relief efforts) are $100,000; and other charitable contributions are $20,000. Under the provision, X is allowed a deduction of $100,000 for 2005 ($10,000 determined without regard to qualified contributions plus $90,000 for the qualified contributions). $20,000 is deductible in each of the five succeeding taxable years (subject to the limitations of section 170(d)(2)(A)(i) and (ii)). $20,000 is the sum of the $10,000 excess referred to in section 170(d)(2)(A) (the excess of $20,000 over $10,000) and the $10,000 excess referred to in paragraph (b)(2)(B) of this provision (the excess of $100,000 over $90,000).

The provision requires that qualified contributions by a corporation be made for relief efforts related to Hurricane Katrina. Corporate taxpayers must substantiate that the contribution is made for such purpose.

Limitation on overall itemized deductions

Under the provision, the deduction for qualified contributions (as defined above) is not treated as an itemized deduction for purposes of the overall limitation on itemized deductions.

Effective Date

The provision is effective on the date of enactment.

B. Charitable Deduction for Contributions of Food Inventories (sec. 302 of the bill)

Present Law

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 certain contributions of 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.[1] To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer, contributed to a charitable organization described in section 501(c)(3) (except for private nonoperating foundations), and the donee must (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements. In the case of contributed property subject to the Federal Food, Drug, and Cosmetic Act, the property must satisfy the applicable requirements of such Act on the date of transfer and for 180 days prior to the transfer.

To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis. The valuation of food inventory has been the subject of ongoing disputes between taxpayers and the IRS. In one case, the Tax Court held that the value of surplus bread inventory donated to charity was the full retail price of the bread rather than half the retail price, as the IRS asserted.[2]

Explanation of Provision

Under the provision, any taxpayer, whether or not a C corporation, engaged in a trade or business is eligible to claim the 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 from which contributions of apparently wholesome food are made. For example, if a taxpayer is a sole proprietor, a shareholder in an S corporation, and a partner in a partnership, and each business makes charitable contributions of food inventory, the taxpayer's deduction for donations of food inventory is limited to 10 percent of the taxpayer's net income from the sole proprietorship and the taxpayer's interests in the S corporation and partnership. However, if only the sole proprietorship and the S corporation made charitable contributions of food inventory, the

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[1] Sec. 170(e)(3). In general, a C corporation's charitable contribution deductions for a year may not exceed 10 percent of the corporation's taxable income. Sec. 170(b)(2).

[2] *Lucky Stores Inc. v. Commissioner,* 105 T.C. 420 (1995).

taxpayer's deduction would be limited to 10 percent of the net income from the trade or business of the sole proprietorship and the S corporation, but not the partnership.

The 10 percent limitation does not affect the application of the generally applicable percentage limitations. For example, if 10 percent of a sole proprietor's net income from the proprietor's trade or business was greater than 50 percent of the proprietor's contribution base, the available deduction for the taxable year (with respect to contributions to public charities) would be 50 percent of the proprietor's contribution base. Consistent with present law, such contributions may be carried forward because they exceed the 50 percent limitation. Contributions of food inventory by a taxpayer that is not a C corporation that exceed the 10 percent limitation but not the 50 percent limitation could not be carried forward.

For purposes of calculating the enhanced deduction, taxpayers who do not account for inventories under section 471 and who are not required to capitalize indirect costs under section 263A are able to elect to treat the basis of the contributed food as being equal to 25 percent of the food's fair market value.[3]

The provision changes the amount of the present-law enhanced deduction for eligible contributions of food inventory to the lesser of fair market value or twice the taxpayer's basis in the inventory. For example, a taxpayer who makes an eligible donation of food that has a fair market value of $10 and a basis of $4 could take a deduction of $8 (twice basis). If the taxpayer's basis was $6 instead of $4, then the deduction would be $10 (fair market value). By contrast, under present law, a C corporation's deduction in the first example would be $7 (fair market value less half the appreciation) and in the second example would be $8. (Under present law, taxpayers other than C corporations generally could take a deduction for a contribution of food inventory only for the $4 basis in either example.) Taxpayers that do not account for inventories under section 471 and who are not required to capitalize indirect costs under section 263A would be able to elect to treat the basis of the contributed food as being equal to 25 percent of the food's fair market value.

Under the provision, the enhanced deduction is available only for food that qualifies as "apparently wholesome food." "Apparently wholesome food" is defined as food intended for human consumption that meets all quality and labeling standards imposed by Federal, State, and local laws and regulations even though the food may not be readily marketable due to appearance, age, freshness, grade, size, surplus, or other conditions.

In addition, the provision provides that the fair market value of donated apparently wholesome food that cannot or will not be sold solely due to internal standards of the taxpayer or lack of market is determined without regard to such internal standards or lack of market and by taking into account the price at which the same or substantially the same food items (as to both type and quality) are sold by the taxpayer at the time of the contribution or, if not so sold at such time, in the recent past.

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[3] This includes, for example, taxpayers who are eligible for administrative relief under Revenue Procedures 2002-28 and 2001-10.

Effective Date

The provision is effective for contributions made after August 28, 2005, and before January 1, 2006.

C. Charitable Deduction for Contributions of Book Inventories (sec. 303 of the bill)

Present Law

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 certain contributions of 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.[4] To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer, contributed to a charitable organization described in section 501(c)(3) (except for private nonoperating foundations), and the donee must: (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements.

Explanation of Provision

The provision modifies the present-law enhanced deduction for C corporations so that it is equal to the lesser of fair market value or twice the taxpayer's basis in the case of qualified book contributions. The provision provides that the fair market value for this purpose is determined by reference to a bona fide published market price for the book. Under the provision, a bona fide published market price of a book means a price: (1) determined using the same printing and edition; (2) determined in the usual market in which such a book has been customarily sold by the taxpayer; and (3) for which the taxpayer can demonstrate to the satisfaction of the Secretary that the taxpayer customarily sold such books in arm's length transactions within seven years preceding the contribution. For example, a publisher's listed retail price for a book would not meet the standard if the publisher could not demonstrate to the satisfaction of the Secretary that the price was one at which the publisher customarily sold the book in its usual market in arm's length transactions occurring within the seven-year period prior to the contribution. If a publisher entered into a contract with a local school district to sell newly published textbooks six years prior to making a qualified book contribution of such textbooks, the publisher could use as a bona fide published market price, the price at which such books regularly were sold to the school district under the contract. By contrast, if a publisher listed in a catalogue or elsewhere a "suggested retail price," but the publisher did not in fact customarily sell the books at such price, the publisher could not use the "suggested retail price" to determine the fair market value of the book for purposes of the enhanced deduction. Thus, in general, a bona fide published market price must be independently verifiable by reference to actual sales within the seven-year period preceding the contribution, and not to a publisher's own price list.

[4] Sec. 170(e)(3).

As an illustration of the mechanics of calculating the enhanced deduction under the provision, a C corporation that made a qualified book contribution with a bona fide published market price of $10 and a basis of $4 could take a deduction of $8 (twice basis). If the taxpayer's basis is $6 instead of $4, then the deduction is $10. Also, in such latter case, if the book's bona fide market published market price was $5 at the time of the contribution but was $10 five years before the contribution, then the deduction is $10.

A qualified book contribution means a charitable contribution of books to: (1) 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; (2) a public library; or (3) an organization described in section 501(c)(3) (except for private nonoperating foundations), that is organized primarily to make books available to the general public at no cost or to operate a literacy program. The donee must: (1) use the property consistent with the donee's exempt purpose; (2) not transfer the property in exchange for money, other property, or services; and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements and also that the books are suitable, in terms of currency, content, and quantity, for use in the donee's educational programs and that the donee will use the books in such educational programs.

Effective Date

The provision is effective for contributions made after August 28, 2005 and before January 1, 2006.

D. Additional Exemption for Housing Hurricane Katrina Displaced Individuals (sec. 304 of the bill)

Present Law

In order to determine taxable income, an individual reduces adjusted gross income ("AGI") by any personal exemptions and either the standard deduction or itemized deductions. Personal exemptions generally are allowed for the taxpayer, his or her spouse if filing jointly, and any dependents (as defined in sec. 151). Personal exemptions are not allowed for purposes of determining a taxpayer's alternative minimum taxable income.

For 2005, the amount deductible for each personal exemption is $3,200. This amount is indexed annually for inflation. The deduction for personal exemptions is phased out ratably for taxpayers with AGI over certain thresholds. These thresholds are indexed annually for inflation. Specifically, the total amount of exemptions that may be claimed by a taxpayer is reduced by two percent for each $2,500 (or portion thereof) by which the taxpayer's AGI exceeds the applicable threshold. (The phaseout rate is two percent for each $1,250 for married taxpayers filing separate returns.) Thus, the personal exemptions claimed are phased out over a $122,500 range (which is not indexed for inflation), beginning at the applicable threshold. The applicable thresholds for 2005 are $145,900 for single individuals, $218,950 for married individuals filing a joint return, $182,450 for heads of households, and $109,475 for married individuals filing separate returns. For 2005, the point at which a taxpayer's personal exemptions are completely phased out is $268,450 for single individuals, $341,450 for married individuals filing a joint return, $304,950 for heads of households, and $170,725 for married individuals filing separate returns.

Explanation of Provision

The provision provides an additional exemption of $500 for each Hurricane Katrina displaced individual of the taxpayer. The 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.

A Hurricane Katrina displaced individual is an individual who (1) was (as of August 28, 2005) a resident of any Hurricane Katrina disaster area, (2) is displaced from their residence located in the area described in (1), and (3) is provided housing free of charge by the taxpayer in the principal residence of the taxpayer for a period of 60 consecutive days which ends in the taxable year. A Hurricane Katrina displaced individual may not be the spouse or any dependent of the taxpayer.

A Hurricane Katrina disaster area for the purposes of the additional exemption is an area (1) with respect to which a major disaster was declared by the President before September 14, 2005, under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act in connection with Hurricane Katrina, and (2) which is determined by the President before such date to warrant assistance from the Federal government under such Act.

The additional exemption is not subject to the income-based phaseouts applicable to other personal exemptions, and is allowed as a deduction in computing alternative minimum taxable income.

Effective Date

The provision applies to taxable years beginning in 2005 and 2006.

E. Increase in Standard Mileage Rate for Charitable Use of Certain Vehicles (sec. 305 of the bill)

Present Law

In general, an itemized deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. Unreimbursed out-of-pocket expenditures made incident to providing donated services to a qualified charitable organization − such as out-of-pocket transportation expenses necessarily incurred in performing donated services − may qualify as a charitable contribution (Treasury Regulation sec. 1.170A-1(g)). No charitable contribution deduction is allowed for traveling expenses (including expenses for meals and lodging) while away from home, whether paid directly or by reimbursement, unless there is no significant element of personal pleasure, recreation, or vacation in such travel (sec. 170(j)).

In determining the amount treated as a charitable contribution where a taxpayer operates a vehicle in providing donated services to a charity, the taxpayer either may deduct actual out-of-pocket expenditures or, in the case of a passenger automobile, may use the charitable standard mileage rate. The charitable standard mileage rate is set by statute at 14 cents per mile (sec. 170(i)). The taxpayer may also deduct (under either computation method), any parking fees and tolls incurred in rendering the services, but may not deduct any amount (regardless of the computation method used) for general repair or maintenance expenses, depreciation, insurance, registration fees, etc. Regardless of the computation method used, the taxpayer must keep reliable written records of expenses incurred. For example, where a taxpayer uses the charitable standard mileage rate to determine a deduction, the IRS has stated that the taxpayer generally must maintain records of miles driven, time, place (or use), and purpose of the mileage. If the charitable standard mileage rate is not used to determine the deduction, the taxpayer generally must maintain reliable written records of actual expenses incurred.

In lieu of actual operating expenses, an optional standard mileage rate may be used in computing the deductible costs of business use of an automobile. The business standard mileage rate is determined by the IRS and updated periodically. For expenses incurred on or after January 1, 2005, and before September 1, 2005, the business standard mileage rate specified by the IRS is 40.5 cents per mile. For expenses incurred on or after September 1, 2005, and before January 1, 2006, the business standard mileage rate specified by the IRS is 48.5 cents per mile (IRS Announcement 2005-99 (September 9, 2005)).

The standard mileage rate for charitable purposes is lower that the standard business rate because the charitable rate covers only the out-of-pocket operating expenses (including gasoline and oil) directly related to the use of the automobile in performing the donated services that a taxpayer may deduct as a charitable contribution. The charitable rate does not include costs that are not deductible as a charitable contribution such as general repair or maintenance expenses, depreciation, insurance, and registration fees. Such costs are, however, included in computing the business standard mileage rate.

Explanation of Provision

The provision allows a taxpayer who uses a vehicle in providing donated services to charity solely for the provision of relief related to Hurricane Katrina to compute the taxpayer's charitable mileage 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 described in section 170(f)(12)(E)(i) (i.e., a motor 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 described in the provision, 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. For example, a taxpayer who uses the statutory mileage rate generally must keep, at a minimum, reliable written records regarding the number of miles driven, the dates on which he incurred the mileage, the name of the charitable organization for which services were provided, the locations in which he provided services to the charitable organization, and the charitable purposes of the services, which purposes must relate to 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 Date

The provision is effective for contributions made on or after August 29, 2005, and before January 1, 2007.

F. Mileage Reimbursements to Charitable Volunteers Excluded from Gross Income (sec. 306 of the bill)

Present Law

In general, an itemized deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. Unreimbursed out-of-pocket expenditures made incident to providing donated services to a qualified charitable organization − such as out-of-pocket transportation expenses necessarily incurred in performing donated services − may qualify as a charitable contribution (Treasury Regulation sec. 1.170A-1(g)). No charitable contribution deduction is allowed for traveling expenses (including expenses for meals and lodging) while away from home, whether paid directly or by reimbursement, unless there is no significant element of personal pleasure, recreation, or vacation in such travel (sec. 170(j)).

In determining the amount treated as a charitable contribution where a taxpayer operates a vehicle in providing donated services to a charity, the taxpayer either may deduct actual out-of-pocket expenditures or, in the case of a passenger automobile, may use the charitable standard mileage rate. The charitable standard mileage rate is set by statute at 14 cents per mile (sec. 170(i)). The taxpayer may also deduct (under either computation method), any parking fees and tolls incurred in rendering the services, but may not deduct any amount (regardless of the computation method used) for general repair or maintenance expenses, depreciation, insurance, registration fees, etc. Regardless of the computation method used, the taxpayer must keep reliable written records of expenses incurred. For example, where a taxpayer uses the charitable standard mileage rate to determine a deduction, the IRS has stated that the taxpayer generally must maintain records of miles driven, time, place (or use), and purpose of the mileage. If the charitable standard mileage rate is not used to determine the deduction, the taxpayer generally must maintain reliable written records of actual expenses incurred.

In lieu of actual operating expenses, an optional standard mileage rate may be used in computing the deductible costs of business use of an automobile. The business standard mileage rate is determined by the IRS and updated periodically. For expenses incurred on or after January 1, 2005, and before September 1, 2005, the business standard mileage rate specified by the IRS is 40.5 cents per mile. For expenses incurred on or after September 1, 2005, and before January 1, 2006, the business standard mileage rate specified by the IRS is 48.5 cents per mile (IRS Announcement 2005-99 (September 9, 2005)).

The standard mileage rate for charitable purposes is lower that the standard business rate because the charitable rate covers only the out-of-pocket operating expenses (including gasoline and oil) directly related to the use of the automobile in performing the donated services that a taxpayer may deduct as a charitable contribution. The charitable rate does not include costs that are not deductible as a charitable contribution such as general repair or maintenance expenses, depreciation, insurance, and registration fees. Such costs are, however, included in computing the business standard mileage rate.

Volunteer drivers who are reimbursed for mileage expenses have taxable income to the extent the reimbursement exceeds deductible travel expenses. Employees who are reimbursed for mileage expenses under a qualified arrangement that pays a mileage allowance in lieu of reimbursing actual expenses generally have taxable income to the extent the reimbursement exceeds the amount of the business standard mileage rate multiplied by the actual business miles.

Explanation of Provision

Under the provision, 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 connection with providing donated services is excludable from the gross income of the volunteer, provided that (1) the reimbursement does not exceed the business standard mileage rate prescribed for business use (as periodically adjusted), and (2) 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. Information reporting required by section 6041 is not required with respect to reimbursements excluded under the provision.

Effective Date

The provision is effective for use of a passenger automobile after the date of enactment, in taxable years ending after the date of enactment. The provision does not apply to use of a passenger automobile after December 31, 2006.

TITLE IV – ADDITIONAL TAX RELIEF PROVISIONS

A. Exclusion for Certain Cancellations of Indebtedness for Victims of Hurricane Katrina (sec. 401 of the bill)

Present Law

Gross income includes income that is realized by a debtor from the discharge of indebtedness, subject to certain exceptions for debtors in Title 11 bankruptcy cases, insolvent debtors, certain farm indebtedness, and certain real property business indebtedness (secs. 61(a)(12) and 108). In cases involving discharges of indebtedness that are excluded from gross income (except for discharges of real property business indebtedness), taxpayers generally exclude discharge of indebtedness from income but reduce tax attributes by the amount of the discharge of indebtedness. The amount of discharge of indebtedness excluded from income by an insolvent debtor not in a Title 11 bankruptcy case cannot exceed the amount by which the debtor is insolvent. For all taxpayers, the amount of discharge of indebtedness generally is equal to the difference between the adjusted issue price of the debt being cancelled and the amount used to satisfy the debt. These rules generally apply to the exchange of an old obligation for a new obligation, including a modification of indebtedness that is treated as an exchange (a debt-for-debt exchange).

Present law generally requires "applicable entities" to file information returns with the IRS regarding any discharge of indebtedness in the amount of $600 or more (section 6050P). This requirement applies without regard to whether the debtor is subject to tax on the discharged indebtedness. The term "applicable entities" 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. Failures to file correct information returns with the IRS or to furnish statements to taxpayers with respect to these discharges of indebtedness are subject to the same general penalty that is imposed with respect to failures to provide other types of information returns. Accordingly, the penalty for failure to furnish statements to taxpayers generally is $50 per failure, subject to a maximum of $100,000 for any calendar year. These penalties are not applicable if the failure is due to reasonable cause and not to willful neglect.

Explanation of Provision

The provision provides that gross income of an individual does not include any amount which would otherwise be includible in gross income by reason of a discharge (in whole or in part) of nonbusiness debt if the indebtedness is discharged by an applicable entity. For these purposes, nonbusiness debt is any indebtedness other than indebtedness incurred in connection

with a trade or business. The provision applies to the discharge of indebtedness of any natural person if the discharge is by reason of damage sustained by the taxpayer in connection with Hurricane Katrina. An applicable entity is an executive, judicial, or legislative agency (as defined in section 3701(a)(4) of title 31 of the U.S. Code) and an applicable financial entity (as defined 6050P(b)(2) of the Code). Similar to the present-law rules, the amount excluded from gross income under this provision reduces the tax attributes of the taxpayer.

Effective Date

The provision applies to discharges made on or after August 29, 2005 and before January 1, 2007.

B. Suspension of Certain Limitations on Personal Casualty Losses (sec. 402 of the bill)

Present Law

Under present law, a taxpayer may generally claim a deduction for any loss sustained during the taxable year and not compensated by insurance or otherwise (sec. 165). For individual taxpayers, deductible losses must be incurred in a trade or business or other profit-seeking activity or consist of property losses arising from fire, storm, shipwreck, or other casualty, or from theft. Personal casualty or theft losses are deductible only if they exceed $100 per casualty or theft. In addition, aggregate net casualty and theft losses are deductible only to the extent they exceed 10 percent of an individual taxpayer's adjusted gross income.

Explanation of Provision

The provision permits individual taxpayers to claim casualty or theft losses attributable to Hurricane Katrina regardless of whether the loss exceeds $100. In addition, personal casualty or theft losses attributable to Hurricane Katrina are deductible without regard to whether the loss exceeds 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 attributable to Hurricane Katrina are disregarded. 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 Date

The provision is effective on the date of enactment.

C. Required Exercise of IRS Administrative Authority (sec. 403 of the bill)

Present

General time limits for filing tax returns

Individuals generally must file their Federal income tax returns by April 15 of the year following the close of a taxable year. The Secretary may grant reasonable extensions of time for filing such returns. Treasury regulations provide an additional automatic two-month extension (until June 15 for calendar-year individuals) for United States citizens and residents in military or naval service on duty on April 15 of the following year (the otherwise applicable due date of the return) outside the United States. No action is necessary to apply for this extension, but taxpayers must indicate on their returns (when filed) that they are claiming this extension. Unlike most extensions of time to file, this extension applies to both filing returns and paying the tax due.

Treasury regulations also provide, upon application on the proper form, an automatic four-month extension (until August 15 for calendar-year individuals) for any individual timely filing that form and paying the amount of tax estimated to be due.

In general, individuals must make quarterly estimated tax payments by April 15, June 15, September 15, and January 15 of the following taxable year. Wage withholding is considered to be a payment of estimated taxes

Suspension of time periods

In general, the period of time for performing various acts under the Code, such as filing tax returns, paying taxes, or filing a claim for credit or refund of tax, is suspended for any individual serving in the Armed Forces of the United States in an area designated as a "combat zone" or when deployed outside the United States away from the individual's permanent duty station while participating in an operation designated by the Secretary of Defense as a "contingency operation" or that becomes a contingency operation. The suspension of time also applies to an individual serving in support of such Armed Forces in the combat zone or contingency operation, such as Red Cross personnel, accredited correspondents, and civilian personnel acting under the direction of the Armed Forces in support of those Forces. The designation of a combat zone must be made by the President in an Executive Order. A contingency operation is defined as a military operation that is designated by the Secretary of Defense as an operation in which members of the Armed Forces are or may become involved in military actions, operations, or hostilities against an enemy of the United States or against an opposing military force, or results in the call or order to (or retention of) active duty of members of the uniformed services during a war or a national emergency declared by the President or Congress.

The suspension of time encompasses the period of service in the combat zone during the period of combatant activities in the zone or while participating in a contingency operation, as well as (1) any time of continuous qualified hospitalization resulting from injury received in the

combat zone or contingency operation or (2) time in missing in action status, plus the next 180 days.

The suspension of time applies to the following acts:

1. Filing any return of income, estate, or gift tax (except employment and withholding taxes);

2. Payment of any income, estate, or gift tax (except employment and withholding taxes);

3. Filing a petition with the Tax Court for redetermination of a deficiency, or for review of a decision rendered by the Tax Court;

4. Allowance of a credit or refund of any tax;

5. Filing a claim for credit or refund of any tax;

6. Bringing suit upon any such claim for credit or refund;

7. Assessment of any tax;

8. Giving or making any notice or demand for the payment of any tax, or with respect to any liability to the United States in respect of any tax;

9. Collection of the amount of any liability in respect of any tax;

10. Bringing suit by the United States in respect of any liability in respect of any tax; and

11. Any other act required or permitted under the internal revenue laws specified by the Secretary of the Treasury.

In the case of a Presidentially declared disaster or a terroristic or military action, the Secretary of the Treasury also has authority to prescribe a period of up to one year that may be disregarded for performing any of the acts listed above. The Secretary also may suspend the accrual of any interest, penalty, additional amount, or addition to tax for taxpayers in the affected areas.

Explanation of Provision

The provision clarifies the scope of the Secretary's authority to suspend the time period for certain acts. The provision adds employment and excise taxes 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 terroristic or military actions.

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. The provision also clarifies that 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 Date

The provision extending IRS administrative relief relating to Hurricane Katrina until at least February 28, 2006, is effective on the date of enactment. The amendments adding employment and excise taxes to those items for which the Secretary may suspend filing and payment requirements are effective for any period for performing an act which has not expired before August 29, 2005.

D. Special Rules for Mortgage Revenue Bonds (sec. 404 of the bill)

Present Law

In general

Under present law, gross income does not include interest on State or local bonds (sec. 103). State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds which are primarily used to finance governmental functions or are repaid with governmental funds. Private activity bonds are bonds with respect to which the State or local government serves as a conduit providing financing to nongovernmental persons (e.g., private businesses or individuals). The exclusion from income for State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds") (secs. 103(b)(1) and 141).

Qualified mortgage bonds

The definition of a qualified private activity bond includes a qualified mortgage bond (sec. 143). Qualified mortgage bonds are issued to make mortgage loans to qualified mortgagors for the purchase, improvement, or rehabilitation of owner-occupied residences. The Code imposes several limitations on qualified mortgage bonds, including income limitations for eligible mortgagors, purchase price limitations on the home financed with bond proceeds, and a "first-time homebuyer" requirement. The income limitations are satisfied if all financing provided by an issue is provided for mortgagors whose family income does not exceed 115 percent of the median family income for the metropolitan area or State, whichever is greater, in which the financed residences are located. The purchase price limitations provide that a residence financed with qualified mortgage bonds may not have a purchase price in excess of 90 percent of the average area purchase price for that residence. The first-time homebuyer requirement provides qualified mortgage bonds generally cannot be used to finance a mortgage for a homebuyer who had an ownership interest in a principal residence in the three years preceding the execution of the mortgage.

Special income and purchase price limitations apply to targeted area residences. A targeted area residence is one located in either (1) a census tract in which at least 70 percent of the families have an income which is 80 percent or less of the state-wide median income or (2) an area of chronic economic distress. For targeted area residences, the income limitation is satisfied when no more than one-third of the mortgages are made without regard to any income limits and the remainder of the mortgages are made to mortgagors whose family income is 140 percent or less of the applicable median family income. The purchase price limitation is raised from 90 percent to 110 percent of the average area purchase price for targeted area residences. In addition, the first-time homebuyer requirement does not apply to targeted area residences.

Qualified mortgage bonds also may be used to finance qualified home-improvement loans. Qualified home-improvement loans are defined as loans to finance alterations, repairs, and improvements on an existing residence, but only if such alterations, repairs, and

improvements substantially protect or improve the basic livability or energy efficiency of the property. Qualified home-improvement loans may not exceed $15,000.

A temporary provision waived the first-time homebuyer requirement for residences located in certain Presidentially declared disaster areas (sec. 143(k)(11)). In addition, residences located in such areas were treated as targeted area residences for purposes of the income and purchase price limitations. The special rule for residences located in Presidentially declared disaster areas does not apply to bonds issued after January 1, 1999.

Explanation of Provision

The provision waives the first-time homebuyer requirement for residences located in a Hurricane Katrina disaster area by treating such residences as if they were targeted area residences. For this rule to apply, issuers must make a determination that the residences financed with qualified mortgage bonds replace residences that were damaged or destroyed by Hurricane Katrina. For this provision, a Hurricane Katrina disaster area is defined as an area with respect to which a major disaster has been declared by the President before September 14, 2005, under the Robert T. Stafford Disaster Relief and Emergency Assistance Act in connection with Hurricane Katrina and which is determined by the President before such date to warrant assistance from the Federal Government under such Act.

The provision also increases from $15,000 to $150,000 the amount of a qualified home-improvement loan that may be financed with qualified mortgage bonds to the extent the home-improvement loan is for the repair of damage caused by Hurricane Katrina.

Effective Date

The provision is effective for bonds issued after August 28, 2005, and before August 29, 2008.

E. Extension of Replacement Period for Nonrecognition of Gain (sec. 405 of the bill)

Present Law

Generally, a taxpayer realizes gain to the extent the sales price (and any other consideration received) exceeds the taxpayer's basis in the property. The realized gain is subject to current income tax unless the gain is deferred or not recognized under a special tax provision.

Under section 1033, gain realized by a taxpayer from an involuntary conversion of property is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property within the applicable period. The taxpayer's basis in the replacement property generally is the cost of such property, reduced by the amount of gain not recognized.

The applicable period for the taxpayer to replace the converted property begins with the date of the disposition of the converted property (or if earlier, the earliest date of the threat or imminence of requisition or condemnation of the converted property) and ends two years after the close of the first taxable year in which any part of the gain upon conversion is realized (the "replacement period").

Special rules extend the replacement period for certain real property and principal residences damaged by a Presidentially declared disaster to three years and four years, respectively, after the close of the first taxable year in which gain is realized. Similarly, the replacement period for livestock sold on account of drought, flood, or other weather-related conditions is extended from two years to four years after the close of the first taxable year in which any part of the gain on conversion is realized. In the case of property compulsorily or involuntarily converted as a result of the terrorist attacks on September 11, 2001, in the New York Liberty Zone, the replacement period is extended from two years to five years, but only if substantially all of the use of the replacement property is in the city of New York (sec. 1400L(g)).

Explanation of Provision

The provision extends from two to five years the replacement period in which a taxpayer may replace converted property, in the case of property that is located in a certain area and that is compulsorily or involuntarily converted as a result of Hurricane Katrina. The converted property must be located in 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 in connection with Hurricane Katrina, and which is determined by the President before that date to warrant assistance from the Federal government under that Act. Substantially all of the use of the replacement property must be located in this area.

Effective Date

The provision is effective upon enactment.

F. Special Look-Back Rule for Determining Earned Income Credit and Refundable Child Credit (sec. 406 of the bill)

Present Law

Present law provides eligible taxpayers with an earned income credit and a child credit. In general, the earned income credit is a refundable credit for low-income workers (sec. 32). The amount of the credit depends on the earned income of the taxpayer and whether the taxpayer has one, more than one, or no qualifying children. Earned income generally includes wages, salaries, tips, and other employee compensation, plus net earnings from self-employment.

Taxpayers with incomes below certain threshold amounts are eligible for a $1,000 credit for each qualifying child (sec. 24). The child credit is refundable to the extent of 15 percent of the taxpayer's earned income in excess of $10,000. (The $10,000 income threshold is indexed for inflation and is currently $11,000 for 2005.) Families with three or more children are allowed a refundable credit for the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income credit, if that amount is greater than the refundable credit based on the taxpayer's earned income in excess of $10,000 (indexed for inflation).

Explanation of Provision

The provision permits qualified individuals to elect to calculate their earned income credit and refundable child credit for the taxable year which includes August 28, 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 28, 2005, is less than their earned income for the preceding taxable year. Qualified individuals are individuals who on August 28, 2005, had their principal place of abode in any area with respect to which a major disaster declaration had been declared by the President before September 14, 2005, under the Robert T. Stafford Disaster Relief and Emergency Assistance Act in connection with Hurricane Katrina, and which was determined by the President before such date to warrant Federal assistance.

For purposes of the provision, in the case of a joint return for a taxable year which includes August 28, 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. Any substitution under the provision applies only with respect to earned income which is attributable to a spouse who is a qualified individual.

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. For administrative purposes, the incorrect use on a return of earned income pursuant to an election under this provision is treated as a mathematical or clerical error. An election under the provision is disregarded for purposes of calculating gross income in the election year.

Effective Date

The provision is effective for the taxable year of a qualified individual that includes August 28, 2005.

G. Secretarial Authority to Make Adjustments Regarding Taxpayer and Dependency Status for Taxpayers Affected by Hurricane Katrina (sec. 407 of the bill)

Present Law

In order to determine taxable income, an individual reduces adjusted gross income ("AGI") by any personal exemptions and either the standard deduction or itemized deductions. Personal exemptions generally are allowed for the taxpayer, his or her spouse, and any dependents (as defined in sec. 151). Personal exemptions are not allowed for purposes of determining a taxpayer's alternative minimum taxable income.

For 2005, the amount deductible for each personal exemption is $3,200. This amount is indexed annually for inflation. The deduction for personal exemptions is phased out ratably for taxpayers with AGI over certain thresholds. These thresholds are indexed annually for inflation. Specifically, the total amount of exemptions that may be claimed by a taxpayer is reduced by two percent for each $2,500 (or portion thereof) by which the taxpayer's AGI exceeds the applicable threshold. (The phaseout rate is two percent for each $1,250 for married taxpayers filing separate returns.) Thus, the personal exemptions claimed are phased out over a $122,500 range (which is not indexed for inflation), beginning at the applicable threshold. The applicable thresholds for 2005 are $145,900 for single individuals, $218,950 for married individuals filing a joint return, $182,450 for heads of households, and $109,475 for married individuals filing separate returns. For 2005, the point at which a taxpayer's personal exemptions are completely phased out is $268,450 for single individuals, $341,450 for married individuals filing a joint return, $304,950 for heads of households, and $170,725 for married individuals filing separate returns.

Present law provides eligible taxpayers with an earned income credit and a child credit. In general, the earned income credit is a refundable credit for low-income workers. The amount of the credit depends on the earned income of the taxpayer and whether the taxpayer has one, more than one, or no qualifying children. Earned income generally includes wages, salaries, tips, and other employee compensation, plus net earnings from self-employment.

Taxpayers with incomes below certain threshold amounts are eligible for a $1,000 credit for each qualifying child. The child credit is refundable to the extent of 15 percent of the taxpayer's earned income in excess of $10,000. (The $10,000 income threshold is indexed for inflation and is currently $11,000 for 2005.) Families with three or more children are allowed a refundable credit for the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income credit, if that amount is greater than the refundable credit based on the taxpayer's earned income in excess of $10,000 (indexed for inflation).

Explanation of Provision

The provision authorizes the Secretary 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 after Hurricane Katrina or by reason of the receipt of hurricane relief. 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 Date

The provision is effective with respect to taxable years beginning in 2005 or 2006.