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This newsletter aims at summarizing the tax breaks available to taxpayers affected by Hurricane Katrina, Rita and Wilma under the provisions of Katrina Emergency Tax Relief Act, 2005 and the Gulf Opportunity Zone Act, 2005.

Extended Tax Deadlines: IRS has extended deadlines that apply to filing returns, paying taxes and performing certain other time sensitive acts for certain taxpayers affected by Hurricane until 28th Feb, 2006. The extension applies to deadlines ending before 28th February 2006.

Charitable Giving Incentives: IRS has temporarily suspended the limits on Charitable Contributions.

- ❖ **Individuals:** Qualified contributions are not subject to the overall limit on itemized deductions or the 50% adjusted gross income (AGI) limit.
- ❖ **Corporations:** A Corporation may elect to deduct qualified cash contributions without regard to the 10% taxable income limit if the contributions were made after 27th August 2005 and before 1st January 2006 to a qualified charitable organization.

Moreover, any taxpayer engaged in a trade or business is eligible to claim a deduction for a contribution of "apparently whole-some food" inventory to a qualified charitable organization described in section 501(c) (3) (except for private non-operating foundations) after 27th August 2005 and before 1st January 2006. A corporation (other than an S corporation) may be allowed a charitable deduction for a qualified book contribution made after 27th August 2005 and before 1st January 2006 to a public school subject to certain terms and conditions.

Casualty and Theft Losses: Losses that arose to personal use property caused by Hurricane Katrina, Rita and Wilma after 24th Aug 2005, 22nd Sept 2005 and 22nd Oct 2005 respectively are not subject to the \$100 or 10% of adjusted gross income limits.

Qualified Gulf Opportunity Zone Losses: The portion of an Net Operating Loss (NOL) that is a qualified GO zone loss can be carried back to the 5 tax years before the NOL year. In addition, the 90% limit on the alternative tax NOL deduction (ATNOLD) does not apply to such portion of the ATNOLD.

Taxation of Qualified Hurricane Distribution: Qualified hurricane distributions are permitted without regard to the need or the actual amount of economic loss. A qualified hurricane distribution is any distribution from an eligible retirement plan after 24th Aug 2005, 22nd Sept 2005 and 22nd Oct 2005 in respect of Hurricane Katrina, Rita and Wilma respectively. The total of qualified hurricane distributions from all plans is limited to \$100000. Qualified hurricane distributions are not subject to the additional 10% tax (or the additional 25% tax for certain distributions from SIMPLE IRAs) on early distributions from qualified retirement plans (including IRAs). However, any distributions received in excess of the \$100000 qualified hurricane distribution limit may be subject to the additional tax on early distributions. Any

portion of a qualified hurricane distribution that is eligible for tax free rollover treatment can be repaid to an eligible retirement plan subject to certain exceptions.

Limits on Plan Loans from Qualified Plans: The \$50000 limit for distributions treated as plan loans is increased to \$100000. In addition, the limit based on 50% of one's vested accrued benefit is increased to 100% of that benefit. The higher limits apply only to loans received beginning from the specified dates and ending on December 31 2006.

Payments on plan loans due before 2007 may be suspended for 1 year by the Plan administrator. To qualify for the suspension, the due date for any loan payment must occur during the period beginning on Aug 28, 2005, Sept 23, 2005 and Oct 23, 2005 if the main home was located in the Hurricane Katrina, Rita and Wilma area respectively.

Earned Income Credit and Child Tax Credit: Tax Payer can elect to use his/her 2004 earned income to figure EIC and additional child tax credit for 2005 if (a) his/her 2005 earned income is less than his/her 2004 earned income and (b) Tax Payer's main home was in specified zone on specified date or the Tax Payer's main home was in the specified disaster area and he/she was displaced from that home because of hurricane.

Additional Exemption for Housing Individuals Displaced by Hurricane Katrina: Taxpayer may be able to claim an additional exemption amount of \$500 for providing housing in his/her main home for each individual displaced by Hurricane Katrina. The additional exemption amount is allowable once per taxpayer for a specific individual in 2005 or 2006, but not in both years. The maximum additional exemption amount that a taxpayer claims for all displaced individuals (subject to certain conditions) is \$2000 (\$1000 if married filing separately).

Education Credits: The education credits have been expanded for students attending an eligible educational institution located in the Gulf Opportunity Zone (GOZ students) for any tax year beginning in 2005 or 2006. The Hope Credit for a GOZ student is increased to 100% of the first \$2000 in qualified education expenses and 50% of the next \$2000 of qualified education expenses for a maximum credit of \$3000 per student. The lifetime learning credit rate for a GOZ student is increased from 20% to 40%.

Recapture of Federal Mortgage Subsidy: Generally taxpayers do not have to recapture any benefit if his/her mortgage loan was a qualified home improvement loan of not more than \$15000. This amount is increased to \$150000 if the loan was provided before 2011 and was used (a) to repair damage caused by Hurricane Katrina to a residence in the Hurricane Katrina disaster area or (b) to alter, repair, or improve an existing owner-occupied residence in the GO Zone, Rita GO Zone or Wilma GO Zone.

Exclusion of Certain Cancellations of Indebtedness by Reason of Hurricane Katrina: Generally, discharges of non-business debts (such as mortgages) made after August 24, 2005 and before January 1, 2007 are excluded from income for individuals whose main home was in the Hurricane Katrina Disaster area on August 25, 2005.

Tax Relief for Temporary Relocation: The IRS may adjust the internal revenue laws to ensure the taxpayers do not lose a deduction or credit or experience a change of filing status in 2005 or 2006 as a result of temporary relocation caused by Hurricane Katrina, Rita and Wilma. However, any such adjustment must ensure that an individual is not taken into account by more than one taxpayer for the same tax benefit.

Special Depreciation Allowance for Businesses: Taxpayer can take a special depreciation allowance for qualified Gulf Opportunity Zone property (subject to certain tests) that was placed in service after August 27, 2005. The allowance is an additional deduction of 50% of the property's depreciable basis (after any section 179 deduction and before figuring the regular depreciation deduction). The allowance is deductible for both the regular tax and the Alternative Minimum Tax (AMT). An increased section 179 deduction is allowable for qualified section 179 Gulf Opportunity (GO) Zone property placed in service in the GO Zone subject to certain conditions and limits.

Work Opportunity Credit: For the work opportunity credit, the definition of "targeted group employee" has been expanded to include a Hurricane Katrina employee. A Hurricane Katrina Employee is

- ❖ A person who, on August 28, 2005, had a main home in the core disaster area and within a two year period beginning on that, is hired to perform services principally in the core disaster area; or
- ❖ A person who, on August 28, 2005, had a main home in the core disaster area, was displaced from the main home as a result of Hurricane Katrina, and was hired during the period beginning on August 28, 2005 and ending on December 31, 2005.

Employee Retention Credit: An eligible employer who conducted an active trade or business in the Gulf Opportunity (GO) Zone, the Rita GO Zone, or the Wilma GO Zone can claim the employee retention credit. The credit is 40% of qualified wages for each eligible employee (up to a maximum of \$6000 in qualified wages per employee). Generally taxpayer must reduce their deduction for salaries and wages by the amount of this credit. For detailed rules and definitions for each hurricane please refer to Publication 4492.

Hurricane Katrina Housing Credit: An employer who conducted an active trade or business in the Gulf Opportunity (GO) Zone can claim the Hurricane Katrina Housing Credit. The credit is equal to 30% of the value (up to \$600 per month per employee) of in-kind lodging furnished to a qualified employee (and the employee's spouse or dependents) from January 1, 2006 through July 1, 2006.

Tax Relief for Reforestation Costs: Taxpayer may be able to elect to deduct a limited amount of reforestation costs for each qualified timber property. The deduction for any tax year generally is limited to \$10000 (\$5000 if married filing separately, \$0 for a trust) This limit for each qualified timber property is increased by the smaller of (a) \$10000 (\$5000 if married filing separately, \$0 for a trust), or (b) the amount of reforestation costs tax payer paid or incurred after the applicable date for the qualified timber property, any portion of which is located in the specified zone subject to certain terms and conditions.

Tax Relief for Demolition and Clean-up Costs: Taxpayer can elect to deduct 50% of any qualified GO Zone clean-up costs for the tax year in which costs are paid or

incurred, instead of capitalizing them. Qualified GO Zone clean-up costs are any amounts paid or incurred after August 27, 2005, and before January 1, 2008 for the removal of debris from, or the demolition of structures on, real property located in the GO Zone that is (a) held by taxpayer for use in a trade or business or for the production of income, or (b) inventory or other property for sale to customers in the ordinary course of his/her trade or business.

Increase in Rehabilitation Tax Credit: The rehabilitation credit is increased for qualified rehabilitation expenditures paid or incurred after August 27, 2005, and before January 1, 2009, on buildings located in the GO Zone as follows:

- ❖ For pre-1936 buildings (other than certified historic structures), the credit percentage is increased from 10% to 13%
- ❖ For certified historic structures, the credit percentage is increased from 20% to 26%

Apart from the above, the following tax breaks are also available:

- ❖ Special Standard Mileage Rates for Charitable use of Vehicles solely related to Hurricane Katrina
- ❖ Mileage Reimbursements to Charitable Volunteers

IRS CIRCULAR 230 DISCLOSURE

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