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Additional tax relief in the Katrina Emergency Tax Relief Act of 2005

The recently enacted Katrina Emergency Tax Relief Act of 2005 (KETRA) contains a host of tax provisions designed to provide immediate relief to individuals and businesses in the Katrina area. While much of the focus in the news has been on KETRA's liberalized rules for charitable giving, its credits for hiring and retaining Katrina employees, and its liberalization of the rules for qualified retirement plan and IRA distributions, KETRA also contains several tax breaks that have generally received less attention but that could be valuable to taxpayers in certain situations. Here's a summary of these provisions.

Katrina casualty losses are fully deductible. Under federal income tax law, an individual generally may claim a deduction for any nonbusiness property loss sustained during the tax year and not compensated by insurance or otherwise that arises from fire, storm, shipwreck, or other casualty, or from theft. These nonbusiness (personal) losses are deductible only to the extent that (1) they exceed $100 per casualty or theft, and (2) aggregate net casualty and theft losses exceed 10% of an individual's adjusted gross income (AGI).

Under KETRA, the $100 per casualty or theft floor and the 10% of AGI floor don't apply to an individual's personal casualty or theft losses that arise in the Hurricane Katrina disaster area.

Discharge of debt related to Katrina is excluded from income. Generally, gross income includes income that is realized by a debtor from the discharge of debt. Under pre-KETRA law, there was no special exclusion for disaster-related discharge of debt.

Under KETRA, qualifying individuals can exclude from income the discharge of any non-trade or business debt by a financial institution or government agency. The discharge must occur after Aug. 24, 2005, and before Jan. 1, 2007. A qualifying individual is one whose principal place of abode on Aug. 25, 2005 was located (i) in the core disaster area or (ii) in the Hurricane Katrina disaster area (but outside the core disaster area) and who suffered economic loss because of Hurricane Katrina. There's no exclusion for discharge of debt to the extent that realty securing the debt is located outside of the Hurricane Katrina disaster area.

Replacement period for Katrina-related involuntary conversions is extended to 5 years. Under KETRA, the period in which a taxpayer may replace involuntarily converted property in the Hurricane Katrina disaster area is extended from two to five years in the case of property that is compulsorily or involuntarily converted due to Hurricane Katrina. The extended replacement period only applies if substantially all of the use of the replacement property is in the Hurricane Katrina disaster area.

Look-back election provided for earned income credit and the refundable child credit. Under KETRA, individuals displaced from their principal residences by Katrina may use their 2004 income to calculate the child credit and the earned income credit on their 2005 tax returns.

IRS may adjust rules to ameliorate effect of Katrina relocations. KETRA gives the IRS the authority to make adjustments in the rules to help prevent taxpayers from losing deductions, credits, or favorable filing status on account of Katrina. 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.

Employment and excise taxes may be deferred for Presidentially declared disasters, combat zone service, or terroristic or military actions. KETRA adds employment and excise taxes to the list of taxes that are postponed for those serving in a combat zone or contingency action, and which may be postponed by the IRS due to Presidentially declared disasters or terroristic or military actions.

Hurricane Katrina filing and payment relief period extended to Feb. 28, 2006. The IRS had previously announced that taxpayers affected by Hurricane Katrina could defer filing and paying certain taxes, and performing certain acts, until Jan. 3, 2006. KETRA defers until Feb. 28, 2006, the filing and payment relief period provided by the IRS to taxpayers affected by Hurricane Katrina. It specifically provides that the deferred date applies to returns relating to, and the payment of, employment and excise taxes.

Please keep in mind that I've described only the highlights of these changes in the new law.