GRASSLEY-BAUCUS TAX RELIEF PACKAGE
FOR INDIVIDUALS AFFECTED BY HURRICANE KATRINA

Cash Flow

1. Discharge of Indebtedness Related to Katrina: Gross income generally includes any amount realized from the discharge of indebtedness. The proposal would provide an exemption for indebtedness discharged by commercial lenders when the forgiveness is in response to damage suffered from Hurricane Katrina. Senators Grassley and Baucus believe that those suffering losses as a result of the hurricane should not be required to pay tax on benevolent cancellation of debts.

2. Early Withdrawals from Retirement Plans: Present law discourages distributions from tax-preferred retirement plans with penalties and other limitations. The proposal would waive the 10% penalty tax for premature distributions from IRAs and qualified retirement plans (including defined benefit plans, 401(k) plans and 403(b) plans) for individuals whose principal residence is in a federally declared natural disaster area. Individuals eligible for this waiver because of Katrina would be permitted to pay income tax on such distributions ratably over a three-year period. Amounts distributed could be re-contributed to a qualified retirement plan over the three-year period following the distribution date and receive rollover treatment. Distributions for home purchases which were not finalized because of Hurricane Katrina could also be re-contributed to a qualified retirement plan or IRA. Limitations on loans from qualified employer plans would be increased for Hurricane Katrina victims by doubling the thresholds to the lesser of $100,000 or 100% of the individual's account balance. Payments due from Katrina victims on qualified plan loans after August 29, 2005, and before August 30, 2006, could be deferred, and twelve months could be added to the maximum repayment period of affected loans. Senators Grassley and Baucus recognize that retirement plans are the primary savings for many individuals. During major disasters the tax code should not prevent individuals in need from accessing their savings.

Employment

3. Extension of WOTC to Katrina Victims. Under current law, the Work Opportunity Tax Credit allows employers to claim a credit against wages paid to new workers that face barriers to employment. It applies to special groups such as residents of empowerment zones, TANF-eligible families, high-risk youth, veterans, SSI beneficiaries, and voc-rehab referrals. The credit max is $2,400 (40% of first year wages up to $6,000, or 25% of wages if less than 400 hours worked). The proposal establishes an additional category of eligible new workers under the WOTC credit for Hurricane Katrina survivors, provided that the worker lived within the disaster zone and became unemployed as a result of damage or destruction to his or her workplace.

· Employers outside the disaster area may hire qualifying employees from the disaster area for one year (August 28, 2005, to August 28, 2006). A change of employer is required.

· Employers inside the disaster area may hire qualifying employees from the disaster area for three years (August 28, 2005, to August 28, 2008). A change of employer is required.

Hurricane Katrina victims who are willing and able to work will face many hardships including homelessness, health problems, and loss of documentation verifying eligibility. The WOTC credit exists to help employees who are currently facing barriers to employment. Hurricane survivors will face a unique set of barriers and need assistance in finding employment.

4. **Katrina Disaster Employee Retention Credit**. Current law allows employers to deduct the cost of salaries paid to employees. This proposal would provide a 40% tax credit for wages paid up to $6,000 if paid after August 28, 2005, and before December 31, 2005, by employers located in the disaster zone. Also, the employee's usual and principal place of work must have been in the disaster zone, but the credit is not affected if the employee reports to work at another location. Employers of activated military Reservists and Guards would also be eligible for this credit as many have been participating in a "pay protection" effort. Wages paid to relatives would be ineligible for the credit. Many of these businesses are not operating at all and are tapping into savings to keep their workforce together during this tragedy. Senators Grassley and Baucus believe the government should assist the loyal employers who are doing the right thing and keeping their workers on payroll.

Housing

5. **Incentive for Housing Aid**: Current law provides a personal exemption for taxpayers, spouses, and dependents. The deduction amount for 2005 is $3,200. The proposal would provide taxpayers who house dislocated persons from Hurricane Katrina for a minimum of sixty days in their principal residences an additional personal exemption of $500 per dislocated person (maximum $2,000 deduction). This additional exemption is not eligible for any person already claimed on the taxpayer's return. This provision would not affect any deductions or exemptions due to the dislocated person on his or her tax return. This proposal will help defray some of the costs incurred by compassionate neighbors and encourage others to do the same.

6. **Relax Restrictions on Mortgage Revenue Bonds**: Mortgage revenue bonds are tax-exempt bonds that state and local governments generally issue through housing finance agencies. The proceeds from the bonds are used to fund below-market interest rate mortgages for certain first-time homebuyers meeting income and purchase price restrictions. Senators Grassley and Baucus believe that it is important to support home ownership in the area impacted by Katrina. The proposal would provide greater access to mortgage revenue bond proceeds by lifting the first-time homeowner requirement and relaxing the purchase price and income limitations for homes in the area damaged by Katrina for the three years following the disaster.

Charitable Giving; Taxpayer Assistance and Protection

7. **Encourage Food Donations by Businesses**: The proposal provides an enhanced deduction for donations of food inventory for businesses through December 31, 2005. 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 contributions of food 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. The proposal would allow all taxpayers to claim an enhanced deduction for donations of food inventory equal to the lesser of fair market value or twice basis. Senators Baucus and Grassley want to encourage farmers, ranchers, food producers, and sellers to donate surplus food inventory during this period when so many are relying on assistance.

8. <u>Encourage Book Donations by Businesses</u>: The proposal provides an enhanced deduction for donations of book inventory through December 31, 2005. Under present law, taxpayers 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 for donations of book inventory. The proposal would allow taxpayers to claim an enhanced deduction for donations of book inventory equal to the lesser of fair market value or twice basis. Senators Baucus and Grassley understand that with the influx of many dislocated children in the wake of hurricane Katrina, many schools across the country lack the supplies they need to handle the additional student population. This proposal is intended to encourage donations of books to schools and other educational programs during this period.

9. <u>IRA Charitable Rollover</u>: The provision would exclude from gross income otherwise taxable Individual Retirement Account (IRA) withdrawals from a traditional or a Roth IRA for qualified charitable distributions. Under the provision, taxpayers who are 70½ and older would be allowed to rollover amounts from their IRA accounts directly to a qualified charitable organization on a tax-free basis. In addition, the provision allows taxpayers aged 59½ and older to transfer IRA funds to a charitable remainder trust and give a remainder trust and give a remainder interest in the trust to charity without tax consequence. Senators Baucus and Grassley believe that removing obstacles for taxpayers to donate their IRAs to charity during this difficult period will provide an important incentive to give to charities. The provision would be effective through December 31, 2005.

10. <u>Corporate Charitable Contributions</u>: The amount allowed as a charitable deduction for a corporation in any taxable year may not exceed ten percent of the corporation's taxable income. The proposal would temporarily increase the percentage limitation to fifteen percent of the corporation's taxable income for one taxable year ending on or before December 31, 2006.

11. <u>Individual Income Limits for Cash Contributions</u>: The proposal raises the permitted cash contribution level for individuals from fifty percent to sixty percent of adjusted gross income for tax years ending on or before December 31, 2005.

12. <u>Encourage IRS Information-sharing with State Charity Officials</u>: This proposal allows the IRS to disclose to appropriate state officials information regarding organizations for which the IRS has denied or revoked tax-exempt status or certain other actions the IRS may have taken. Unfortunately, there have already been numerous news reports of scam artists creating fraudulent charities to take advantage of Americans who want to help the victims of Katrina. Senators Grassley and Baucus want to ensure that the IRS and state officials are working closely together to combat fraudulent charitable organizations taking advantage of a generous public.

13. Taxpayer Assistance: To ensure that families and businesses receive the full benefit of these proposed tax relief provisions, it is vital that the IRS be able to provide significant taxpayer assistance to those affected and to administer effectively the tax relief provisions proposed today. Some of these provisions encourage charitable giving, allow taxpayers to access retirement funds without penalty, and expand the availability of tax-exempt bonds for rebuilding homes. In addition, the IRS is expediting reviews of applications from new organizations seeking tax-exempt status as well as requests from donors seeking to verify an organization's tax-exempt status. This proposal dedicates all fees from employee plan and exempt organization letter rulings and determination letters to IRS for its own disaster recovery, tax relief administration and assistance and for administration of tax-exempt entities and charitable donations. Current law provides that only a portion of these fees are dedicated for the use of the IRS.

14. Increased Mileage Rate for Calculating Charitable Contribution Mileage Deduction: The mileage rate individuals may use to compute a tax deduction for personal vehicle expenses associated with charitable work is statutory and has not been increased since 1997. This proposal sets the charitable mileage rate at fifty percent of the standard business mileage rate that is determined periodically by the Internal Revenue Service. Making the rate flexible by linking it to the business rate takes fluctuations in gas prices into account and will encourage charitable activity.

15. Casualty Loss Provision. Under present law, non-business casualty losses are deductible by taxpayers who itemize only to the extent they exceed ten percent of adjusted gross income and a one-hundred dollar floor. In some circumstances, taxpayers are permitted to include a current-year casualty loss on an amended prior year return. The proposal eliminates the ten percent floor for casualty losses incurred in the Hurricane Katrina disaster area, including those claimed on amended returns. Removing the floor will result in increased loss deductions and the amended return option will get money to the victims much sooner, helping them to get back on their feet.

16. Section 1033(h) Involuntary Conversions. Present law allows taxpayers not to recognize gain with respect to homes that are damaged or destroyed as a result of a presidentially declared disaster if the taxpayer replaces the property within a four-year period. Business property that is destroyed must be replaced within a two-year period to avoid gain recognition. The proposal extends the replacement period to five years for a taxpayer to purchase property to replace property that was damaged or destroyed within the presidentially declared disaster area for Katrina. The extended replacement period applies to principal residences and business property.

17. IRS Administrative Relief: The Internal Revenue Code authorizes the Secretary to extend deadlines for up to one year to file tax returns and to make payments and deposits for income, estate and gift taxes. Employment taxes are specifically excluded and excise taxes are not specifically included. The IRS issued a notice for victims of Katrina extending the time period until January 3, 2006, to file any returns, pay any taxes or make any deposits due. Although this is intended to apply to employment and excise taxes, it is unclear that the IRS has the authority to do so. This proposal extends the deadlines until February 28, 2006, and clarifies that the extension includes employment and excise taxes in addition to income, estate and gift taxes. Penalties and interest that would otherwise apply are waived.