

Client Alert

A report
for clients
and friends
of the firm

October 2005

Katrina Tax Relief Legislation Increases Deduction Limits on Charitable Contributions of Cash

The "Katrina Emergency Tax Relief Act of 2005" ("KETRA"), signed into law by President Bush on September 23, 2005, temporarily lifts certain deductibility limits on charitable contributions of cash made during the period between August 28, 2005 and December 31, 2005. In the case of individual donors, there is no requirement that the contributions be made to organizations engaged in Hurricane Katrina relief efforts.

Suspension of Percentage Limitations

Contributions by Individuals

Under current law, the amount deductible by an individual taxpayer is limited to a percentage of the taxpayer's contribution base, which is his or her adjusted gross income ("AGI") without regard to any net operating loss carryback. The applicable percentage limitation depends on the nature of the donee organization, but in any case, the deduction is capped at 50 percent of the taxpayer's contribution base. Any charitable contributions in excess of the percentage limitation may generally be carried forward as a deduction in the following five years.

The provisions in KETRA remove the 50 percent limitation and allow deductions for "Qualified Contributions" (defined below) up to the amount by which the taxpayer's contribution base exceeds the deduction for other charitable contributions. Qualified Contributions which exceed this amount may generally be carried forward as a deduction in the following five years.

For example, assume individual A's contribution base is \$100,000. On July 30, 2005, A contributed \$60,000 to University X. Before the passage of KETRA, A would have been allowed a \$50,000 deduction for 2005, reaching his or her 50% cap. The excess, an additional \$10,000, may be carried forward as a deduction in the following five years. Now assume that on October 4, 2005, A made a Qualified Contribution of \$80,000. Under KETRA, A is allowed a deduction of \$100,000 for 2005 (\$50,000 computed without regard to the Qualified Contribution plus \$50,000 from the Qualified Contribution). \$40,000 (\$10,000 of excess from the June 30 contribution plus \$30,000 of excess from the October 4 contribution) may be carried forward as a deduction in the following five years.

Contributions by Corporations

Under current law, charitable contributions made by corporations are capped at 10 percent of the corporation's taxable income computed without regard to net operating or capital loss carrybacks.

KETRA waives the 10 percent limitation rule and allows a deduction for Qualified Contributions made by corporations up to the amount by which the corporation's taxable income exceeds the deduction for other charitable contributions. Contributions exceeding this amount may generally be carried over to succeeding taxable years.

Qualified Contributions

Qualified Contributions are defined as 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) of the Internal Revenue Code of 1986, as amended (the "Code"), such as churches, hospitals, schools, universities, and other qualified non-profit organizations. Thus, contributions made to private foundations are excluded.

In the case of a corporation, Qualified Contributions must be for relief efforts related to Hurricane Katrina.

Corporate taxpayers are required to substantiate that the contribution is made for such a purpose.

In the case of both individuals and corporations, a taxpayer must also elect to have the contributions treated as Qualified Contributions.

Donor-Advised Funds and Supporting Organizations Excluded

Qualified Contributions do not include contributions for the establishment or maintenance of a segregated fund or account with respect to which the donor (or the donor's appointees) has, or reasonably expects to have, advisory privileges with respect to distributions or investments by reason of the donor's status as a donor. In addition, Qualified Contributions do not include contributions to supporting organizations described in section 509(a)(3) of the Code.

Overall Limitation on Itemized Deductions

Under current law, the total amount of otherwise allowable itemized deductions (other than medical expenses, investment interest, and casualty, theft, or wagering losses) is reduced by 3 percent of the taxpayer's AGI in excess of a certain threshold. For 2005, that AGI threshold is \$145,950 (\$72,975 for a married individual filing a separate return).

Under KETRA, the charitable deduction up to the amount of Qualified Contributions made during the year is not treated as an itemized deduction for purposes of the overall limitation on itemized deductions.

**NEW YORK • LOS ANGELES • WASHINGTON
BOSTON • BOCA RATON • NEWARK
NEW ORLEANS • PARIS**

Client Alert

The Tax Department at Proskauer Rose LLP counsels domestic, foreign and tax-exempt clients in a broad spectrum of tax issues. For more information about this practice area, contact:

Jacob I. Friedman
212.969.3805 – jfriedman@proskauer.com

Amanda H. Nussbaum
212.969.3642 – anussbaum@proskauer.com

Andrew H. Kleiman
212.969.3133 – akleiman@proskauer.com

Proskauer Rose is an international law firm that handles a full spectrum of legal issues worldwide.

You can also visit our Website at www.proskauer.com

This publication is a service to our clients and friends. It is designed only to give general information on the developments actually covered. It is not intended to be a comprehensive summary of recent developments in the law, treat exhaustively the subjects covered, provide legal advice or render a legal opinion.

© 2005 PROSKAUER ROSE LLP. All rights reserved.