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CLIENT NEWSLETTER

NEW TAX LAW:

On September 23, 2005, the president signed the Katrina Emergency Tax Relief Act of 2005, which contains 21 separate tax provisions that apply to victims of the hurricane and those assisting and/or making contributions to the relief operations. The special relief provisions in this act are specific only to victims of Hurricane Katrina. Victims of Hurricanes Rita and Wilma and other disasters are not covered by the new law – at least not yet. Here are a few of the provisions that might benefit you.

Charitable-giving incentives:

You may deduct a larger amount of cash donations for any donations made between August 28 and December 31, 2005 to any qualified charity.

If you provide shelter for individuals displaced by Hurricane Katrina, you may claim an exemption of \$500 per person housed (with a maximum of \$2,000).

The deductible mileage rate for Katrina relief work is increased to 29/34 cents per mile

Retirement plan relief:

Victims may take up to \$100,000 in qualified disaster-relief distributions from an IRA or pension plan. The tax on the distributions may be spread over 3 years and the distributions are not subject to a penalty. You may also recontribute the amount to a plan within three years and pay no tax.

The maximum loan amount from qualified plans has increased to \$100,000 for victims.

Other benefits:

Two work-related credits for employers affected by Hurricane Katrina.

Cancellation of non-business debt due to Katrina is not taxable income.

Non-business Katrina casualty losses are not subject to any deductible amounts, thus increasing the tax deduction.

You have 5 years (rather than 3) to replace property destroyed due to Katrina.

Victims of Katrina may use 2004 or 2005 income to compute the Earned Income Credit and refundable Child Tax Credit.

Filing and payment deadlines for victims have been extended and there will be relief of penalties and interest. (Filing extensions and interest forgiveness also apply to victims of Hurricane Rita and to most state taxes, as well.)

State benefits:

Many states (such as California) have not yet conformed to these new federal tax benefits. If you have been affected by Katrina or are making large charitable contributions, we should talk about how best to plan your 2005 tax situation, including the state impact.

YEAR END TAX STRATEGIES:

It's that time of year again – time to start planning to cut your 2005 taxes.

Here is a tax strategy that works for a lot of people. It's called "bunching deductions". To understand how bunching works, start with the basic idea that you can take either the "standard deduction" or your itemized deductions, whichever amount is greater. Now, as an example, let's say, each year your standard deduction is \$10,000 and your itemized deductions add up to \$8,000 (I'm using round numbers to illustrate). In that case, you will use your standard deduction while your itemized deductions go to waste – every year!

Now suppose there were a way to shift your \$8,000 of itemized deductions from Year 1 to Year 2. In that case, you'd still get a standard deduction of \$10,000 in Year 1 but in Year 2 your itemized deductions add up to \$16,000. If you keep doing this each year, you get a tax break every other year.

Some deductible expenses can't be shifted, of course, but here are some that can:

Charitable contributions: You have complete control over the timing of charitable contributions. Many people like to give large contributions to their place of worship during the holiday season. So, in year 1 wait a week and make the contribution just after December 31 to push the deduction to Year 2. In Year 2 make the contribution in December. As such, both contributions are made in Year 2. In Year 3 wait until January of Year 4, and so on.

Medical expenses: You have no control over when you get sick but you have a lot of control over when you pay for services. You also have control over when you get your annual checkups. Schedule those checkups near the end of the year and vary between December and January. And here's a big one: Call your insurance company and schedule your annual premium billing to arrive in December with a January due date.

Property taxes: Many jurisdictions allow for semi-annual payments with the two payments crossing into different calendar years. So, in one year break up the payments into two. In the other year, make a full year's payment on the initial due date.

State taxes: This area can get a little tricky but, if you make quarterly estimated state tax payments you can control whether you make your fourth quarter payment in December or January. There are other ways to control your state tax payments but there are penalties if you don't follow certain rules.

These are just a few general ideas and there are other considerations at work. If you want to discuss any of these issues, please contact me.

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