Tax Relief and Health Care Act of 2006

On December 9, 2006, Congress passed the long-awaited legislation extending many popular but expired tax provisions. In addition to the extenders, the legislation also included some new tax provisions, including ones impacting HSAs and individuals with certain minimum tax credit carryovers. The President signed the bill on December 20, 2006.

Extended Provisions – Individual Tax		
Archer Medical Savings Accounts — New Accounts	2006 and 2007	Any eligible individual can establish a new Archer MSA through 2007.
Continuing-Care Facilities — Imputed Loan Interest	2011 and later years	The exemption from the imputed interest rules for certain loans individuals age 62 or older make to a qualified continuing care facility is made permanent.
Earned Income Credit—Combat Pay	2007	The election to include combat pay as earned income for purposes of the EIC is extended one year to 2007.
Educator's Deduction	2006 and 2007	The provision allowing teachers and other educators an above-the-line deduction for up to $250 of qualified classroom expenses is extended for two years to 2006 and 2007.
Musical Works—Capital Gain Treatment	Sales and exchanges after 2010	The election to treat self-created musical works as capital assets when sold or exchanged is made permanent.
Residential Energy Efficient Property Credit	Property placed in service in 2008	The 30% tax credit allowed for the cost of certain residential energy efficient property is extended one year to include property placed in service through 2008.
State and Local Sales Taxes Deduction	2006 and 2007	The election to deduct state and local sales taxes in lieu of state and local income taxes is extended for two years to 2006 and 2007.
Tuition and Fees Deduction	2006 and 2007	The deduction for qualified tuition and fees is extended two years to 2006 and 2007. The same rules that applied in 2005 (for example, deduction amounts and AGI limits) apply for 2006 and 2007.

2006 Form 1040—Reporting Extended Tax Provisions

The IRS announced details on how taxpayers can use existing lines on the current Form 1040 and other tax documents to claim the three major extenders provisions. The key forms (Forms 1040, 1040A, Schedule A&B, and instructions) went to print in early November and reflected the law in effect at that time. The instructions contain a cautionary note to taxpayers that the legislation was pending at the time of printing.

Taxpayers using Form 1040 will have to follow special instructions if they are claiming any of the three deductions. Form 1040 will not be updated. Instead, taxpayers should follow these steps:

Higher Education Tuition and Fees Deduction:

- Taxpayers must file Form 1040 to take this deduction for up to $4,000 of tuition and fees paid to a post-secondary institution. It cannot be claimed on Form 1040A.
- The deduction for tuition and fees will be claimed on Form 1040, line 35, "Domestic production activities deduction." Enter "T" on the dotted line to the left of that line entry if claiming the tuition and fees deduction, or "B" if claiming both a deduction for domestic production activities and the deduction for tuition and fees. For those entering "B," taxpayers must attach a breakdown showing the amounts claimed for each deduction.

State and Local General Sales Tax Deduction:

- The deduction for state and local general sales taxes will be claimed on Schedule A (Form 1040), line 5, "State and local income taxes." Enter "ST" on the dotted line to the left of line 5 to indicate you are claiming the general sales tax deduction instead of the deduction for state and local income tax.
- The IRS also will issue Publication 600 for 2006, which includes the state and local sales tax tables, a worksheet and instructions for figuring the deduction.

Educator Expenses Deduction:

- Educators must file Form 1040 in order to take the deduction for up to $250 of out-of-pocket classroom expenses. It cannot be claimed on Form 1040A.
- The deduction for educator expenses will be claimed on Form 1040, line 23, "Archer MSA Deduction." Enter "E" on the dotted line to the left of that line entry if claiming educator expenses, or "B" if claiming both an Archer MSA deduction and the deduction for educator expenses on Form 1040. If entering "B," taxpayers must attach a breakdown showing the amounts claimed for each deduction.

Other Individual Tax Provisions		
AMT—Minimum Tax Credit (MTC) Carryforward	2007 - 2012	A portion of an individual's MTC may qualify as an "AMT refundable credit amount", which is a refundable credit to the extent it exceeds the tax liability for the year. The AMT refundable credit amount (computed annually) equals the greater of (a) $5,000, or the long-term unused MTC, if less, or (b) 20% of the long-term unused MTC. • The "long-term unused MTC" is the amount of the MTC credit applicable to tax years before the 3rd immediately preceding tax year (for example, for 2007, the MTC attributable to 2003 and earlier years). • MTC carryforwards are assumed to be used on a FIFO basis. • The AMT refundable amount phases-out for high income taxpayers.
HSAs — Funding with FSA and HRA Terminations	Transfers on or after date of enactment and before 2012	Subject to certain limitations, an employer may make a one-time transfer of the balance in an employee's flexible spending account (FSA) or health reimbursement account (HRA) to the employee's health savings account (HSA). The employee is not taxed on the transfer out of the FSA or HRA nor is a deduction allowed for the transfer into the HSA.
HSAs — Funding with IRA Distribution	2007 and later years	An individual may contribute to an HSA (subject to normal annual limits) using a one-time direct trustee-to-trustee transfer from an IRA. The distribution from the IRA is not taxable nor is the HSA contribution deductible.
HSAs — Limit on Contributions	2007 and later years	The rule limiting allowable contributions to the health plan's annual deductible, if less than the IRS-prescribed amount, is repealed. Thus, after 2006, an HSA contribution can be made up to the IRS-prescribed amount without regard to the plan's annual deductible.

HSAs — Part-Year Coverage	2007 and later years	The HSA contribution limit is based on a full year's coverage even though actual coverage during the year is less than 12 months provided the taxpayer maintains the high deductible health coverage throughout all of the next tax year.
Mortgage Insurance Premiums — Principal Residence	2007	Taxpayers can claim an itemized deduction for mortgage insurance premiums paid or accrued in connection with acquisition indebtedness on a qualified personal residence. The deduction phases out ratably by 10% for each $1,000 (or portion thereof) by which the taxpayer's AGI exceeds $100,000. (Phase-out amounts are halved for MFS). Thus, it's not available for taxpayers with AGI greater than $109,000 ($54,500 for MFS). Only amounts paid on mortgage insurance contracts issued after 2006 qualify. **Note:** The Joint Committee on Taxation Report states that the deduction doesn't phase out completely until AGI exceeds $11110,000. However, based on the actual wording of the law, it's phased out when AGI exceeds $109,000.
Residence Gain Exclusion — Employees of the Intelligence Community	2007-2010	The special rules allowing members of the uniformed services or foreign service to suspend the five-year test period for purposes of excluding gain from the sale of their principal residence is extended to employees of the intelligence community (for example, CIA, National Security Agency, etc.) stationed overseas.

Extended Provisions—Business Tax		
Bonus Depreciation — GO Zone Property	Property placed in service in 2009 and 2010	For purposes of the 50% bonus depreciation allowed for property placed in service in the Gulf Opportunity (GO) Zone, the deadline for certain depreciable real property is extended two years to property placed in service before 201111. Personal property and software used in such real property also qualifies for bonus depreciation if certain conditions are met. Only property located in a county or parish of the GO Zone that sustained damage from the 2005 hurricanes to more than 60% of its occupied housing units is eligible for the extension.
Charitable Donations — Scientific Property and Computer Equipment	Property donated in tax years beginning in 2006 and 2007	C corporations can claim an enhanced deduction for donations of certain constructed scientific property or computer equipment. Qualified donations now also include property assembled by the taxpayer and for donations of computer equipment, the enhanced deduction is extended for two years (the provision for donations of scientific property is permanent).
Credit for New Energy Efficient Homes	Homes sold in 2008	The tax credit allowed to builders of energy efficient homes is extended one year to include homes sold through 2008.
Depreciation — Indian Reservation Property	Property placed in service in 2006 and 2007	The accelerated depreciation provisions for business property located on and used to conduct business on an Indian reservation is extended for two years to property placed in service through 2007.
Depreciation — Qualified Leasehold Improvements and Qualified Restaurant Property	Property placed in service in 2006 and 2007	The reduced MACRS recovery period (from 39 to 15 years) for qualified leasehold improvements and qualified restaurant property is extended for two years to property placed in service in 2006 and 2007.
Energy Efficient Commercial Buildings Deduction	Property placed in service in 2008	A building owner's deduction for certain energy saving improvements is extended one year to include property placed in service through 2008.
Indian Employment Tax Credit	Tax years beginning in 2006 and 2007	The tax credit for wages and health insurance costs paid to enrolled members of an Indian tribe (or their spouse) who live on or near and work on an Indian reservation is extended for two years.
New Markets Tax Credit	2008	The new markets tax credit is extended a year to 2008.

Percentage Depletion — Taxable Income Limit	Tax years beginning in 2006 and 2007	The taxable income limit on the amount of percentage depletion allowed for marginal production properties is suspended through tax years beginning in 2007.
Research Tax Credit	Amounts paid or incurred after 2005 and before 2008	The tax credit for business research and experimental expenditures is extended for two years. In addition, for tax years ending after 2006, the rates for the alternative incremental credit are increased and a new alternative simplified credit is available.
Welfare-to-Work (WTW) Credit and Work Opportunity Tax Credit (WOTC)	Wages paid to workers beginning work in 2006 and 2007	The WTW credit (available to businesses hiring certain long-term family assistance recipients) and the WOTC (available to businesses hiring specially targeted groups of individuals) are extended, without modification, to include individuals beginning work in 2006. For 2007, the two credits are combined and modified by expanding the eligibility of food stamp recipients (age increased from 25 to 40), revising the eligibility requirements for ex-felons (without regard to family income) and increasing the certification filing deadline from 21 to 28 days.

Other Business Tax Provisions		
U.S Production Deduction	First two tax years beginning after 2005 and before 2008	The Section 199 domestic producers deduction is expanded to allow businesses operating in Puerto Rico to include their Puerto Rico activities (if subject to U.S. tax) when computing the deduction.