

PKF PERSPECTIVES

TAX RELIEF AND HEALTH CARE ACT OF 2006

On December 20, 2006, the "Tax Relief and Health Care Act of 2006" (the "Act") was signed into law by President Bush. The Act extended a number of provisions, modified others, and created some new provisions. The Act is a wide-ranging measure that preserves a variety of popular tax breaks for families and businesses, extends energy provisions encouraging alternative and renewable energy sources, and includes trade, oil drilling, and Medicare provisions. Here is a look at some of the key tax provisions in the new law that affect individual and business taxpayers.

Taxpayers have **two options** for determining deductible sales tax:

- (1) actual sales tax paid if receipts are maintained for IRS verification, **or**
- (2) approximate sales tax paid as estimated in tables provided by the Secretary of the Treasury plus sales tax on certain additional items (such as a boat or car) that may be added to the table amount.

COMBAT PAY TREATED AS EARNED INCOME FOR PURPOSE OF THE EARNED INCOME TAX CREDIT

The rule allowing excluded combat pay to count as income for purposes of calculating the earned income tax credit is extended through 2007.

NEW LAW CHANGES AFFECTING INDIVIDUALS

TUITION DEDUCTION

The tax deduction for qualified higher education expenses is extended through 2007. The deduction allows taxpayers to deduct up to \$4,000 (depending on their income) of higher education expenses in lieu of claiming the Hope or Lifetime Learning tax credits. The deduction is taken "above-the-line," meaning that it may be claimed by all

individual taxpayers regardless of whether they itemize their deductions.

DEDUCTION FOR CERTAIN EXPENSES OF ELEMENTARY AND SECONDARY SCHOOL TEACHERS

The tax break permitting elementary and secondary school teachers and certain other school professionals to deduct up to \$250 of out-of-pocket costs incurred to purchase books, supplies and other classroom equipment is extended through 2007.

The deduction is available to all individual taxpayers regardless of whether they itemize their deductions.

AVAILABILITY OF MEDICAL SAVINGS ACCOUNTS

New contributions to Archer medical savings accounts ("Archer MSAs") may be made through 2007 (instead of through 2005, as under prior law).

New contributions may be made after 2007 only by or for individuals who previously had Archer MSAs, and employees who are employed by a participating employer.

STATE AND LOCAL GENERAL SALES TAXES

The tax break allowing individual taxpayers to elect to take an itemized deduction for state and local general sales taxes in lieu of the itemized deduction permitted for state and local income taxes is extended through 2007.



Individuals may make tax-deductible contributions to an Archer MSA to pay for health care expenses. The distributions are tax-free if used to pay for eligible medical expenses.

EXTENSION OF CERTAIN EXPIRING ENERGY PROVISIONS AND OTHER ENERGY PROVISIONS

The new law provides an extension through 2008 of a number of energy provisions that would have expired at the end of 2007 under prior law.

For individuals, the most important of these provisions is a one-year extension of the 30 percent tax credit for the purchase of residential solar water heating, solar electric equipment and fuel cell property through December 31, 2008.

HEALTH SAVINGS ACCOUNT PROVISIONS

The new law includes many changes for health savings accounts (HSAs), including:

- allowing one-time rollovers from health flexible spending accounts (FSAs) and health reimbursement arrangements (HRAs) into HSAs (after the enactment date and before 2012);
- repeal of the annual plan deductible limit on HSA contributions (after 2006);
- expanded contributions limit for part year coverage (after 2006); **and**
- allowing one-time rollovers from IRAs into HSAs (after 2006).

INCENTIVE STOCK OPTION AMT PROVISIONS

For tax years beginning after the enactment date, a new law change allows individuals to take advantage of a refundable credit with respect to certain long-term unused alternative minimum tax (AMT) credits existing before January 1, 2013. The annual credit amount, subject to a phase-out, is the greater of

- (1) the lesser of \$5,000 or the amount of the long-term unused AMT credit, **or**

- (2) 20 percent of the amount of the long-term unused AMT credit.

This provision is designed to help taxpayers who wound up with AMT problems because of their exercise of incentive stock options.

PREMIUMS FOR MORTGAGE INSURANCE

A new itemized deduction for the cost of premiums for mortgage insurance on a qualified personal residence is established. The deduction is phased-out ratably by 10 percent for each \$1,000 by which the taxpayer's adjusted gross income exceeds \$100,000. The new deduction applies for 2007 only.

FRIVOLOUS SUBMISSIONS

The new law increases the penalty for frivolous tax return submissions from \$500 to \$5,000 and expands the penalty to all taxpayers and all types of Federal taxes. This increased penalty also applies to frivolous submissions for lien and levy collection due process, installment agreements, offers-in-compromise, and taxpayer assistance orders.

NEW LAW CHANGES AFFECTING BUSINESSES

RESEARCH TAX CREDIT

The research and development (R&D) credit, which expired at the end of 2005 under prior law, is extended to qualified amounts paid or incurred during 2006 and 2007. In addition, for tax years ending after 2006, the new law enhances the credit by

- (1) increasing the rates of the alternative incremental credit, **and**
- (2) creating a new alternative simplified credit that does not use gross receipts as a factor (so that newer businesses can access the credit).



WORK OPPORTUNITY AND WELFARE-TO-WORK TAX CREDITS

The work opportunity tax credit (WOTC), which is a credit for wages paid by employers who hire individuals from certain targeted groups, and the welfare-to-work tax credit (WWTC), which is a credit for wages paid by employers who hire long-term family assistance recipients, are extended in their current form for 2006 and combined in 2007. Modifications of the combined credit include expanded eligibility for the WOTC (raised age ceiling for food stamp recipients from 25 to 40), revised eligibility requirements for ex-felons, and extension of the paperwork filing deadline from 21 days to 28 days.

NEW MARKETS TAX CREDIT

The credit is extended for one year (through the end of 2008), permitting a \$3.5 billion maximum annual amount of qualified equity investments. A ***new markets tax credit*** applies for qualified equity investments to acquire stock in a community development entity (CDE).

A CDE is any domestic corporation or partnership

- (1) whose primary mission is serving or providing investment capital for low-income communities or low-income persons,
- (2) that maintains accountability to residents of low-income communities through representation on governing or advisory boards of the CDE, **and**
- (3) is certified by the Treasury Department as an eligible CDE.

QUALIFIED ZONE ACADEMY BONDS (QZABs)

QZABs are tax credit bonds issued by states or localities principally for school renovation. Bond holders may claim a tax credit against Federal income taxes in lieu of receiving interest.

The new law extends QZABs for two years and authorizes states to issue up to \$400 million of QZABs for 2006 and 2007.

The new law also adds special rules relating to expenditures and arbitrage and new information reporting rules.

BROWNFIELD REMEDIATION EXPENSING

Expensing of costs associated with cleaning up hazardous ("brownfield") sites is extended through 2007, and the definition of an eligible contaminated site is expanded to include sites contaminated by petroleum products.

LEASEHOLD AND RESTAURANT IMPROVEMENT RECOVERY

The accelerated writeoff for certain leasehold improvements and restaurant property (depreciation over 15 years instead of 39 years) is extended through 2007.

ENHANCED DEDUCTION FOR CORPORATE CONTRIBUTIONS OF COMPUTER EQUIPMENT FOR EDUCATIONAL PURPOSES



A corporation may claim an enhanced deduction equal to the lesser of

- (a) basis plus half of the property's appreciation, **or**
- (b) twice the property's basis, for contributions of scientific equipment or apparatus to a higher education institution or a tax-exempt organization (but not a private foundation) organized and operated primarily to conduct scientific research.

GO ZONE BONUS DEPRECIATION

The bonus 50 percent first-year depreciation break that was included in the Gulf Opportunity Zone Act of 2005 is modified by extending the placed-in-service deadline for certain property used in certain highly damaged areas within the Gulf Opportunity Zone.

MANUFACTURING DEDUCTION FOR U.S. BUSINESSES WITH BRANCHES IN PUERTO RICO

The new law allows qualifying U.S. businesses operating as branches in Puerto Rico to claim the Section 199 domestic manufacturing deduction, effective for the first two years of the taxpayer beginning after 2005 and before 2008.

MINE SAFETY PROVISIONS

The new law provides 50 percent expensing for certain equipment expenditures related to safety equipment for underground mines located in the United States and provides tax credits for certain mine rescue team training programs, effective for three years through 2008.

NEW LAW CHANGES AFFECTING ENERGY PROVISIONS

CREDIT FOR ELECTRICITY PRODUCED FROM CERTAIN RENEWABLE RESOURCES

The placed-in-service date for facilities qualifying for the renewable electricity production tax credit is extended for one year through December 31, 2008 for certain facilities (e.g., those producing electricity from wind, closed-loop biomass, open-loop biomass, small irrigation, landfill gas, and trash combustion).

ENERGY CREDIT FOR CERTAIN BUSINESS PURCHASES

The 30 percent business tax credit for the purchase of fuel cell power plants and solar equipment is extended through December 31, 2008.

CREDIT TO HOLDERS OF CLEAN RENEWABLE ENERGY BONDS

The clean renewable energy bond (CREB) program is extended through December 31, 2008 and an additional \$400 million of CREB bonding authority is provided.

SPECIAL DEPRECIATION ALLOWANCE FOR CELLULOSIC BIOMASS ETHANOL PLANT PROPERTY

The new law provides 50 percent bonus first-year depreciation for new qualified cellulosic ethanol plants placed in service after the date of enactment of the new law and before 2013.

CREDIT FOR NEW ENERGY EFFICIENT HOMES

The tax credit for builders of new energy efficient homes is extended for one year through December 31, 2008. The credit applies to manufactured homes meeting a 30 percent energy reduction standard and other homes meeting a 50 percent standard.

DEDUCTION FOR ENERGY EFFICIENT COMMERCIAL BUILDINGS

The deduction for energy efficient commercial buildings meeting a 50 percent energy reduction standard is extended for one year, through December 31, 2008.

CLEAN COAL GASIFICATION TAX CREDIT

The tax credits for subbituminous coal gasification projects are modified, effective for applications for certification submitted after October 2, 2006, to ensure that more of these facilities are constructed.

Items in this publication should not be considered official statements of position, nor advice for individuals or organizations without consulting a professional advisor. This information is not intended to be, nor can it be, used by any taxpayer for the purpose of avoiding tax penalties. For more information, please contact tax directors Leo Parmegiani or Joe Lee.

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