

The recently passed 2006 Tax Relief and Health Care 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 the key tax provisions in the new law.

ITEMS AFFECTING INDIVIDUAL TAXPAYERS

Extension and modification of certain tax relief provisions: The new law extends through 2007, and in certain circumstances modifies, provisions which under prior law either expired at the end of 2005 or would have expired at the end of 2006. These include:

- ***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.
- ***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.
- ***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. 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% tax credit for the purchase of residential solar water heating, solar electric equipment and fuel cell property through Dec. 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).

Other tax relief provisions: The new law also contains a package of other tax provisions designed to provide additional tax relief and certainty to taxpayers. These include:

- ***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 Jan. 1, 2013. The annual credit amount, subject to a phase-out, is the greater of (i) the lesser of \$5,000 or the amount of the long-term unused AMT credit, or (ii) 20% 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.
- ***Self-created musical works.*** The tax break that was enacted on a temporary basis in 2005 providing capital gains treatment for self-created musical works when these works are sold by the artist is made permanent.
- ***Sale of residences by intelligence officers.*** The new law gives non-military intelligence officers stationed abroad the same liberalized home sale exclusion rules available to active military personnel. This change applies to sales of homes after the enactment date of the new law and before Jan. 1, 2011.
- ***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% for each \$1,000 by which the taxpayer's adjusted gross income exceeds \$100,000. The new deduction applies for 2007 only.
- ***Loans to qualified continuing care facilities.*** The new law makes permanent a provision contained in the Tax Increase Prevention and Reconciliation Act of 2005 that reforms the tax treatment of loans to qualified continuing care facilities.

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.

ITEMS AFFECTING BUSINESS TAXPAYERS

Extension and modification of certain tax relief provisions: The new law extends through 2007, and in certain circumstances modifies, provisions which under prior law either expired at the end of 2005 or would have expired at the end of 2006. These include:

- **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 (i) increasing the rates of the alternative incremental credit and (ii) 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.
- **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.
- **Indian employment tax credit.** The business tax credit available for employers of qualified employees that work and live on or near an Indian reservation is extended through 2007.
- **Accelerated depreciation for business property on Indian reservations.** A special depreciation recovery period for qualified Indian reservation property is extended to property placed in service through 2007.

- ***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.*** The rule that encourages businesses to contribute computer technology and equipment to schools by allowing an enhanced deduction for such contributions is extended through 2007.
- ***Suspension of 100 percent-of-net income limitation on percentage depletion for oil and gas from marginal wells.*** This tax break is extended through 2007.

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. It also contains a package of other energy provisions. The changes include:

- ***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 Dec. 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% business tax credit for the purchase of fuel cell power plants and solar equipment is extended through Dec. 31, 2008.
- ***Credit to holders of clean renewable energy bonds.*** The clean renewable energy bond (CREB) program is extended through Dec. 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% 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 Dec. 31, 2008. The credit applies to manufactured homes meeting a 30% energy reduction standard and other homes meeting a 50% standard.
- ***Deduction for energy efficient commercial buildings.*** The deduction for energy efficient commercial buildings meeting a 50% energy reduction standard is extended for one year, through Dec. 31, 2008.
- ***Clean coal gasification tax credit.*** The tax credits for subbituminous coal gasification projects are modified, effective for applications for certification submitted after Oct. 2, 2006, to ensure that more of these facilities are constructed.

Certain provisions made permanent: A number of provisions that were enacted on a temporary basis by the Tax Increase Prevention and Reconciliation Act of 2005 are made permanent, including:

- The provision treating environmental cleanup settlement funds as governmentally-owned (i.e., not subject to tax) if certain standards and requirements are met
- The provision simplifying the application of the active trade or business test to certain corporate distributions by applying this test on an affiliated group basis
- The provision providing capital gains treatment for self-created musical works when these works are sold by the artist