

Tax News Update

Morison Cogen LLP

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Tax Relief and Health Care Act of 2006

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As you may know, on December 20, 2006, President Bush signed into law the *Tax Relief and Health Care Act of 2006*. In addition to extending certain tax provisions that had expired

The above-the-line deduction for college tuition payments. This deduction also had expired after 2005. It allows you to deduct “above the line” a portion of qualified higher education tuition and fees. Taxpayers with adjusted gross incomes (AGIs) not exceeding \$65,000 for singles and \$130,000 for joint filers are eligible for a maximum annual deduction of \$4,000.

Those with AGIs up to \$80,000 for singles and \$160,000 for joint filers can deduct up to \$2,000.

Note that you can’t claim this deduction if you claim the Hope or Lifetime Learning credit for the same student. But the AGI phase-out ranges for the credits are lower (\$45,000 – \$55,000 for singles

and \$90,000 – \$110,000 for joint filers). So the deduction may benefit you if you don’t qualify for the credits.

Other extensions that benefit individuals include the deduction for up to \$250 of qualified out-of-pocket teacher expenses (through 2007), the availability of Archer Medical Savings Accounts (through 2007), and the credit for certain residential alternative energy expenditures (through 2008).

EXTENSIONS BENEFITING BUSINESSES

Several provisions geared more toward businesses have also been extended, including:

at the end of 2005 or that had been set to expire soon, the act introduces some new rules and important tax breaks we think you’ll want to know about.

EXTENSIONS BENEFITING INDIVIDUALS

Some of the extended provisions are specific to individuals. Two of the more significant — both extended through 2007 — are:

The state and local sales tax itemized deduction. This deduction, which had expired at the end of 2005, allows you to deduct either state and local income taxes or state and local sales taxes. It primarily benefits those living in states with no income tax but may also benefit taxpayers who live in low-income-tax states or who purchase major items, such as cars or boats. Referring to the Optional State Sales Tax Tables in IRS Publication 600 is the easiest way to calculate the deduction. But if you spend more than average for your income level, you may enjoy a larger deduction by saving your receipts and totaling up the actual sales tax paid.

*“What does the
Tax Relief
& Health
Care Act
mean to you”*

*New tax credits
for businesses &
individuals.*

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Tax Relief and Health Care Act of 2006 *(cont'd)*



New act extends many energy-related tax breaks.

The research and development (R&D) credit.

This credit, which had expired at the end of 2005, has been extended through 2007. Generally, it is equal to 20% of qualified research expenses in excess of a certain amount based on the company's historical activity. But businesses can instead

take the alternative incremental credit (AIC), based on a stated percentage of qualified expenses in excess of average expenses over four years.

For 2007 the new law enhances the R&D credit in two ways. First, it increases the stated percentage for the AIC. Second, it offers the alternative simplified credit (ASC), equal to 12% of qualified research expenses exceeding 50% of the previous three tax years' average expenses. If there were no qualified expenses in any of those years, the ASC equals 6% of the current year's expenses.

Combined with previous rule changes that have liberalized the requirements for taking this credit in recent years, the new law makes the credit a powerful tax-saving tool for many businesses.

Employment credits for hiring low-income workers. The new law not only extends the previously expired Welfare-to-Work and Work Opportunity credits through 2006 but also combines and enhances them for 2007. These credits benefit businesses hiring employees from certain economically disadvantaged groups, such as ex-felons and food stamp recipients. The credits generally equal 40% of qualified first-year wages or 25% of such wages if employment is more than 120 hours but less than 400. "Qualified" wages cannot exceed

\$6,000. This means that, depending on whether the 40% or 25% amount applies, the credit cannot exceed either \$2,400 or \$1,500 per eligible employee. Combining the two credits should make calculations easier.

The other 2007 enhancements include an extension of the time employers have to file certification documents and elimination of the requirement that ex-felons be from an economically disadvantaged family.

Accelerated depreciation for leasehold and restaurant improvements.

The extension of this provision through 2007 allows a shortened recovery period of 15 years (rather than 39 years) for qualified leasehold and qualified restaurant improvements. Those made to the interior of a nonresidential building more than three years after the building was placed in service generally qualify. And the improvements can be made by either the lessor or the lessee.

"The R & D credit has been extended"

ENERGY-RELATED TAX BREAKS

Many provisions have been extended through 2008, including:

The credit for energy efficient new homes, the deduction for energy efficient commercial buildings, the renewable electrical energy production credit, and the authority to issue clean renewable energy bonds.

Other extensions that benefit businesses include Gulf Opportunity Zone bonus depreciation (through 2010), the ability to deduct rather than capitalize certain environmental remediation costs (through 2007), and the deduction for corporate donations of certain computer and scientific equipment to schools and public libraries (through 2007).

HSA ENHANCEMENTS

As the act's name suggests, it also addresses health care, specifically Health Savings Accounts (HSAs). The new law makes notable and permanent changes to the HSA rules. HSAs allow you to contribute pretax income to an account that bears interest or is invested in mutual funds, and withdrawals for health care expenses are tax free. The maximum HSA contribution previously was limited to the lesser of the policy's deductible or the IRS-sanctioned maximum allowable amount. Now, starting in 2007, the policy's deductible does not factor into the contribution limit. Thus, regardless of the policy's deductible, for 2007 the contribution limit is \$2,850 for a policy with individual-only coverage and \$5,650 for a policy that covers the participant's family.

Other important changes with respect to HSAs include the following:

Annual contribution limits are no longer pro-rated for participants who become eligible during the year, so long as they are eligible at the end of the year. One caveat is that participants who later become ineligible may be subject to a recapture of prior deductions.

Participants can make a one-time transfer to their HSAs from flexible spending accounts (FSAs) and health reimbursement accounts (HRAs). The maximum transfer is the account balance on the day of the transfer or on Sept. 21, 2006, whichever is less. Transfers can be made on or after the date of enactment through Dec. 31, 2011.

And, in an effort to allow quicker access to retirement savings to pay medical expenses, the new law allows participants to make a one-time, irrevocable rollover of funds from an IRA into an HSA after Dec. 31, 2006. The rollover,



which is neither taxable as an IRA distribution nor deductible as an HSA contribution, is limited to the maximum allowable HSA contribution for the year.

EXPANDED AMT CREDIT

In an effort to help taxpayers who were stung by the AMT when they exercised qualified stock options and who haven't been able to use the resulting AMT credit in subsequent years, the new law allows for a refundable credit starting in 2007 and ending in 2012. The refundable amount each year depends on your long-term unused

minimum tax credits and AGI.

You may be able to claim as much as 20% of the unused AMT credit each year as a refundable credit if the unused amount is significant. Otherwise, you may be eligible to use the lesser of \$5,000 or the entire unused amount.

*“Permanent
changes to HSA
rules”*

MORE TAX BREAKS, TECHNICAL CORRECTIONS AND OBSOLETE TAX FORMS

Also included in the law is a new provision that permits you to deduct amounts paid for private mortgage insurance premiums — but only for amounts paid during 2007



New law allows for a refundable AMT credit starting in 2007.

Tax Relief and Health Care Act of 2006 *(cont'd)*

and only in certain situations. Further, there are various miscellaneous provisions in the

law that range from breaks with narrow applicability, such as permanent capital gains treatment for self-created musical works, to items as innocuous as technical corrections.

One interesting impact of changes being passed so late in the year is that the 2006 tax forms have already been printed and will have to be updated.

THE BOTTOM LINE

There are many tax saving opportunities within the *Tax Relief and Health Care Act of 2006* — some that may greatly benefit you. If you have questions about this important tax law or would like more information or how you might take full advantage of it to reduce your tax liability for 2006, 2007 and beyond, please give us a call.

Morison Cogen LLP remains focused on advising individuals and businesses on ways to minimize their taxes and maximize their financial well-being. We look forward to working with you to help you keep more of your money where it belongs—in your pocket, not the government's.

This act is among the latest tax legislation that may affect you. Stay informed.



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