



Tax Relief and Health Care Act of 2006 (H.R. 6111)

On December 20, 2006, President Bush signed the *Tax Relief and Health Care Act of 2006*. This long awaited legislation extends several tax breaks that expired on December 31, 2005. In addition to these extensions, the new law contains some new provisions for relaxing the rules for Health Savings Accounts (HSAs), a way to minimize the alternative minimum tax (AMT) consequences for those who exercised incentive stock options, and a one-year itemized deduction for private mortgage insurance on qualified personal residences.

This summary includes the key tax provisions of the new legislation.

Extension and Modification of Certain Provisions	
Qualified tuition and related expenses	<p>The \$4,000 above-the-line deduction for qualified tuition and related expenses is extended until December 31, 2007.</p> <p>The following applicable dollar amount limits on the higher-education expense deduction apply (Code Sec. 222(b)(2)(B)):</p> <ul style="list-style-type: none"> • \$4,000, for a taxpayer whose modified AGI for the tax year doesn't exceed \$65,000 (\$130,000 for a joint return); • \$2,000, for a taxpayer whose modified AGI for the tax year doesn't exceed \$80,000 (\$160,000 for a joint return); and • Zero, for any other taxpayer.

	<p>The applicable dollar amounts for 2006 through 2007 are the same as the limits that were in effect for 2005.</p> <p>Effective for tax years beginning after December 31, 2005 and before January 1, 2008.</p>
Optional itemized deduction for state and local sales tax	<p>Taxpayers can elect to take an itemized deduction for state and local general sales taxes instead of an itemized deduction for state and local income taxes withheld. The provision is extended for two years.</p> <p>Effective for tax years beginning after December 31, 2005 and before January 1, 2008.</p>
Educator expense deduction	<p>Eligible educators are permitted a \$250 above-the-line deduction for two more years for costs incurred for unreimbursed out-of-pocket classroom supplies. Eligible educators include kindergarten through 12th grade teachers, instructors, counselors, principals, or aides in any elementary or secondary school. Eligible expenses include costs for books, supplies (other than nonathletic supplies for courses of instruction in health or physical education), computer equipment (including related software and services), other equipment, and supplementary materials used in the classroom.</p> <p>Effective for expenses paid or incurred in tax years beginning after December 31, 2005 and before January 1, 2008.</p>
Mortgage insurance premiums	<p>Mortgage insurance premiums paid or accrued during 2007 by a taxpayer for qualified mortgage insurance in connection with acquisition indebtedness with respect to the taxpayer's qualified residence are treated as qualified residence interest.</p> <p>The deduction is subject to a phase-out. The amount treated as interest must be reduced (but not below zero) by 10 percent of the amount of qualified mortgage insurance for each \$1,000 (or fraction thereof) that the taxpayer's adjusted gross income (AGI) for the tax year exceeds \$100,000. For married taxpayers filing separate returns, the reduction equals 10 percent of the amount of qualified mortgage insurance for each \$500 (or fraction thereof) that the taxpayer's AGI for the tax year exceeds \$50,000.</p> <p>Qualified mortgage insurance means mortgage insurance provided by Veterans Administration (VA), the Federal Housing Administration (FHA) or the Rental Housing</p>

	<p>Association (RHA), and private mortgage insurance as defined by Sec. 2 of the <i>Homeowners Protection Act of 1998</i>.</p> <p>Effective for amounts paid or accrued after December 31, 2006, and apply only if the amounts satisfy the following conditions:</p> <ul style="list-style-type: none"> • The amounts must be paid or accrued before January 1, 2008; • The amounts may not be properly allocable to any period after December 31, 2007; and • The amounts must be paid or accrued with respect to a mortgage insurance contract issued after December 31, 2006.
<p>Combat pay</p>	<p>Military personnel may elect to treat combat pay that is excluded from gross income under Sec. 112 as earned income in determining both eligibility for the earned income tax credit (EITC) and the amount of that credit. The availability of this election is extended for one year through tax years ending before January 1, 2008.</p> <p>Effective for tax years beginning after December 31, 2006.</p>
<p>Personal residence ownership and use test</p>	<p>Taxpayers serving in certain capacities are permitted to suspend the running of the five-year ownership and use period for purposes of determining whether a sale or exchange of an individual's principal residence qualifies for the \$250,000/\$500,000 exclusion. At the election of an individual, the five-year ownership and use period with respect to the property is suspended during any period that the individual or the individual's spouse is serving on qualified official extended duty. The <i>Act</i> adds another category of individual serving on qualified official extended duty. Qualified individuals include the following:</p> <ul style="list-style-type: none"> • A member of the uniformed services; • A member of the U.S. Foreign Service; or • An employee of the intelligence community (new). <p>An employee of the intelligence community is defined under Code Sec. 121(d)(9)(C)(iv) as an employee of:</p>

	<ul style="list-style-type: none"> • The Office of the Director of National Intelligence; • The Central Intelligence Agency (CIA); • The National Security Agency (NSA); • The Defense Intelligence Agency; • The National Geospatial-Intelligence Agency; • The National Reconnaissance Office; • Any other office within the Dept. of Defense for the collection of specialized national intelligence through reconnaissance programs; • Any of the intelligence elements of the Army, the Navy, the Air Force, the Marine Corps, the Federal Bureau of Investigation (FBI), the Dept. of Treasury, the Dept. of Energy, and the Coast Guard; • The Bureau of Intelligence and Research of the Dept. of State; or • Any of the elements of the Dept. of Homeland Security concerned with the analyses of foreign intelligence information. <p>Effective for sales or exchanges after December 20, 2006 and before January 1, 2011.</p>
Research credit	<p>Taxpayers are entitled to a research credit equal to 20 percent of the amount by which the taxpayer's qualified research expenses paid or incurred exceed a specific base amount. The credit is extended for two more years.</p> <p>Effective for amounts paid or incurred after December 31, 2005.</p>
Changes Relating to Health Savings Accounts (HSAs)	
Rollover from IRA to health savings accounts (HSAs)	<p>Individuals will be permitted to make a one-time transfer from an IRA to an HSA from which to pay future medical expenses.</p> <p>A "qualified HSA funding distribution" is a distribution from an employee's IRA (other than a SEP or a SIMPLE IRA plan) to the extent that the distribution is contributed to his/her HSA in a direct trustee-to-trustee transfer. An individual may make an IRA-to-HSA rollover election only for one qualified HSA funding distribution during his/her lifetime. Once made, an IRA-to-HSA rollover election is irrevocable.</p> <p>The amount that can be distributed from the IRA and contributed to an HSA is limited to the</p>

	<p>otherwise maximum deductible contribution amount to the HSA computed on the basis of the type of coverage under the high deductible health plan at the time of the contribution. The amount that can otherwise be contributed to the HSA for the year of the contribution from the IRA is reduced by the amount contributed from the IRA. No deduction is allowed for the amount contributed from an IRA to an HSA.</p> <p>Only one distribution and contribution may be made during the lifetime of the individual, except when a distribution and contribution are made during a month in which an individual has self-only coverage as of the first day of the month, an additional distribution and contribution may be made during a subsequent month within the taxable year in which the individual has family coverage. The limit applies to the combination of both contributions.</p> <p>Effective for tax years beginning after December 31, 2006.</p>
<p>Rollovers from flexible spending arrangements (FSAs) and health reimbursement arrangements (HRAs) to an HSA</p>	<p>Employers are allowed to roll over unused health FSA and HRA balances to an HSA as a “qualified HSA distribution” on a one-time and limited basis.</p> <p>A qualified HSA distribution is treated as a contribution by an employer to an employee’s HSA under Sec. 106(d). Amounts contributed to an HSA under these rules are excludable from the employee’s gross income and wages for employment tax purposes.</p> <p>A qualified HSA distribution is a distribution from an employee’s health FSA or HRA to the extent the distribution:</p> <ul style="list-style-type: none"> • Does not exceed the lesser of the balance in the arrangement on September 21, 2006 or as of the date of the distribution; and • Is contributed by the employer directly to his HSA before January 1, 2012. <p>Effective generally, for distributions made on or after December 20, 2006.</p>
<p>HSA contribution limits</p>	<p>The new law eliminates the references to the plan’s annual deductible when determining annual contribution limits.</p> <p>The monthly limit for 2007 is:</p> <ul style="list-style-type: none"> • One-twelfth of \$2,850 (\$237.50 monthly), for an eligible individual who has self-only coverage under a high deductible health plan (HDHP) as of the first day of the month.;

	<p>or</p> <ul style="list-style-type: none"> • One-twelfth of \$5,650 (\$470.83 monthly), for an eligible individual who has family coverage under a HDHP as of the first day of the month. <p>Effective for tax years beginning after December 31, 2006.</p>
HSA cost-of-living adjustments	<p>The new law modifies the cost-of-living adjustment that applies under the HSA rules for tax years beginning after 2007. The Sec. 1(f)(4) consumer price index (CPI) for a calendar year will have to be determined as of the close of the 12-month period ending on March 31 of the calendar year rather than August 31 for the purpose of making cost-of-living adjustments for monthly dollars limit for deductible HSA contributions, and required dollar amounts for HDHP annual deductibles.</p> <p>The IRS is required to publish the adjusted dollar amounts no later than June 1 of the preceding calendar year.</p> <p>Effective for adjustments made for any tax year beginning after 2007.</p>
Contributions for part-year HSA eligibility	<p>The reduction in the deductible limit for part-year coverage is eliminated and now allows eligible individuals who establish an HSA midway through the year to contribute the full-year amount.</p> <p>Effective for tax years beginning after December 31, 2006.</p>
Archer Medical Savings Accounts (MSAs)	<p>Taxpayers will be allowed to establish Archer MSAs through 2007. The new law removes the 2005 cut-off date and replaces it with 2007.</p> <p>Effective December 20, 2006.</p>
Amendments for Certain Cost Recovery Property	
Energy efficient commercial building property	<p>The deduction for qualified energy efficient building property is extended for one more year through 2008.</p> <p>A deduction is allowed in an amount equal to the cost of energy efficient commercial building property placed in service during the tax year. The maximum deduction for any building for any tax year is the excess (if any) of \$1.80 multiplied by the building's square footage, over the aggregate amount of the deduction for the building for all earlier tax years.</p>

	Effective December 20, 2006.
Qualified leasehold property	The treatment of qualified leasehold improvement property as 15-year MACRS property is extended for two years to property placed in service before January 1, 2008. Effective for property placed in service after December 31, 2005.
Qualified restaurant property	The treatment of qualified restaurant property as 15-year MACRS property is extended for two years to property placed in service before January 1, 2008. Effective for property placed in service after December 31, 2005.
GO Zone property	The placed-in-service deadline for “specified Gulf Opportunity Zone extension property” is extended to December 31, 2010. Specified Gulf Opportunity Zone extension property is property where substantially all of the use of the property is in one or more specified portions of the GO Zone, and which is: <ul style="list-style-type: none"> • Nonresidential rental property or residential rental property that is placed in service by the taxpayer before January 1, 2011; or • If the specified Gulf Opportunity Zone extension property is software or tangible property, substantially all of the use of which is inside a building that meets the pre-January 1, 2011 deadline (above), the property must be placed in service no later than 90 days after the building is placed in service. Effective for tax years ending after August 27, 2005.
Percentage depletion for oil and gas wells	The rule suspending the 100 percent-of-taxable-income limitation with respect to oil and gas production from marginal properties is extended to include any tax year beginning before January 1, 2008. The suspension is retroactively extended to apply to calendar years 2006 and 2007, and to fiscal years beginning as late as December 31, 2007. Effective for tax years beginning after December 31, 2005 and before January 1, 2008.
Employment Tax Credits	
Work opportunity credit (WOTC)	Employers who hire members of certain targeted groups may get a credit against income taxes of 40% (25% in certain circumstances) of first-year wages, up to \$6,000 of wages per eligible

	<p>employee. The credit expired for wages paid after December 31, 2005. The credit has been extended for two more years and is available for wages paid to certain employees before December 31, 2007.</p> <p>Effective for individuals who begin work for the employer after December 31, 2005 and before January 1, 2008.</p>
Maximum age requirement for food stamp recipient	<p>For purposes of the work opportunity credit, maximum age requirement for being a member of the “targeted group” consisting of qualified food stamp recipients increases from less than age 25 to less than age 40.</p> <p>Effective for individuals who begin work for the employer after December 31, 2006 and before January 1, 2008.</p>
Low-income requirement eliminated for ex-felon group	<p>For purposes of the work opportunity credit, an ex-felon was required to be a member of a family that had annualized income that was no more than 70 percent or less of the Bureau of Labor Statistics lower living standard. The low-income requirement has been eliminated. An individual need only be certified by a designated local agency as meeting the recent felony requirement to qualify as a qualified ex-felon.</p> <p>Effective for individuals who begin work for the employer after December 31, 2006 and before January 1, 2008.</p>
Welfare-to-work credit	<p>A credit is available to an employer for eligible wages paid or incurred to or for “long-term family assistance recipients” for service rendered during the first two years of employment. The maximum credit, for each long-term family assistance recipient employed, is 35 percent of the first \$10,000 of eligible wages for service rendered in the first year of employment plus 50 percent of the first \$10,000 of eligible wages for service rendered in the second year of employment for a total maximum credit of \$8,500. The credit is extended for two more years.</p> <p>The <i>Act</i> repeals the welfare-to-work credit for wages paid after December 31, 2006 and designates “long-term family assistance recipients” as a “targeted group” for purposes of the WOTC.</p> <p>Effective for wages paid or incurred to or for a qualified individual who begins work for the employer after December 31, 2005 and before January 1, 2008. The consolidation of the</p>

	welfare-to-work credit with the WOTC and other modifications are effective for wages paid or incurred to or for a qualified individual who begins work for an employer after December 31, 2006 and before January 1, 2008.
Energy Related Credits	
Residential energy efficient property credit	<p>The residential energy efficient property credit for homeowners is extended for one year. It is now available for property placed in service before January 1, 2009.</p> <p>The new law also provides that the 30 percent of the amount paid for qualified solar energy property expenditures, rather than qualified photovoltaic property expenditures, is eligible for the credit. The maximum credit for qualified solar energy property expenditures in a tax year is \$2,000.</p> <p>Effective on December 20, 2006. The residential energy efficient property credit is available for property placed in service before January 1, 2009.</p>
Energy efficient home builder credit	<p>An eligible contractor may claim a business credit for each qualified new energy efficient home that the contractor constructs and which is acquired by a person from the contractor for use as a residence. The credit is either \$2,000 for a 50 percent energy reduction in energy usage, or \$1,000 for a 30 percent energy reduction in energy usage. The credit is extended for one more year.</p> <p>Effective for qualified new energy efficient homes whose construction is substantially completed and purchased after December 31, 2005 and before January 1, 2009.</p>
Alternative Minimum Tax (AMT) Relief	
Refundable AMT credit	<p>The new law makes a portion of the AMT credit refundable. An AMT credit is available when the taxpayer is subject to AMT in a tax year as the result of a deferral adjustment, such as the exercise of an incentive stock option. An individual's AMT that is attributable to deferral adjustments generates a minimum tax credit that the taxpayer can use in a later tax year to reduce his regular tax for that year when the regular tax exceeds tentative minimum tax.</p> <p>The new law provides that an individual's minimum tax credit for any tax year beginning before January 1, 2013, can't be less than the "AMT refundable credit amount and makes that amount refundable. The term "AMT refundable credit amount" means the amount equal to the</p>

	<p>greater of:</p> <p>(1) The lesser of:</p> <ul style="list-style-type: none"> • \$5,000, or • The amount of the “long-term unused minimum tax credit” for the tax year, or <p>(2) 20 percent of the amount of the long-term unused minimum tax credit.</p> <p>The “long-term unused minimum tax credit” means, with respect to any tax year, the portion of the minimum tax credit [i.e., the excess of the adjusted net minimum tax (ANMT) for all earlier tax years over the minimum tax credit for those years] attributable to the ANMT for tax years before the third tax year immediately preceding the tax year.</p> <p>The long-term unused minimum tax credit doesn’t take into account any minimum tax credit for the three immediately preceding tax years. The minimum tax credit amounts for those three years are allowable under the “regular” minimum tax credit rules. But because the “regular” minimum tax credit is nonrefundable, any unused amounts must be carried over to later tax years, rather than refunded.</p> <p>Effective for tax years beginning after December 20, 2006 and before January 1, 2013.</p>
Foreign Provisions	
Domestic production activities deduction	<p>Domestic production gross receipts include income from sources within Puerto Rico. Under the new law, the term “U.S.” includes the Commonwealth of Puerto Rico. This change allows the taxpayer to take into account its Puerto Rico business activity for purposes of calculating its domestic production gross receipts and qualified production activities income under Sec. 199, but only if the gross receipts from sources within Puerto Rico are currently taxable for U.S. federal income tax purposes.</p> <p>Effective for tax years beginning after December 31, 2005, but only for a taxpayer’s first two tax years beginning after that date and before January 1, 2008.</p>
Miscellaneous Provisions	
Self-created musical works	The option to treat certain sales of musical compositions or copyrights in musical works created by the taxpayer’s personal efforts as being sales of capital assets and therefore

	<p>generating capital gain has been made permanent.</p> <p>Effective for sales and exchanges in tax years beginning after May 17, 2006.</p>
Frivolous submission penalty	<p>The penalty imposed for making a frivolous submission that is intended to delay or impede the IRS is increased to \$5,000. The penalty is extended to apply to any tax return required under the Internal Revenue Code and to requests for collection due process hearings, installment agreements, offers-in-compromise, and taxpayer assistance orders.</p> <p>Effective for submissions made and issues raised after the IRS first prescribes a list of frivolous positions under Code Sec. 6702(c).</p>
Whistleblower rewards	<p>The IRS is authorized to pay rewards for information necessary for detecting underpayments of tax, or detecting and bringing to trial and punishment, persons guilty of violating, or conniving to violate, the tax laws.</p> <p>If the IRS proceeds with any administrative or judicial action based on information brought to the IRS's attention by an individual, then the whistleblower will receive as an award at least 15 percent, but not more than 30 percent, of the collected proceeds (including penalties, interest, additions to tax, and additional amounts) resulting from the action, or from any settlement of the action.</p> <p>Effective for information provided on or after December 20, 2006.</p>
Whistleblower attorney fees	<p>The new law provides an above-the-line deduction for attorneys' fees and costs relating to whistleblower rewards paid for providing information regarding violations of the tax laws.</p> <p>Effective for information provided on or after December 20, 2006.</p>