PUBLICATION

The Tax Relief and Health Care Act of 2006

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On December 9, 2006, Congress passed the Tax Relief and Health Care Act of 2006, which was signed into law by the President on December 20, 2006. The Act provides for extensions and modifications of certain previously or soon to be expired tax relief provisions, extensions of certain expiring energy provisions, health savings account provisions and other general tax relief provisions. Perhaps more importantly, the Act provides a level of certainty that taxpayers have not had since the provisions started to expire in 2005. The following is a summary of some of the most important extensions and modifications:

Optional Itemized Deduction for Sales and Use Taxes Extended for Two Years. The optional itemized deduction for state and local sales and use taxes that applied only for tax years beginning in 2004 and 2005 under pre-Act law is reinstated and made available for tax years beginning after 2005 and before 2008. This provision of the Act provides that a taxpayer may 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. Electing taxpayers may deduct either the amount of state and local general sales taxes paid, by accumulating receipts or the amount determined under IRS tables plus the actual amount of sales taxes paid on motor vehicles, boats and other big-ticket items. The sales tax deduction is particularly beneficial to taxpayers in states that impose a sales tax but not an income tax, i.e., Alaska, Florida, Nevada, South Dakota, Tennessee, Texas, Washington and Wyoming. It will also benefit any taxpayer who paid more in sales taxes than income taxes.

Above-the-Line Deduction for Higher Education Expenses. The new Act allows taxpayers to deduct up to $4,000 (subject to phase-outs at higher income levels) of higher education expenses in lieu of claiming the Hope or Lifetime Learning tax credits. All individual taxpayers, regardless of whether they itemize their deductions, may claim the deduction. The Act extends this deduction for two years through 2007.

Research and Development (R&D) Tax Credit Extended for Two Years and Modified for 2007. With the passage of the Act, the research credit is retroactively reinstated and made available for amounts paid or incurred after Dec. 31, 2005, and before Jan. 1, 2008. This was one of the most anticipated extensions in the Act. In addition to the extension, which became effective January 1, 2007, the provision increases the value of the alternative incremental credit and adds a new alternative simplified credit that does not use a gross receipts factor.

Extension and Modification of the New Markets Tax Credit (NMTC). The NMTC provides a tax credit to taxpayers who invest in businesses which are located in qualified low-income neighborhoods. The provision extends the NMTC for one year. The provision also requires that the Secretary of the Treasury prescribe regulations to ensure that rural counties receive a proportional allocation of qualified equity investments to that which metropolitan counties receive.

Corporate Donations of Scientific Property, Computer Technology and Equipment Used for Research. The Act extends a provision that encourages businesses to contribute computer equipment and software to elementary, secondary and postsecondary schools by allowing an enhanced deduction for such contributions. The provision would also allow equipment "assembled by" the donor to qualify for the enhanced deduction. This provision of the Act extends the computer deduction provisions for contributions made during taxable years beginning after December 31, 2005, and ending on or before December 31, 2007.

Expensing of Remediation Costs Extended for Two Years and Expanded. The provision that permitted expensing of costs associated with cleaning up hazardous sites expired on December 31, 2005. Under the Act, taxpayers may continue to expense costs incurred in cleaning up certain contaminated sites through 2007. The provision also expands the definition of an eligible contaminated site to include sites contaminated by petroleum products. The deduction may be claimed against regular tax and the alternative minimum tax ("AMT").

Accelerated Write-off for Qualified Leasehold Property and Qualified Restaurant Improvements Extended for Two Years. The Act extends for two years the 15-year straight-line write-off (instead of straight-line 39 year write-off) for qualified leasehold improvements and qualified restaurant improvements. The accelerated write-off applies to property placed in service after Dec. 31, 2005, and before Jan. 1, 2008. Under pre-Act law, the accelerated write-off was not available for otherwise eligible property placed in service after 2005.

Archer MSAs (Medical Savings Accounts). The provision allows individuals to 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. The Act extends the provision for two years through 2007.

Certain Gulf Opportunity Zone Bonus Depreciation. This provision of the Act modifies the bonus depreciation rules that were included in the Gulf Opportunity Zone Act of 2005 by extending the placed-in-service deadline for certain property used in specific highly-damaged areas within the Gulf Opportunity Zone.

One-Time-Only Rollovers From Health FSAs and HRAs into HSAs. The Act permits an employer to make a one-time transfer of the balance in an employee's health reimbursement account (HRA) or flexible spending account (FSA) to an HSA. The maximum transfer is the lesser of the HRA or FSA balance on the date of transfer or September 21, 2006. There is also a provision that requires the plan be maintained for at least 12 months after the transfer or it will be subject to tax and a 10% excise tax. Transfers must be made before January 1, 2012.

Repeal of Annual Deductible Limitation on HSA Contributions. The prior law limited HSA contributions to the lesser of the deductible for medical coverage, or $2,700 ($5,450 family). HSAs require that the deductible amount be at least $1,050 for single coverage and $2,100 for family coverage. The Act modifies the prior contribution limit by allowing a contribution of $2,700 for single coverage ($5,450 for family), even if the deductible is less than $2,700 ($5,450 family).

Modification of Active Business Definition Under Section 355 Made Permanent. Normally, corporations are taxed on distributions of property to shareholders as if the assets were sold at fair market value. However, Section 355 of the Internal Revenue Code provides corporations with the flexibility to distribute one or more of their businesses to their shareholders, such as in a spin-off, without triggering gain or loss if the transaction meets certain requirements. One of the requirements is that both the distributing and distributed corporations continue to conduct an "active trade or business" after the distribution. Prior law defined the active trade or business test by looking at all corporations in the distributing corporation's and the distributed subsidiary's affiliated group to determine if the active trade or business test is satisfied. The affiliated group rule was set to expire after 2010. The Act makes the rule permanent.

Itemized Deduction for the Cost of Premiums for Mortgage Insurance on a Qualified Personal Residence. This new provision establishes an itemized deduction for the cost of mortgage insurance on a qualified personal residence. The deduction is phased-out ratably by 10% for each $1,000 by which the taxpayer's adjusted gross income ("AGI") exceeds $100,000. Therefore, the deduction is unavailable for a taxpayer with an AGI in excess of $110,000. The provision is effective for amounts paid or accrued (and applicable to the period) after December 31, 2006 and before January 1, 2008 for mortgage contracts issued after December 31, 2006.