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TAX AND BUSINESS *Alert*™

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Congress Extends Popular Tax Breaks

Congress recently passed the Tax Relief and Health Care Act of 2006 (TRHCA), which extended a number of popular tax breaks. Some of the more popular federal income tax provisions extended by the TRHCA include the following items affecting individual taxpayers:

- ***State and Local Sales Tax Deduction.*** Taxpayers can claim a deduction for state and local *sales* taxes in lieu of deducting state and local *income* taxes. This deduction originally expired after 2005, but was extended by the TRHCA for two additional years and will now expire at the end of 2007. Taxpayers have the option of deducting the actual sales taxes paid if they maintain their sales receipts, or they can use the optional IRS tables to compute their deduction. If the tax tables are used, taxpayers can add the sales tax paid on the purchase of a motor vehicle, boat, aircraft, or a home (including mobile and prefabricated homes and the materials to build a home) to the table amount.

- ***Tuition Deduction.*** The TRHCA extends for two years through 2007 the provision allowing taxpayers to deduct up to $4,000 (depending on their income) of post-secondary tuition and fees for higher education paid for themselves, their spouse, or a qualifying dependent.

- ***Deduction for Teacher Classroom Expenses.*** The TRHCA extended for two years through 2007 the tax provision allowing "eligible educators," including kindergarten through 12th grade teachers, instructors, counselors, principals, or aides in any elementary or secondary school, to deduct up to $250 of eligible out-of-pocket classroom expenses each year. Eligible expenses include 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.

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Taxpayer Advocate Reports to Congress

The Taxpayer Advocate Service is an independent service within the IRS that assists taxpayers who are experiencing economic harm, who are seeking help in resolving tax problems that have not been resolved through normal channels, or who believe that an IRS system or procedure is not working as it should.

Nina E. Olson, National Taxpayer Advocate.

National Taxpayer Advocate Nina E. Olson recently released her annual report to Congress and designated the alternative minimum tax (AMT) and the federal tax gap (the excess of tax liabilities over the amounts collected) as the most serious problems facing taxpayers. The AMT was designated as the most serious problem in the Advocate's report, both in its own right and because it symbolizes the broader problem of tax-law complexity. The tax gap remains a high priority because noncompliance by some taxpayers requires every compliant taxpayer to pay, on average, more than $2,200 in extra tax each year to subsidize that noncompliance.

SBA Offers Small Business Services

The Small Business Administration (SBA) at **www.sba.gov** was created in 1953 as an independent agency of the federal government. The SBA's mission is to assist, counsel, and aid small businesses; foster free competition; and strengthen the U.S. economy.

The SBA website offers helpful information on business planning and starting, managing, and selling a business. The website also contains information on financial assistance, contract opportunities, disaster assistance, and online training for small business owners.

Mortgage Insurance Premiums May Be Deductible in 2007

The Tax Relief and Health Care Act of 2006 established, under very limited circumstances, an itemized deduction for mortgage insurance premiums paid on acquisition indebtedness for a qualified personal residence. Basically, the deduction is available only for amounts paid or accrued during 2007 for mortgage insurance contracts issued during 2007 for the taxpayer's personal residence.

The deduction is phased out ratably by 10% for each $1,000 (or fraction thereof) by which the taxpayer's adjusted gross income (AGI) exceeds $100,000. Thus, the deduction is unavailable for taxpayers with an AGI exceeding $109,000 ($54,500 for married filing separately).

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The TRHCA also extended a number of business income tax breaks that had expired at the end of 2005, including, but not limited to, the following:

- ***Research and Development (R&D) Tax Credit.*** The TRHCA extends the R&D credit for two years through 2007. It also increases the value of the alternative incremental credit and adds a new alternative simplified credit.

- ***Work Opportunity Tax (WOT) and Welfare-to-Work (WTW) Credits.*** The WOT credit applies to employers who hire individuals from groups that are considered to face barriers to employment, while the WTW applies to employers who hire individuals who have received public assistance for an extended period of time. Both credits expired at the end of 2005. The TRHCA extends the credits without modification through 2006, then combines them for 2007 and relaxes some of the rules for qualification.

- ***Fifteen-year Depreciation for Qualified Leasehold and Restaurant Improvements.*** The cost of leasehold and restaurant improvements is generally depreciated over 39 years. However, qualified leasehold and restaurant improvements placed in service before 2006 could be recovered using the straight-line (SL) method over 15 years. The TRHCA extends this 15-year SL method for two years for qualifying assets placed in service through 2007.

Finally, the TRHCA extends through 2008 several energy tax provisions that would have expired at the end of 2007, including (but, once again, not limited to):

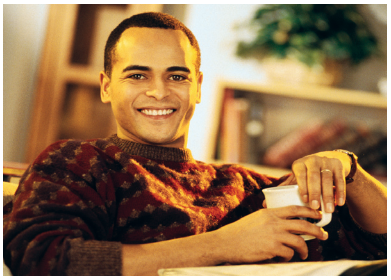
- ***Credit for Residential Energy-efficient Property.*** This credit equals 30% of expenditures for your personal residence for: (a) qualified solar water heating equipment (limited to a maximum credit of $2,000), (b) qualified electricity-generating solar photovoltaic property (maximum credit of $2,000), and (c) qualified fuel cell property (maximum credit of $500 for each ½ kilowatt of capacity). Before the TRHCA, the credit only applied to equipment placed in service during 2006 or 2007. The TRHCA extends this credit for one year, for property placed in service in 2008.

- ***Credit for New Energy-efficient Homes.*** Homebuilders qualify for a $2,000 credit for each new home sold for use as a residence in 2006 and 2007 if the home (a) is located in the U.S., (b) is substantially completed after August 25, 2005, (c) has an annual heating and cooling energy consumption that is at least 50% below the annual heating and cooling energy consumption of a comparable dwelling, and (d) has building envelope component improvements that account for at least one-fifth of the 50% reduction in heating and cooling energy consumption. The TRHCA extends this credit for one year, for property sold in 2008.

- ***Deduction for Energy-efficient Commercial Buildings.*** Up to $1.80 per square foot can be deducted for the cost of energy-efficient property placed in service during 2006 or 2007. The $1.80 is cumulative and must be reduced by any deductions claimed in prior years. The TRHCA extends this credit for one year, for property placed in service during 2008.

The Tax Relief and Health Care Act of 2006 is another in a series of smaller tax bills passed by Congress. We monitor Congressional tax legislation to ensure our clients receive the tax-saving benefits to which they are entitled. Please call us if you have questions about the TRHCA or to discuss any individual or business tax planning or compliance issue.

New Health Savings Account (HSA) Opportunities



Eligible individuals, basically those covered solely by a high deductible health insurance plan, can make deductible contributions to health savings accounts (HSAs), or their employer can make excludable contributions on their behalf. No tax is paid on the earnings in the HSA or on distributions as long as they're used to pay qualified medical expenses. Distributions not used to pay qualified medical expenses are taxable and are subject to a 10% penalty if received before the taxpayer reaches age 65.

The Tax Relief and Health Care Act of 2006 contains a number of changes starting in 2007 designed to make it easier for taxpayers (and their employers) to take advantage of HSAs. To help fund an HSA, individuals can make one tax-free transfer from each of their health flexible spending accounts (FSAs) and health reimbursement accounts (HRAs). The transfer can be made any time before 2012.

Individuals can also make a one-time-only, tax-free rollover, via direct trustee-to-trustee transfer, from an IRA (but not a SEP or SIMPLE IRA) to an HSA. Only one such rollover can be made during a taxpayer's lifetime.

The TRHCA makes it easier for employees covered by their employers' health FSA plan in one year (which generally precludes them from being eligible for an HSA for that year and any grace period for that year) to switch to an HSA. The TRHCA provides that, under certain circumstances, employees will not be ineligible for an HSA during any year solely because an FSA they participated in the previous year has a grace period that extends into that year. This will allow individuals who no longer participate in an FSA to be eligible for HSAs as of the beginning of the year following the year they no longer participate in the FSA.

Finally, the maximum deductible HSA contribution is no longer limited to the insurance policy's deductible amount for the year (this limit applied before 2007). This means that, for 2007, the maximum amount that can be contributed to an HSA is $2,850 for self-only coverage and $5,650 for family coverage.

With the ever-increasing cost of health care, these new opportunities for HSAs will help provide some additional relief.

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