Summary of the Tax Relief and Health Care Act of 2006

Provided by:

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Life Insurance, Annuities and Long-Term Care

The Tax Relief and Health Care Act of 2006 was signed into law by President Bush on December 20, 2006.

With just a few weeks left in the 2006 tax year, Congress passed a much-anticipated package of "tax extenders," which retroactively restore some popular tax breaks to the beginning of 2006 that had expired at the end of 2005.

There's more than "tax extenders" included in this bill, however. The Act expands and enhances Health Savings Accounts, enhances some tax incentives, revises certain deadlines, includes some "technical corrections" to existing tax laws and includes some miscellaneous tax relief.

The estimated cost of the legislation is $26.5 billion in 2006 and 2007 and $45.1 billion over 10 years.

The attached summary reviews items of general interest. As you review the summary, pay particular attention to any provisions you feel may impact on your situation. If you would like additional information on the Tax Relief and Health Care Act of 2006 or to discuss the impact of specific provisions on your planning, please call my office.

The Tax Relief and Health Care Act of 2006

The Tax Relief and Health Care Act of 2006 (the Act) was passed by Congress on December 9, 2006 and signed into law by President Bush on December 20, 2006.

State and Local Sales Tax Deduction:

A 2004 tax act allowed taxpayers who itemize to deduct **either** their state and local income taxes **or** their state and local sales taxes in 2004 and 2005. This deduction, which was especially popular with residents of states without state/local income taxes, expired on December 31, 2005. The Act retroactively restores the state and local sales tax deduction for 2006 and extends it through 2007.

College Tuition Deduction:

The college tuition deduction is another popular tax break that expired on December 31, 2005, but has now been retroactively restored for 2006 and extended through 2007.

For both 2006 and 2007, a $4,000 above-the-line deduction for college tuition and qualifying fees is available to single taxpayers with adjusted gross incomes of $65,000 or less ($130,000 for joint filers). Single taxpayers with adjusted gross incomes up to $80,000 ($160,000 for joint filers) can deduct up to $2,000 of college tuition and qualifying fees.

NOTE: Tuition and fees paid for elementary or secondary education cannot be deducted. In addition, the college tuition deduction cannot be claimed in the same year as a HOPE or Lifetime Learning credit for the same student.

Teacher's Classroom Expense Deduction:

Another popular tax break, the teacher's classroom expense deduction, expired on December 31, 2005, but has now been retroactively restored for 2006 and extended through 2007.

Teachers and other education workers are eligible for a $250 above-the-line deduction for certain out-of-pocket classroom expenses, such as classroom supplies, books and computer equipment and software. The deduction is available to teachers and other education workers (counselors, principals, classroom aides) who work at least 900 hours during the school year in a kindergarten, elementary or secondary school.

Health Savings Accounts:

Health savings accounts (HSAs) are a relatively new way to pay for health care costs, combining tax-advantaged personal savings with a high-deductible health insurance plan.

The Tax Relief and Health Care Act of 2006 added a number of permanent enhancements to HSAs. Most of the following enhancements take effect in 2007:

Expanded Annual Contribution Limits

Under current law, 2006 HSA contributions are limited to a statutory maximum of $2,700 for self-only coverage/$5,450 for family coverage or the high-deductible health insurance plan's deductible, if less.

Beginning in 2007, the Act allows HSA contributions to be made up to the annual statutory maximum, regardless of the health insurance plan's deductible. The annual statutory maximum in 2007 is $2,850 for self-only coverage and $5,650 for family coverage.

Full-Year Contributions for Part-Year Coverage

Under current law, contributions for coverage that begins during 2006 have to be pro-rated for the number of months of HSA coverage. So, for example, a family beginning their HSA plan on July 1 can contribute only 6/12 (or one-half) the lesser of the policy's deductible or the annual statutory maximum of $5,450.

Beginning in 2007, taxpayers who begin their HSA coverage during the year can make HSA contributions equal to the full annual statutory maximum, regardless of when during the year their coverage begins.

Rollovers

The Act makes available two different rollovers of funds into an HSA, so that funds are immediately available to meet health care needs:

- On or after the date of enactment, employees have a one-time opportunity to roll over funds on a tax-free basis from an unused flexible spending account (FSA) and/or a health reimbursement account (HRA) into an HSA. The maximum transfer amount is the lesser of the balance as of the date of the transfer or September 21, 2006 and the transfer must be made before January 1, 2012.

- Beginning January 1, 2007, a one-time, once-in-a-lifetime rollover of funds from an IRA to an HSA may be made. The amount rolled over cannot exceed the annual HSA statutory maximum for the year.

Other HSA Provisions

The Act also allows employers to make additional HSA contributions for lower-paid workers and requires the Treasury Department to issue HSA cost-of-living deductible and contribution requirements by June 1 of each year (instead of November).

Mortgage Insurance Deduction:

Certain taxpayers will be able to deduct the full cost of mortgage insurance in 2007. Here are the requirements:

- The full deduction is available to taxpayers with an adjusted gross income of $100,000 or less. The deductible amount quickly phases out above $100,000, so that no mortgage insurance deduction is available to taxpayers with an adjusted gross income of more than $110,000.
- The mortgage must close in 2007. The deduction is not available for mortgages that closed in prior years unless the mortgage is refinanced in 2007.
- You have to itemize in order to take advantage of the mortgage insurance deduction.
- This is a one-time deduction for 2007 only. A future Congress may well extend the deduction, but there are no guarantees.

Stock Options and the AMT:

Many people who exercised incentive stock options during the "dot-com boom" were subject to the alternative minimum tax, which also generated minimum tax credits that have not been used. Some relief is now available: beginning in 2007, taxpayers who have unused AMT credits from incentive stock options can receive a refundable credit worth up to 20% per year over the next five years. This tax break, however, phases out at adjusted gross incomes over $156,400 for singles and $234,600 for married couples filing jointly.

Tax Form Confusion:

Unfortunately, the late passage of this tax legislation came after the IRS deadline for printing tax forms and instructions for the 2006 tax year. As a result, taxpayers are being instructed to place certain deductions, such as for state and local sales taxes, the college tuition deduction and the teacher's classroom expense deduction, on lines for other items and use an identifying code for each of these last minute tax deduction extensions:

- **State and local sales tax deduction:** Enter the deduction on line 5 of Schedule A and write "ST" on the dotted line to the left of line 5.
- **College tuition deduction:** Enter the deduction on line 35 of the 1040 and write "T" to the left of line 35. If you are also taking the Domestic production activities deduction on line 35, enter the total of the two deductions on line 35, write "B" to the left of line 35 and attach a separate sheet showing the amounts for each deduction.
- **Classroom expense deduction:** Enter the deduction on line 23 of the 1040 and write "E" on the dotted line to the left of line 23. If you are also taking an Archer MSA deduction, enter the total of the two deductions on line 23, write "B" to the left of line 23 and attach a separate sheet showing the amounts for each deduction.

Whether you prepare your own tax return or use a tax return preparation provider, if you qualify for any of the tax deduction extensions, carefully review your 2006 income tax return to make certain it is completed properly. Also, the IRS will not be geared up to process returns claiming these deductions until early February, so it's best not to file until then.