

## NEW TAX LAW, Part I

Dear clients and friends:

The Tax Relief and Health Care Act passed in December 2006 is a wide-ranging measure that preserves a variety of popular tax breaks for families and businesses. It also contains provisions regarding alternative and renewable energy, and Medicare. The following are some of the key tax provisions affecting you as an individual. Next month, NEW TAX LAW Part II, we will outline the key provisions affecting business and energy.

### (I) PROVISIONS AFFECTING INDIVIDUALS

#### (a) Extensions and modifications:

***Tuition deduction.*** The tax deduction for qualified higher education expenses is extended through 2007. The deduction allows taxpayers to deduct up to \$4,000 (depending on their income) of higher education expenses in lieu of claiming the Hope or Lifetime Learning tax credits. The deduction is taken “above-the-line,” meaning that it may be claimed by all individual taxpayers regardless of whether they itemize their deductions.

***State and local general sales taxes.*** The tax break allowing individual taxpayers to 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 is extended through 2007. Taxpayers have two options for determining deductible sales tax: (i) actual sales tax paid if receipts are maintained for IRS verification or (ii) approximate sales tax paid as estimated in tables provided by the Secretary of the Treasury plus sales tax on certain additional items (such as a boat or car) that may be added to the table amount.

***Deduction for certain expenses of elementary and secondary school teachers.*** The tax break permitting elementary and secondary school teachers and certain other school professionals to deduct up to \$250 of out-of-pocket costs incurred to purchase books, supplies and other classroom equipment is extended through 2007. The deduction is available to all individual taxpayers regardless of whether they itemize their deductions.

***Tax credit for first-time homebuyers in the District of Columbia.*** The tax break allowing first-time homebuyers in D.C. to claim a tax credit of up to \$5,000 on the purchase price of the home is extended through 2007.

***Availability of medical savings accounts.*** New contributions to Archer medical savings accounts (“Archer MSAs”) may be made through 2007 (instead of through 2005, as under prior law). New contributions may be made after 2007 only by or for individuals who previously had Archer MSAs, and employees who are employed by a participating employer. Individuals may 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.

***Extension of certain expiring energy provisions and other energy provisions.*** The new law provides an extension through 2008 of a number of energy provisions that would have expired at the end of 2007 under prior law. For individuals, the most important of these provisions is a one-year extension of the 30% tax credit for the purchase of residential solar water heating, solar electric equipment and fuel cell property through Dec. 31, 2008. Energy improvement equipment installed in individual homes were not extended. These credits continued to be effective for 2006 and 2007 only.

***Health savings account provisions.*** The new law includes many changes for health savings accounts (HSAs), including: allowing one-time rollovers from health flexible spending accounts (FSAs) and health reimbursement arrangements (HRAs) into HSAs (after the enactment date and before 2012); repeal of the annual plan deductible limit on HSA contributions (after 2006); expanded contributions limit for part year coverage (after 2006); and allowing one-time rollovers from IRAs into HSAs (after 2006).

**(b) Other tax relief provisions:**

***Incentive stock option AMT provisions.*** For tax years beginning after the enactment date, a new law change allows individuals to take advantage of a refundable credit with respect to certain long-term unused alternative minimum tax (AMT) credits existing before Jan. 1, 2013. The annual credit amount, subject to a phase-out, is the greater of (i) the lesser of \$5,000 or the amount of the long-term unused AMT credit, or (ii) 20% of the amount of the long-term unused AMT credit. This provision is designed to help taxpayers who wound up with AMT problems because of their exercise of incentive stock options.

***Self-created musical works.*** The tax break that was enacted on a temporary basis in 2005 providing capital gains treatment for self-created musical works when these works are sold by the artist is made **permanent**.

***Premiums for mortgage insurance.*** A new itemized deduction for the cost of premiums for mortgage insurance on a qualified personal residence is established. The deduction is phased-out ratably by 10% for each \$1,000 by which the taxpayer's adjusted gross income exceeds \$100,000. The new deduction applies for 2007 only.

***Loans to qualified continuing care facilities.*** The new law makes **permanent** a TIPRA provision (Tax Increase Prevention and Reconciliation Act of 2005, passed in 2006) regarding the 100% exemption from "imputed interest rule" for qualified loans made to qualified continuing care facilities by lender(s) of 62 or older.

***Frivolous submissions.*** The new law increases the penalty for frivolous tax return submissions from \$500 to \$5,000 and expands the penalty to all taxpayers and all types of federal taxes. This increased penalty also applies to frivolous submissions for lien and levy collection due process, installment agreements, offers-in-compromise, and taxpayer assistance orders.

