Anthony P. Curatola, Editor

Retroactive Provisions of the Tax Relief & Health Care Act of 2006

The Tax Relief and Health Care Act of 2006 (P.L. 109-432), or TR&HCA, was signed by President Bush on December 20, 2006. In some cases, the tax legislation breathes new life into expired provisions by extending them retroactively for expenses paid or incurred in 2006. Although this retroactive legislation is welcome relief for many taxpayers, its timing creates havoc for many because the 2006 tax forms, IRS publications, and, of course, tax software products may not reflect the changes. This article, therefore, will highlight some of the legislation's provisions.

Higher Education Expense Deduction

IRC §222(e) provides an above-the-line deduction for individuals who incurred qualified tuition and related expenses for higher education during the taxable year. In general, qualified expenses include tuition and fees required for the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer to enroll in or attend classes of instruction at an eligible institution of higher education. Although this provision had expired for expenses paid or incurred after December 31, 2005, TR&HCA extends it through December 31, 2007.

Teacher's out-of-pocket expense

IRC §62(a)(2)(D) provides an above-the-line deduction for up to $250 annually of expenses paid or incurred by an eligible educator for books, supplies (other than nonathletic supplies for courses of instruction in health or physical education), computer equipment (including related software and services) and other equipment, and supplementary materials used in the classroom by the eligible educator. This tax provision originally expired December 31, 2005, but TR&HCA retroactively reinstates it with a new expiration date of December 31, 2007.

Itemized state and local tax option

For taxable years 2004 and 2005, individual taxpayers had the option to take an itemized deduction for either state and local general sales taxes or state and local income taxes, whichever was greater. Better yet, if the taxpayer elected to itemize the sales tax amount, then the actual amount incurred could be deducted by accumulating sales tax receipts or by using the table amount created by the Secretary of the Treasury to show the allowable deduction. Like the two prior tax provisions, TR&HCA retroactively extends this for tax years 2006 and 2007.

Mortgage insurance premiums

Here is a new tax provision for tax year 2007 *only*. A taxpayer may deduct premiums paid or accrued for qualified mortgage insurance incurred as acquisition indebtedness on a qualified residence during 2007. The deductible amount is phased out ratably by 10% for every $1,000 that the taxpayer's adjusted gross income (AGI) exceeds $100,000 ($50,000 for a married individual filing a separate return). Thus, taxpayers can't claim this deduction if their AGIs exceed $110,000 ($55,000 for a married individual filing a separate return).

IRC §163(h)(4)(E) defines qualified mortgage insurance as mortgage insurance provided by the Veterans Administration, the Federal Housing Administration, the Rural Housing Administration, or private mortgage insurance. The prepayment of such insurance isn't deductible in the period paid, however, but rather in the period due.

Indian Employment Tax Credits

In general, IRC §45A provides a tax credit for employers on the first $20,000 of qualified wages and health insurance costs paid or incurred for a qualified employee. IRC §45A(c) defines a qualified employee as any employee who is an enrolled member of an Indian tribe or the spouse of an enrolled member of an Indian tribe, who performs substantially all of the services within an Indian reservation, and whose principal place of abode while performing the services is on or near that reservation.

The credit is equal to 20% of the amount by which the eligible employee qualified wages and health insurance costs during the current year exceed the qualified wages and costs incurred by the employer during 1993. The credit is an incremental credit. An employer's current-year qualified wages and qualified employee health insurance costs (up to $20,000 per employee) are eligible for the credit only to the extent that the sum of such costs exceeds the sum of comparable costs paid during 1993.

An employee is qualified if the total amount of wages paid or incurred during the taxable year by the employer with respect to that employee exceeds an amount determined at an annual rate of $30,000 (inflation adjusted to $40,000 for 2006). In addition, the employee isn't qualified if he or she is related to the employer (in the case of an individual employer) or to one of the employer's shareholders, partners, or grantors.

Combat Pay

In general, military compensation earned by members of the Armed Forces while serving in a combat zone may be excluded from gross income. Better yet, the Working Families Tax Act of 2004 provided that any taxpayer in 2004 and 2005 may elect to treat combat pay that is otherwise excluded from gross income under IRC §112 as earned income for purposes of the child care credit and the earned income credit. This election was extended for 2006 by the Gulf Opportunity Zone Act of 2006 and for 2007 by TR&HCA.

District of Columbia Homebuyer Credit

First-time homebuyers of a principal residence in the District of Columbia are eligible for a nonrefundable tax credit of up to $5,000 of the purchase price. The $5,000 maximum credit applies both to individuals and married couples. It is phased out for taxpayers with AGIs between $70,000 and $90,000 ($110,000 and $130,000 for joint filers). This credit expired for purchases after December 31, 2005, but is extended retroactively by TR&HCA to December 31, 2007.

Work Opportunity and Welfare-to-Work Tax Credits

The work opportunity tax credit (WOTC) is available on an elective basis for employers hiring individuals from one or more of eight targeted groups. The welfare-to-work tax credit (WTW) is available on an elective basis to employers of qualified long-term family assistance recipients. TR&HCA retroactively extends both credits for tax year 2006 without any modifications. For tax year 2007, the two credits are combined, and the following modifications are made: First, the deadline for submitting paperwork for certification of employees under WOTC is extended from 21 to 28 days. Second, the maximum age for the target group consisting of food stamp recipients will include individuals between the ages of 18 and 39 (ages 18 and 24 for 2006). Third, the family low-income requirement is eliminated from the target group consisting of ex-felons.

Still Changing

In this discussion, I've focused on the key changes of the tax provisions, such as the extension dates or modifications. The specific details of many of these tax provisions have been discussed in this column over the past few years. Given the numerous tax legislation acts that have been signed into law over the past five years, it's no surprise that most of us don't have a solid grasp of the laws. The good news is that things will probably get worse as Congress continues to tinker with the Code and tax simplification leads to increased need for tax accountants by taxpayers. ■

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