

# 2006 ends with new tax law

The Tax Relief and Health Care Act of 2006, enacted by Congress on December 11, 2006, and signed into law on December 20, ended the year on a positive note for taxpayers. Several taxpayer-friendly provisions of earlier law, scheduled for extinction at the end of tax year 2006 have been extended. And there is an added bonus: The new law enhances Health Savings Accounts (HSAs), making them an even more attractive health insurance option. In sum, the Act offers \$45.1 billion in tax benefits. Here are the major items of interest for individuals.

## **The “extenders”**

*The higher education tuition deduction.* This “above-the-line” deduction was available from 2002 through 2005, but it expired at the end of 2005. The deduction now has been made available for 2006 and 2007 tax years. The maximum deduction remains at \$4,000 for those taxpayers whose adjusted gross income (AGI) does not exceed \$65,000 for single filers and \$130,000 for married couples filing jointly. A \$2,000 deduction is permitted for a single taxpayer with an AGI of \$80,000 and for joint filers, \$160,000.

*The deduction for state and local sales taxes.* A provision in a 2004 tax law allowed a deduction for either the state income taxes or sales taxes paid, whichever was greater. This deduction also expired at the end of 2005, but now is likewise extended through 2007. Deducting either of the taxes is especially valuable to taxpayers who live in a state that does not impose an income tax.

*The classroom expense deduction.* Also extended through 2007, this above-the-line tax deduction lets teachers and other education workers write off up to \$250 in school supplies and other qualified expenses that they have incurred. (Expenses exceeding \$250 and nonclassroom supplies are deductible as miscellaneous expenses, but only to the extent that they exceed 2% of AGI.)

## **Expanded HSAs**

The Health Savings Account is a relatively new kid on the block (first available in 2004). With an HSA you are allowed to deduct your contributions to the account, avoid tax on the earnings, and even make withdrawals from the account tax free as long as they are used to pay qualified medical expenses. The changes in the new law with regard to HSAs are especially good news because they are *permanent*, rather than expiring, provisions.

*Increased contributions.* HSA contributions now are permitted up to the annual statutory maximums. For 2007 that amount is \$2,850 for single coverage and \$5,650 for family coverage. These maximums are available regardless of the health plan’s deductible

amount. Previously, the deduction was limited to the *lesser* of the deductible on the individual's high-deductible health plan or the statutory maximum.

*Expansion of the limit on partial-year coverage.* Taxpayers who enroll in an HSA-eligible plan in the middle of the year now can make a full year's contribution, rather than a prorated amount.

*IRA rollover to HSA.* This is a once-in-a-lifetime opportunity that allows you to roll over funds from your IRA to an HSA, subject to the HSA contribution limits.

*FSA rollover to HSA.* If your employer sponsors either a health flexible spending account (FSA) or a health reimbursement account (HRA), you can make a one-time transfer of the balance in your FSA or HRA to your HSA. The maximum allowable transfer is the *lesser* of the balance as of the date of the transfer or September 21, 2006. The transfer must be made before January 1, 2012.

### **Left on the table**

One of the reasons why this package of tax benefits came down to the finish line in terms of the Congressional recess was that it had been attached to more controversial tax bills, notably, the repeal/reduction of the federal estate tax.

Of more immediate concern is Congress' failure to extend the higher alternative minimum tax (AMT) exemption amounts for 2007. As of now, the exemptions have dropped back significantly, exposing many more middle-income taxpayers to the AMT. Last year it was well into 2006 before Congress passed legislation keeping the higher exemption amounts in place for that year—a scenario that will have to be repeated in order to preserve them for 2007.

(January 2007)

© 2007 M.A. Co. All rights reserved.