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The Hidden Tax Breaks of 2006

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As the 109th Congress was hurrying out the door, it took the time to pass just a few pieces of legislation. One of the most significant of these is the Tax Relief and Health Care Act of 2006. The Act extends several tax breaks that were expected to expire and modifies others. Here is a quick guide to the act and how it might impact your tax liability.

EXTENDERS

For most taxpayers, these extenders will have the biggest impact. These extend some tax breaks that were set to expire and even resurrect some that technically had expired with the 2005 tax year.

❖ **Sales tax instead of income tax.**

You can once again elect to deduct state and local general sales taxes in lieu of state and local income taxes. This was in effect for 2004 and 2005 and has now been reinstated for 2006 and 2007.

❖ **Qualified higher education expenses.**

In lieu of the Hope and Lifetime Learning Credits, you can deduct certain qualified education expenses. The deductions are \$4,000 (AGI of \$130,000 or less joint, \$65,000 or less single) and \$2,000 (AGI of \$160,000 or less joint and \$80,000 or less single). This applies to both tax years 2006 and 2007.

❖ **Teacher expenses.**

Elementary and high school teachers can deduct up to \$250 for expenses related to their teaching.

❖ **Depreciation for leasehold improvement and restaurant property.**

Qualified property in these two categories placed in service between December 31, 2005 and December 31, 2007 is again eligible for accelerated depreciation.

❖ **Manufacturing in Puerto Rico.**

This was left out of the most recent definition of “domestic manufacturing” in Section 199. This has been changed for the first two tax years beginning after 12/31/05 and before 1/1/08.

❖ **Qualified research expenses.**

If your business has certain specific research expenses, the tax credit you have enjoyed for them has been extended for tax years 2006 and 2007.

❖ **Work Opportunity/Welfare-to-Work.**

If you employ people who are or were recently on public assistance, the tax credits for employing them has been extended through tax year 2007.

❖ **Health savings accounts.**

This deduction was limited to the annual deductible of your “high deductible



health plan” (in 2006 this was \$1,050 - \$5,250 for individual plans and \$2,100 - \$10,500 for family plans). The new law removes the limitation for 2006 and permits an HSA contribution of \$2,700 for individuals and \$4,500 for families, even if your health plan’s annual deductible is lower.

NEW TAX BREAKS

❖ **Mortgage insurance deduction.**

You can now deduct the cost of premiums on mortgage insurance for your qualified personal residence for tax year 2007. This phases out for individual filers whose AGI exceeds \$50,000 (10% for each \$500 over) and for joint filers whose AGI exceeds \$100,000 (10% for each \$1000 over).

❖ **Alternative Minimum Tax.**

The new law included another temporary, partial fix for the Alternative Minimum Tax. If you have unused AMT credits from 3 or more years prior to the current tax year, you may be able to reduce your regular income tax and get a refund. These credits are applied on a first-in, first-out basis (the oldest must be used first).

LOST AND FOUND

For most taxpayers, the biggest issue with all of this is that the IRS printed all the forms for tax year 2006 *before* the law was enacted. This means that many of the extenders will not show up on your form. Here is how you handle the three most likely to impact you:

❖ **Sales tax (instead of income tax).**

Use line 5, Schedule A, Form 1040.

That line reads “State and local income taxes.” Enter “ST” on the dotted line to the left of this line to show that you are claiming sales tax instead.

❖ **Higher education deduction.**

Use line 35 of Form 1040. This reads “Domestic production activities deduction.” Enter “I” on the dotted line to the left of this line to show that you are claiming this deduction only. If you’re eligible for both deductions, enter “B” and attach a breakdown showing the amounts claimed for each deduction.

❖ **Educator deduction.**

Use line 23 of Form 1040. This line reads “Archer MSA Deduction,” and involves medical savings accounts. If you are claiming only this deduction, enter “E” on the dotted line to the left of this line. If you’re eligible for both, enter “B” and attach a breakdown showing the amounts claimed for each deduction.

THE BOTTOM LINE

This is one year when it is really going to pay to get professional advice from a CPA. If you don’t, you could miss out on a deduction to which you’re entitled or earn yourself aggravation by reporting the deductions incorrectly.

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