SPECIAL TAX ALERT

the Anchin Advantage

Dedicated to helping you grow your business

Tax Alert:

Subject: Tax Relief and Health Care Act of 2006

As you may know, on Dec. 20, 2006, President Bush signed into law the Tax Relief and Health Care Act of 2006. In addition to extending certain tax provisions that had expired at the end of 2005 or that had been set to expire soon, the act introduces some new rules and important tax breaks we think you'll want to know about.

Extensions Benefiting Individuals

The state and local sales tax itemized deduction. This deduction, which had expired at the end of 2005, allows you to deduct either state and local income taxes or state and local sales taxes. It primarily benefits those living in states with no income tax but may also benefit taxpayers who live in low-income-tax states or who purchase major items, such as cars or boats. Referring to the Optional State Sales Tax Tables in IRS Publication 600 is the easiest way to calculate the deduction.

Extensions Benefiting Businesses

The research and development (R&D) credit. This credit, which had expired at the end of 2005, has been extended through 2007. Generally, it is equal to 20% of qualified research expenses in excess of a certain amount based on the company's historical activity. But businesses can take the alternative incremental credit (AIC) instead, based on a stated percentage of qualified expenses in excess of the average expenses over four years.

For 2007, the new law enhances the R&D credit in two ways. First, it increases the stated percentage for the AIC. Second, it offers the alternative simplified credit (ASC), equal to 12% of qualified research expenses exceeding 50% of the previous three tax years' average expenses. If there were no qualified expenses in any of those years, the ASC equals 6% of the current year's expenses.

Combined with previous rule changes that have liberalized the requirements for taking this credit in recent years, the new law makes the credit a powerful tax-saving tool for many businesses.

Employment credits for hiring low-income workers. The new law not only extends the previously expired Welfare-to-Work and Work Opportunity credits through 2006 but also combines and enhances them for 2007.

Accelerated depreciation for leasehold and restaurant improvements. The extension of this provision through 2007 allows a shortened recovery period of 15 years (rather than 39 years) for qualified leasehold and qualified restaurant improvements. Those improvements made to the interior of a nonresidential building more than three years after the building was placed in service generally qualify. The improvements can be made by either the lessor or the lessee.

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Energy-related tax breaks. Many provisions have been extended through 2008, including:

- The credit for energy efficient new homes,
- The deduction for energy efficient commercial buildings,
- The renewable electrical energy production credit, and
- The authority to issue clean renewable energy bonds.

Other extensions that benefit businesses include Gulf Opportunity Zone bonus depreciation (through 2010), the ability to deduct rather than capitalize certain environmental remediation costs (through 2007), and the deduction for corporate donations of certain computer and scientific equipment to schools and public libraries (through 2007).

HSA Enhancements

As the act's name suggests, it also addresses health care, specifically Health Savings Accounts (HSAs). The new law makes notable and permanent changes to the HSA rules. HSAs allow you to contribute pretax income to a special account that bears interest or is invested in mutual funds, and withdrawals for health care expenses from this account are tax free. The maximum HSA contribution previously was limited to the lesser of the related policy's deductible or the IRS-sanctioned maximum allowable amount. Now, starting in 2007, the policy's deductible does not factor into the contribution limit. Thus, regardless of the policy's deductible, for 2007 the contribution limit is $2,850 for a policy with individual-only coverage and $5,650 for a policy that covers the participant's family.

And, in an effort to allow quicker access to retirement savings to pay medical expenses, the new law allows participants to make a one-time, irrevocable rollover of funds from an IRA into an HSA after Dec. 31, 2006. The rollover, which is neither taxable as an IRA distribution nor deductible as an HSA contribution, is limited to the maximum allowable HSA contribution for the year.

Expanded AMT Credit

In an effort to help taxpayers who were stung by the AMT when they exercised qualified stock options and who haven't been able to use the resulting AMT credit in subsequent years, the new law allows for a refundable credit starting in 2007 and ending in 2012. The refundable amount each year depends on your long-term unused minimum tax credits and adjusted gross income (AGI). You may be able to claim as much as 20% of the unused AMT credit each year as a refundable credit if the unused amount is significant. Otherwise, you may be eligible to use the lesser of $5,000 or the entire unused amount.

There are many tax saving opportunities within the Tax Relief and Health Care Act of 2006 - some that may benefit you. We will be reviewing your specific situation for benefits. Feel free to call us to discuss these changes at any time.

Anchin, Block & Anchin LLP

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Anchin, Block & Anchin LLP, Accountants and Consultants, Anchin Advantage, Special Tax Alert September 2006 The *Anchin Advantage Special Tax Alert* is published as deemed necessary by Anchin, Block & Anchin LLP, Accountants and Consultants, 1375 Broadway, New York, NY 10018. Telephone (212) 840-3456. A service for clients, business associates and staff, this newsletter contains articles which are general in nature and based on sources which are believed to be authoritative. Specific applications would require consideration of all facts and circumstances by qualified professionals. The firm will be pleased to provide additional details upon request. No part of this newsletter may be reproduced or utilized in any form or by any means without written permission from Anchin, Block & Anchin LLP.