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CRS Report for Congress

Tax Provisions in the Tax Relief and Health Care Act of 2006 (H.R. 6111)

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Summary

As one of the last acts of the 109th Congress, the House and Senate passed the Tax Relief and Health Care Act of 2006 (H.R. 6111). This report summarizes the tax provisions in Division A — Title I (extenders), Title II (energy tax provisions), Title III (health savings accounts), and Title IV (other provisions). For more information on tax extenders, see CRS Report RL32367, *Temporary Tax Provisions ("Extenders") Expired in 2005*; for information on energy tax policy, see CRS Report RL33578, *Energy Tax Policy: History and Current Issues*; for information on health savings accounts, see CRS Report RL33257, *Health Savings Accounts: Overview of Rules for 2007*.

Title I — Extenders. Sections 101 to 122 extend various expiring tax provisions. The following provisions are extended through 2007:

- the deduction for qualified tuition and related expenses;
- the deduction for state and local sales taxes;
- the research and development credit (the Act also makes other changes, including increasing the rates for the alternative incremental credit and creating an alternative simplified credit);
- the work opportunity tax credit and welfare-to-work tax credit (the Act also consolidates the two credits);
- the election to treat combat pay as earned income for the earned income tax credit;
- the authority to issue qualified zone academy bonds;
- the deduction for expenses of school teachers;
- the provision allowing brownfields remediation costs to be expensed (the Act also extends the provision to the cleanup of petroleum products);
- the designation of the District of Columbia as an enterprise zone and its authority to issue tax-exempt bonds, the 0% capital gains rate for qualified D.C. assets, and the first-time D.C. homebuyers credit;
- the Indian employment tax credit and the provision allowing accelerated depreciation for business property on Indian reservations;

- the provision allowing 15-year straight-line cost recovery for qualified leasehold improvements;
- the provision suspending the limitation on the excise tax cover over on rum to Puerto Rico and the U.S. Virgin Islands;
- the rule that group health plans provide mental health benefits parity;
- the enhanced charitable contribution deduction for corporate donations of computer technology equipment;
- the authority for Archer medical savings accounts;
- the suspension of the percentage depletion method's income limitation for oil and natural gas produced from marginal properties;
- a limited credit for conducting economic activity in American Samoa;
- the authority to use certain funds for IRS undercover operations; and
- the provisions allowing IRS disclosure of taxpayer information to facilitate combined employment tax reporting and for reasons relating to terrorist activities and income-contingent student loan repayment.

The new markets tax credit is extended through 2008, and the deadline for placing certain Gulf Opportunity Zone property in service to be eligible for bonus depreciation is extended through 2010. Section 123 provides rules for making elections under the extended provisions to account for the fact that some provisions had expired in 2005.

Title II — Energy Tax Provisions. Title II extends several expiring energy tax provisions through 2008:

- section 201 effectively extends the renewable energy credit in IRC § 45,
- section 202 extends the clean renewable energy bonds credit in IRC § 54 and raises the caps on the amount of bonds that may be issued and the amount that may be used to finance projects of governmental bodies,
- section 204 extends the IRC § 179D deduction for energy-efficient commercial buildings,
- section 205 extends the credit in IRC § 45L for energy-efficient homes,
- section 206 extends the credit in IRC § 25D for residential energy-efficient property and replaces the term "qualified photovoltaic property expenditures" with "qualified solar electric property expenditures,"
- section 207 extends the energy credit in IRC § 48, and
- section 208 extends the rule in IRC § 4041 that lowers the fuel excise tax rate on qualified methanol and ethanol fuel.

Title II includes several non-extender provisions. Section 203 amends the credit for advance coal projects in IRC § 48A by adding a performance standard for sulfur dioxide removal in electric generation units designed to use subbituminous coal. For cellulosic biomass ethanol plant property placed in service prior to January 1, 2013, section 209 provides an additional first-year depreciation deduction equal to 50% of the taxpayer's adjusted basis in the property. Section 210 increases the types of expenditures that may be made from the Leaking Underground Storage Tank Trust Fund. Section 211 amends the credit under IRC § 45K for producing fuel from a non-conventional source so that the credit phaseout, which occurs when the reference price of oil exceeds $23.50 per barrel (adjusted for inflation), does not apply to facilities producing coke and coke gas. The section also clarifies that the special rules applicable to these facilities do not apply to facilities producing coke or coke gas from petroleum-based products.

Title III — Health Savings Accounts. Section 301 names Title III the "Health Opportunity Patient Empowerment Act of 2006."

Sec. 302. Section 302 allows a tax-free transfer of funds from a flexible spending arrangement or health reimbursement arrangement to a health savings account (HSA). Among other requirements, the contribution must be made before 2012. An employee who fails to remain an eligible individual (e.g., fails to be covered by a high-deductible health plan) during the 12-month period following the distribution is subject to tax on the distribution and a 10% penalty tax. An employer who offers the distribution to some, but not all, eligible individuals is also subject to an excise tax.

Secs. 303-305. Under IRC § 223, individuals may deduct HSA contributions, subject to several limitations. One limitation is that the deduction for an individual under age 55 is limited to the lesser of his or her annual deductible or $2,250 ($4,500 for family coverage, both are adjusted for inflation) and is reduced for individuals who are HSA-eligible for only part of a year. Section 303 sets this cap at $2,250 or $4,500 (both adjusted for inflation). Section 304 requires that the COLAs for determining the limitations be calculated and released by June 1 of each year. Section 305 allows an individual who is HSA-eligible for only part of a year, including during the last month of that year, to be treated as eligible for that entire year. An individual who does not remain HSA-eligible during the following year is subject to tax on the contributions that would have exceeded the deduction limitations, had they applied, and a 10% penalty tax.

Sec. 306. Section 306 provides that, for purposes of determining whether an employer is subject to the excise tax in IRC § 4980G for failing to make comparable HSA contributions, highly compensated employees are not treated as comparable participating employees for non-highly compensated employees.

Sec 307. Section 307 allows a one-time, tax-free distribution from an individual retirement account to an HSA, subject to several limitations. An individual who does not remain an eligible individual during the 12-month period following the distribution is subject to tax on the distribution and a 10% penalty tax.

Title IV — Other Provisions.

Sec. 401. IRC § 199 allows a deduction for income attributable to domestic production activities, limited to 50% of the wages paid by the taxpayer allocable to such activities. Section 401 treats Puerto Rico as part of the United States, so long as the taxpayer's gross receipts from sources within Puerto Rico are subject to U.S. taxation. The provision is effective for the first two taxable years beginning after December 31, 2005, and before January 1, 2008.

Sec. 402. One step in calculating a taxpayer's liability under the alternative minimum tax is adding back various tax preference items to his or her taxable income, as computed under the regular income tax. Some of the adjustments result in the taxpayer losing the benefit of tax deferral. To avoid double taxation (i.e., taxing the item in the current year under the AMT and again in a future year under the regular income tax), these deferral adjustments yield a minimum tax credit that the taxpayer may carry forward to reduce regular income taxes in future years. Section 402 makes the minimum tax credit partially refundable for unused credits that have been carried forward for a number of

years. It is phased out for higher-income individuals. The unused credit must be from taxable years beginning before January 1, 2013.

Sec. 403. Under IRC § 6039, corporations involved in a transfer of stock options to an individual must provide information about the transfer to the individual. Section 403 requires that the corporation file a return with the IRS in addition to providing information to the person involved in the transfer.

Secs. 404 and 405. Section 404 allows taxpayers to expense 50% of the cost of qualified mine safety equipment property for use in U.S. underground mines. The original use of the property must commence with the taxpayer, and the property must be placed in service before 2009. Section 405 creates a tax credit for employers based on the training program costs of qualified mine rescue team employees. The credit equals 20% of the costs, limited to $10,000, paid for each qualified employee. It expires in 2008.

Sec. 406. IRC § 7623 allows the IRS to pay sums to individuals who provide information that assists the agency in detecting tax underpayment and other tax law violations. The award is based on the amount collected, other than interest. The IRS has set the maximum award at 15% of the amount collected (limited to $10 million), which is reduced depending on the specificity and value of the information. Section 406 sets the award for information leading the IRS to proceed with an administrative or judicial action between 15% and 30% of the amount collected. This is reduced if information from other sources was more useful to the IRS. The rules apply only if the action involves a disputed amount in excess of $2 million and, if the taxpayer in the action is an individual, his or her gross income exceeds $200,000. The section also requires the IRS begin to set up an office to administer the award program. In addition, section 406 creates an above-the-line deduction for attorney's fees and costs paid by an individual in connection with providing the information and allows the individual to appeal the amount or denial of an award to the U.S. Tax Court.

Sec. 407. Section 407 increases the maximum $500 penalty on individuals who file a frivolous income tax return to $5,000 and applies the penalty provision to all taxpayers and federal taxes. It also allows the IRS to impose a penalty of up to $5,000 on taxpayers who make frivolous submissions for collection due process hearings, installment agreements, offers-in-compromise, and taxpayer assistance orders, and it authorizes the IRS to disregard such submissions. The section also requires the IRS to publish a list of frivolous positions, arguments, requests, and submissions.

Sec. 408. Section 408 adds the meningococcal and human papillomavirus vaccines to the list of vaccines in IRC § 4131 that are subject to an excise tax of 75¢ per dose.

Sec. 409. Settlement funds are sometimes established by agreement between the Environmental Protection Agency and a private party to pay for the cleanup of hazardous waste sites. Under IRC § 468B, as amended by the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA, P.L. 109-222), qualifying settlement funds are exempt from income tax. Section 409 makes this treatment permanent.

Sec. 410. During a corporate division such as a spin-off, a distribution of stock in a controlled subsidiary by a parent corporation to its shareholders is tax-free to both the distributing corporation and the shareholders if the requirements in IRC § 355 are met.

One requirement is that both the parent corporation and subsidiary must have engaged in the active conduct of a trade or business for at least five years. Under TIPRA, the "active conduct" test is determined by looking at the activities of the entire affiliated group, not just the parent and subsidiary. Section 410 makes the TIPRA provision permanent.

Sec. 411. Under IRC § 143, the proceeds of qualified veterans' mortgage bonds must be used to make mortgage loans to qualified veterans. Only certain states may issue these bonds, and they are limited in the amount that may be issued. TIPRA gradually increased the limits for Alaska, Oregon, and Wisconsin so that the limit in 2010 for each state is $25 million, but the amount is reduced to zero for years after 2010. Section 411 makes the $25 million limit permanent for these three states.

Sec. 412. Prior to TIPRA, the sale of self-created musical works resulted in ordinary income. TIPRA created a temporary rule that allows a taxpayer to treat the work as a capital asset and, therefore, to be taxed on the gain from the sale at the applicable capital gains rates. Section 412 makes the TIPRA provision permanent.

Secs. 413 and 415. IRC §§ 1352 to 1359 provide special rules that allow corporations operating qualified vessels involved in international shipping activities to pay a tax based on tonnage as opposed to the corporate income tax. The vessel must be a U.S. flag vessel of at least 10,000 deadweight tons and be used exclusively in foreign trade. Incidental use in domestic trade is permitted if the operator provides notice to the IRS; however, if the vessel is used for domestic trade for more than 30 days during the year, the vessel is no longer treated as a qualified vessel. TIPRA lowered the 10,000 ton limitation to 6,000, and section 413 makes that provision permanent. Section 415 eases the rules regarding notice and the 30-day limit for qualifying vessels operating in the Great Lakes Waterway and St. Lawrence Seaway.

Sec. 414. The arbitrage provision in IRC § 148 disallows the exemption of interest on state and local government bonds if the proceeds are invested in higher-yield investments or if the debt service on the bonds is secured by or paid from those investments. An exception has existed since 1984 that allows the income from the investments of the Texas Permanent University Fund to secure a limited amount of bonds issued by the state university systems. Because of changes made to the Texas constitution in 1999, the 1984 exception does not accurately reflect the relationship between the Fund and the systems; however, the IRS has agreed to continue to apply the 1984 exception through August 2007, which TIPRA extended to August 2009. Section 414 makes the treatment permanent.

Sec. 416. Under IRC § 143, mortgage revenue bonds are tax-exempt bonds used to finance below-market rate mortgages for low- and moderate-income homebuyers who have not owned a home for the past three years. Section 416 provides a one-time waiver of the three-year requirement for bonds used to finance residences for veterans. The bonds must be issued before January 1, 2008.

Sec. 417. Under IRC § 121, taxpayers may exclude from gross income up to $250,000 ($500,000 if married filing jointly) of the gain realized from the sale of a principal residence. The taxpayer must have used the property as a principal residence for at least two of the five years preceding the date of sale. A taxpayer may elect to suspend the 5-year period for up to 10 years during the time that the taxpayer or spouse

is on qualified official extended duty as a member of the uniformed services or U.S. Foreign Service. Section 417 allows intelligence community employees to make the suspension election for sales made before January 1, 2011.

Sec. 418. IRC § 1043 allows executive branch officers and employees who must sell property to comply with conflict-of-interest requirements to defer tax by reinvesting the gain in certain investments. Section 418 extends the rule to judicial officers.

Sec. 419. IRC § 163 allows a deduction for interest paid on acquisition indebtedness or home equity indebtedness for the taxpayer's residence. Section 419 treats qualified mortgage insurance premiums as such interest for taxpayers with adjusted gross income below $110,000. The treatment does not apply to mortgage insurance contracts issued before January 1, 2007, or amounts paid after December 31, 2007.

Sec. 420. IRC § 6427 allows a partial refund for the fuel excise taxes paid on kerosene if the fuel is used for a non-taxable use. Generally, the ultimate purchaser may claim the refund or waive the refund so it may be claimed by the ultimate vendor; however, in the case of noncommercial aviation, only the ultimate vendor may claim the refund. Section 420 changes the noncommercial aviation rule to allow the purchaser to claim the refund or waive it so the ultimate vendor may claim it. The section also allows the ultimate purchaser of kerosene used in aviation for a non-taxable farming purpose to claim a refund for taxes paid on purchases made between December 31, 2004, and October 1, 2005, reduced by any refunds claimed by the ultimate vendor.

Sec. 421. Section 421 amends IRC § 6103 to allow the IRS to provide tax information to governmental entities that are formed and operated by municipalities that impose income taxes as authorized by state law and collectively have a population that exceeds 250,000. There must be a disclosure agreement between the IRS and entity, and the disclosure may only be for purposes of the municipalities' tax administration.

Sec. 422. Section 422 amends the rules in IRC § 5388 relating to alcohol excise taxes that provide for the designation of wines by semi-generic names.

Sec. 423. Section 423 amends the credit for railroad track maintenance expenditures in IRC § 45G to provide that these expenditures are calculated using a taxpayer's gross expenditures for maintaining railroad track owned or leased by a Class II or Class III railroad, regardless of any consideration for the expenditures given by the railroad that made the assignment of the track.

Sec. 424. Section 424 imposes an excise tax on charitable remainder trusts that have unrelated business taxable income. The tax equals the income.

Sec. 425. Section 425 makes permanent the TIPRA rule in IRC § 7872 that exempts loans made pursuant to a continuing care contract to a qualified continuing care facility from the below-market interest rate rules.

Sec. 426. Section 426 contains technical corrections clarifying IRS regulatory authority under section 103(b) of the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222), relating to subpart F income, and authority to permit interest suspension under section 903 of the American Jobs Creation Act of 2004 (P.L. 108-357).