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Senate seals deal on tax break renewals

The Senate, following House passage, votes to extend business tax credits and personal deductions as the 109th Congress calls it a day.

December 9, 2006

After months of promises, delays and legislative jockeying, lawmakers will send a nearly $40 billion tax and trade bill to President Bush that renews for two years a host of expired business tax credits and popular individual tax breaks, and introduces a new, one-year itemized deduction for mortgage insurance premiums.

Following House passage, the Senate on early Saturday morning voted in favor of the legislation. The main component of the tax portion is the research and development credit for businesses. But it also includes education and sales tax deductions.

The tax breaks had expired at the end of 2005 and were originally tossed out of a $70 billion tax relief bill that passed last May to allow for the cost of extending the reduced tax rate on capital gains and dividends.

Lawmakers extended the tax breaks for two years beginning retroactively on Jan. 1, 2006.

Since the IRS has already mailed out its 1040 form and instructions, it now will need to issue supplemental instructions regarding how and where taxpayers should include the extended deductions on their 2006 federal tax return.

Here's a quick look at the deductions in the legislation that will benefit individuals:

Tuition deduction

The tuition deduction is an above-the-line deduction for qualified higher education expenses, meaning it can be taken even if you don't itemize deductions on your federal return.

The deduction may be taken on a maximum of $4,000 in tuition and fees for taxpayers with adjusted gross income (AGI) of $65,000 or less ($130,000 for married couples filing jointly) or $2,000 for taxpayers with AGIs of $80,000 or less ($160,000 for married couples).

The tuition deduction may not be taken for expenses for which you are claiming an education credit (e.g., the HOPE or lifetime learning credits). You must choose one or the other if you qualify for both.

State and local sales tax deduction

The extension would give taxpayers the option on their federal return of deducting either what they paid in state and local income tax or what they paid in state and local general sales taxes, whichever is higher.

This provision has been of greatest advantage to taxpayers who live in the handful of states that don't impose an income tax and to those who live in states with high sales taxes and relatively low income taxes.

There are nine states without personal income tax: Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington and Wyoming.

Teachers' classroom deduction

The provision allows elementary and secondary teachers to continue to deduct their out-of-pocket costs -- up to $250 -- for buying classroom supplies. As with the tuition break, it is an above-the-line deduction and can be taken even if you don't itemize deductions on your federal return.

Mortgage insurance premium deduction

The legislation allows taxpayers who itemize their deductions to deduct premiums paid for mortgage insurance - which typically is required when home buyers purchase their homes with less than 20 percent down.

Currently, only the interest paid on one's mortgage is deductible if the taxpayer itemizes deductions.

The new insurance premiums deduction will only apply to mortgage insurance contracts issued in 2007 and is only available to taxpayers whose adjusted gross incomes do not exceed $110,000 ($55,000 for married taxpayers filing separately).