Lally&Co.
CPAs and Business Advisors

The
EVERGREEN
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The Evergreen. Always Growing.

Like the evergreen oak tree, Lally & Co. is always growing. With the support and loyalty of our clients and friends we have grown into a firm of 40 individuals serving clients in many diverse fields. Our growth gives us the ability to better serve our clients and provide effective solutions to their needs. If you have questions about your business or personal tax situation, please contact us. We welcome your call and are always looking for ways to better serve you.

Contact our office or visit our website for more information.

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Dear Clients and Friends,

As the year nears its end, many clients are asking how they can prepare for the 2015 tax filing season and the 2016 tax year. This newsletter discusses certain tax planning techniques and items to be aware of in the upcoming year.

As you read through *The Evergreen*, please do not hesitate to contact us if you have questions regarding an article or regarding your business or personal tax situation. We would be happy to hear from you! This and past issues of *The Evergreen* are available on our website at http://lallycpas.com/newsletters/.

First Look At Year-End Tax Planning

The approach of year-end 2015 makes it tax planning season. Tax law developments in 2015 can affect, for example, the deduction of costs and expenses, the treatment of contributions to tax-favored accounts, and the inclusion of certain benefits in income. Traditional year-end planning techniques for investments and retirement are also important. Small businesses also have some tools for year-end tax planning. Although it may seem early to contemplate year-end planning, the remaining weeks of 2015 will pass quickly and taxpayers need to be proactive.

Investments

Taking inventory of gains and losses at this time to map out a year-end buy, sell or hold strategy later makes particular sense. Investors should note that immediate losses in the stock markets do not necessarily translate into tax losses. The fact that assets purchased several years ago may still yield taxable gains because of low basis, and the existence of the wash sale rule if a stock is purchased within 30 days before or after a sale, should be considered in assessing current tax positions.

Taxpayers should also remember the higher tax rate environment that is now in its third year. Not only has the top rate jumped to 39.6 percent for ordinary income (and short-term capital gains) but the rate for long-term capital gains and qualified dividends has increased from 15 to 20 percent. Furthermore, a 3.8 percent net investment tax applies to taxpayers with income above a non-inflation-adjusted threshold ($250,000 for married taxpayers filing jointly; $125,000 for married taxpayers filing separately; and $200,000 for all other taxpayers).

Saving For Retirement

Although most IRA contributions for a particular year may be made until the filing date for that year, other deadlines are at year end, such as contributions to 401(k) plans and Roth conversions and re-conversions. Required minimum distributions for retirees and those over age 70 ½ also generally carry a year-end distribution date beyond which a penalty applies. One exception allows an individual

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Firm Announcements

Andrew D. Coleman, CPA became father to baby boy, John Andrew "Jack" Coleman, born October 9, 2015

Christine Fromlak joined our Tax Department in October as a Tax Associate

Lauren (Silvestri) Takacs re-joined our Tax Department in October as a Tax Senior

Nicholas J. Wasco joined our Tax Department in October as a Tax Associate

Patrick J. Leedy joined our Tax Department in September as a Tax Associate

Zachary E. Miles, **CPA** successfully completed the Uniform CPA Exam in August 2015

Important Dates

November 16, 2015 – Extended Foundation Returns Due

December 15, 2015 – 2015 4th Quarter Estimated Payments For C-Corp's Due

January 15, 2016 – 2015 4th Quarter Estimated Payments Due

turning age 70 ½ to delay starting distributions until April 1 of the year following the year in which the individual turns 70 ½.

Small Businesses

Many small businesses have relied on the generous Section 179 deduction, which is now up for renewal as part of the extenders legislation, to gain an immediate write-off for equipment, rather than follow depreciation schedules. One alternative now available to many businesses is the de minimis safe harbor threshold amount under the final so-called "repair regs." Currently, a de minimis safe harbor under the repair regulations allows taxpayers to deduct certain items cost $5,000 or less (per item or invoice) and that are deductible in accordance with the company's accounting policy reflected on their applicable financial statement (AFS). IRS regulations also provide a $500 de minimis safe harbor threshold for taxpayers without an applicable financial statement.

New Tax Laws

So far this year, Congress has passed and President Obama has signed several tax bills. Two new laws impact tax planning for public safety officers. The Don't Tax Our Fallen Public Safety Heroes Act clarifies that both federal and state benefits for public safety officers fallen or injured in the line of duty are treated the same in the tax code and are not taxable. The Defending Public Safety Employees' Retirement Act affects retirement planning. Generally, taxpayers who receive an early distribution from a qualified retirement plan are subject to a 10 percent penalty, unless an exemption exists. The Defending Public Safety Employees' Retirement Act expands the exemption to include certain federal law enforcement officers, federal firefighters, customs and border protection officers, and air traffic controllers.

Late last year, Congress passed the legislation creating A Better Life Experience (ABLE) accounts. States are now enacting enabling legislations, which along with federal law, will allow ABLE accounts to be set up for qualified individuals with disabilities (who became disabled before age 26) for tax years beginning after December 31, 2014. Contributions in a total amount up to the annual gift tax exclusion amount, currently $14,000, can be made to an ABLE account on an annual basis, and distributions are tax-free if used to pay qualified disability expense

One bill that has not yet passed is legislation to extend the so-called tax extenders. The Tax Increase Prevention Act of 2014 (TIPA) only extended these popular but temporary tax breaks for 2014. The expired extenders include the state and local sales tax deduction, higher education tuition deduction, transit benefits parity, research tax credit, the work opportunity tax credit, and many others. The extenders are likely to be renewed for 2015 but Congress may wait till December to pass a bill. Our office will keep you posted of developments.

When Must Individuals Pay Estimated Taxes?

Many federal income taxes are paid from amounts that are withheld from payments to the taxpayer. For instance, amounts roughly equal to an employee's estimated tax liability are generally withheld from the employee's wages and paid over to the government by the employer. In contrast, estimated taxes are taxes that are paid throughout the year on income that is not subject to withholding. Individuals must make estimated tax payments if they are

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self-employed or their income derives from interest, dividends, investment gains, rents, alimony, or other funds that are not subject to withholding.

Estimated income tax payments are required from taxpayers who:

1. expect to owe at least $1,000 in tax for the year, after subtracting taxes that were paid through withholding and tax credits; and
2. expect that the amount of taxes to be paid during the year through other means will be less than the smaller of—
   - 90% of the tax shown on the current year's tax return, or
   - 100% of the tax shown on the previous year's return (the previous year's return must cover all 12 months). This 100-percent test increases to 110 percent if the taxpayer's AGI for the previous year exceeds $150,000.

U.S. citizens who have no tax liability for the current year are not required to make estimated tax payments.

Form 1040-ES. Taxpayers use Form 1040-ES to calculate, report, and pay their estimated tax. The annual liability may be paid in quarterly installments that are due based upon the taxpayer's tax year. However, no payments are required until the taxpayer has income upon which tax will be owed. Taxpayers may also credit their overpayments from one year against the next year's estimated tax liability, rather than having them refunded.

Generally, the required installment is 25 percent of the required annual payment. However, a taxpayer who receives taxable income unevenly throughout the year can elect to pay either the required installment or an annualized income installment. The use of the annualized income installment method, provided on a worksheet contained in the instructions to Form 2210, Underpayment of Estimated Tax by Individuals and Fiduciaries, may reduce or eliminate any penalty for underpaid taxes.

Due Dates. For most individual taxpayers, the quarterly due dates for estimated tax payments are:

For the Period:	Due Date:
Jan. 1 – Mar. 31	Apr. 15
Apr. 1 – May 31	Jun. 15
June 1 – Aug. 31	Sept. 15
Sept. 1 – Dec. 31	Jan. 15 next year

Penalties. A penalty generally applies when a taxpayer fails to make estimated tax payments, pays less than the required installment amount, or makes late payments. However, the IRS may waive the penalty if the underpayment was due to casualty, disaster or other unusual circumstances.

President Signs Highway Bill Revising Return Due Dates, Making Other Compliance Change

President Obama signed the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 on July 31. The Act revises some important return due dates, overrules a Supreme Court tax decision, revises the employer shared responsibility requirements in the Affordable Care Act (ACA), and includes other tax compliance measures.

Although the highway and transportation funding portion of the Act is temporary (Congress must come up with another funding bill by late October), the tax compliance measures are permanent.

Return Due Dates

The Act changes the filing deadlines for a number of major tax forms. For the most part, however, these changes first apply to 2016 tax year returns that are due in 2017. Nothing will change for the return filing season coming up in early 2016.

The Act provides that the due date for partnerships to file Form 1065, U.S. Return of Partnership Income and Schedule K-1s, Partner's Share of Income, will move from April 15 to March 15 (or to the 2 ½ months after the close of its tax year for fiscal-year taxpayers). Under the Act, the filing deadline for regular C corporation's moves from March 15 (or the 15th day of the 3rd month after the end of its tax year) to April 15 (or the 15th day of the 4th month after the end of its tax year).

For C corporations with tax years ending on June 30, the filing deadline will remain at September 15 until tax years beginning after December 31, 2025, when it will become October 15. An automatic six-month extension will be available for C corporations, except for calendar-year C corporations through 2025, during which an automatic five-month extension until September 15 will generally apply.

A number of other filing extension deadlines will also change, starting in 2017.

The Act shifts the due date for the FBAR (Report of Foreign Bank and Financial Accounts, FinCEN Form 114) from June 30 to April 15 with a maximum extension of a six-month period ending October 15.

Overstatement of Basis

In the Home Concrete case, the Supreme Court ruled that an

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overstatement of basis does not result in an omission of income for statute of limitations purposes. Under the Act, the six-year limitations period applies where any overstatement of basis results in a substantial omission (25 percent or more) of income. The Act is effective for all returns for which the normal assessment period remained open as of the date of enactment and for returns filed after that date.

Affordable Care Act

The new Act revises the ACA's employer shared responsibility requirements ("employer mandate"). Under the Act, an individual is not taken into account for purposes of the ACA's employer shared responsibility requirements for applicable large employers (ALEs) if the individual has coverage under TRICARE or a VA health care program. This Act provides that this treatment may be applied retroactively, to months beginning after December 31, 2013.

Mortgage Reporting

Mortgage servicers file Form 1098, Mortgage Interest Statement, to report certain information to the IRS. Included in the Act are additional reporting requirements for mortgage servicers, including the amount of the outstanding mortgage principal, the address (or description of property without an address) of the property, and loan origination date. The additional reporting requirements apply to returns and statements the due date for which (determined without regard to extensions) is after December 31, 2016.

Stepped-up Basis

The Act requires consistency between estate tax value and the "stepped-up basis" of assets acquired from a decedent. Executors of large estates will be required to disclose to the IRS information identifying the value of each interest received.

Additional Provisions

Pension funds. The Act extends through 2025 the ability of qualified employers to transfer excess pension assets to fund retiree health benefits and retiree life insurance.
Military veterans. Under the Act, a veteran's eligibility to contribute to a health savings account (HSA) is not affected by receipt of medical care for a service-connected disability.
Fuel taxes. The Act uniformly imposes taxes on liquefied natural gas (LNG), liquefied petroleum gas (LPG), and compressed natural gas (CNG) on an energy-equivalent basis.

Developments Continue to Impact the Mortgage Interest Deduction

The mortgage interest deduction is widely used by the majority of individuals who itemize their deductions. In fact, the size of the average mortgage interest deduction alone persuades many taxpayers to itemize their deductions. It is not without cause, therefore, that two recent developments impacting the mortgage interest deserve being highlighted. These developments involve new reporting requirements designed to catch false or inflated deductions; and a case that effectively doubles the size of the mortgage interest deduction available to joint homeowners. But first, some basics.

Mortgage Interest Deduction Ground Rules

Mortgage interest — or "qualified residence interest" — is deductible by individual homeowners. Qualified residence interest generally includes interest paid or accrued during the tax year on debt secured by either the taxpayer's principal residence or a second dwelling unit of the taxpayer to the extent it is considered to be used as a residence (a "qualified residence").

Qualified residence interest comprises amounts paid or incurred on acquisition indebtedness and home equity indebtedness. Acquisition indebtedness is debt that is both:

1. secured by a qualified residence, and
2. incurred in acquiring, constructing or substantially improving the residence.

Home equity indebtedness is any debt secured by a qualified residence that is not acquisition indebtedness to the extent of the difference between the amount of outstanding acquisition indebtedness and the fair market value of the qualified residence.

A qualified residence for purposes of the home mortgage interest deduction can be the principal residence of the taxpayer, and one other residence selected by the taxpayer. In other words, the deduction is limited to interest payments on two homes.

Qualified residence interest is subject to several dollar limitations:

- The total acquisition indebtedness (principal) on which qualified residence interest is deductible is limited to $1 million ($500,000 in the case of married individuals filing separately).
- The total amount of home equity indebtedness (principal) taken into account in calculating deductible qualified residence interest may not exceed $100,000 ($50,000 in the case of married individuals filing separately).

Information reporting. Mortgage service providers have been required to report only the following

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information to the IRS annually with respect to individual borrower:

- the name and address of the borrower;
- the amount of interest received for the calendar year of the report; and
- the amount of points received for the calendar year and whether the points were paid directly by the borrower.

The amount of interest received by a mortgage service provider is reported on Form 1098, Mortgage Interest Statement, to the IRS. Form 1098 must also be furnished by the mortgage service provider to the payor on or before January 31 of the year following the calendar year in which the mortgage interest is received.

More Detailed Form 1098 Coming

The 2015 Surface Transportation Act (aka the Highway bill), which was signed into law on July 31, 2015, will require that Form 1098, Mortgage Interest Statement, filed with the IRS and provided to homeowners, include information on:

1. the amount of outstanding principal of the mortgage as of the beginning of the calendar year,
2. the address of the property securing the mortgage, and
3. the loan origination date.

These items are in addition to the information that parties were already required to provide to the IRS and payors under existing law.

The Government Accountability Office (GAO) had expressed concern that the information reported on Form 1098 is insufficient to allow the IRS to enforce compliance with the deductibility requirements for qualified residence interest. This criticism has included in particular, but not limited to, the dollar limitations imposed on acquisition indebtedness and home equity indebtedness.

While the modifications are intended to boost compliance with the deductibility requirements for qualified residence interest, they also impose a new burden on mortgage service providers. To give mortgage service providers time to reprogram their systems, the additional reporting requirements apply to returns and statements required to be furnished after December 31, 2016.

Joint Ownership

Another major development impacting on some homeowners' mortgage interest deduction also took place this summer. Reversing the Tax Court, a panel of the Court of Appeals for the Ninth Circuit has found that when multiple unmarried taxpayers co-own a qualifying residence, the debt limit provisions apply per taxpayer and not per residence (Voss, CA-9, August 7, 2015). The question was one of first impression in the Ninth Circuit, the court observed.

Background. The taxpayers, registered domestic partners, obtained a mortgage to purchase a house (the Rancho Mirage property). In 2002, the taxpayer refinanced and obtained a new mortgage. That same year, the taxpayers purchased another house (the Beverly Hills property) with a mortgage, which they subsequently refinanced and obtained a home equity line of credit totaling $300,000. The total average balance of the two mortgages and the line of credit during the tax years at issue was approximately $2.7 million.

Both taxpayers filed separate income tax returns. Each individual claimed home mortgage interest deductions for interest paid on the two mortgages and the home equity line of credit. The IRS calculated each taxpayer's mortgage interest deduction by applying a limitation ratio to the total amount of mortgage interest that each petitioner paid in each taxable year. The limitation ratio was the same for both: $1.1 million ($1 million of home acquisition debt plus $100,000 of home equity debt) over the entire average balance, for each tax year, on the Beverly Hills mortgage, the Beverly Hills home equity line of credit, and the Rancho Mirage mortgage. The taxpayers challenged the IRS's calculations but the Tax Court ruled in favor of the agency.

Court's analysis. Code Sec. 163(h)(3), the court found, provides that interest on a qualified residence, by a special carve-out, is not considered "personal interest," which would otherwise be nondeductible by taxpayers who are not corporations. A qualified residence is the taxpayer's principal residence and one other residence of the taxpayer which is selected by the taxpayer for the tax year and which is used by the taxpayer as a residence.

The court further found the Tax Code limits the aggregate amount treated as acquisition indebtedness for any period to $1 million and the aggregate amount treated as home equity indebtedness for any period to $100,000. In the case of a married individual filing a separate return, the debt limits are reduced to $500,000 and $50,000.

Looking at the language of the Tax code, the court found that the debt limit provisions apply per taxpayer and not per residence. There was no reason not to extend this treatment to unmarried co-owners, the court concluded. Thus, each of the homeowners were entitled to the $1 million limit.

Whether this holding will hold up in jurisdictions other than the Ninth Circuit, and whether it will apply to joint ownership situations for vacation homes, for example, remains to be tested.

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How Do I Form a Partnership For Tax Purposes?

A business operated by two or more owners can elect to be taxed as a partnership by filing Form 8832, the Entity Classification Election form. A business is eligible to elect partnership status if it has two or more members and:

- is not registered as anything under state law,
- is a partnership, limited partnership, or limited liability partnership, or
- is a limited liability company.

Publicly traded businesses cannot elect to be treated as partnerships.

Form 8832 allows a business to select its classification for tax purposes by checking the box on the form: partnership, corporation, or disregarded. If no form is filed, the IRS will assume that the entity should be taxed as a partnership or disregarded as a separate entity. An LLC that makes no federal election will be taxed as a partnership if it has more than one member and disregarded if it has only one member. An LLC must make an affirmative election to be taxed as a corporation. The IRS language on Form 8832 uses the term "association" to describe an LLC taxed as a corporation.

Form 8832 has no particular due date. There is a space on the form (line 4) for the entity to note what date the election should take effect. The date named can be no earlier than 75 days before the form is filed, and no later than 12 months after the form is filed. It is most important to file Form 8832 within the first few months of operations if the entity desires a tax treatment that differs from the tax status the IRS will apply by default if no election is made.

A few businesses do not qualify to be partnerships for federal tax purposes. These are:

1. a business that is a corporation under state law,
2. a joint stock company,
3. an insurance company,
4. most banks,
5. an organization owned by a state or local government,
6. a tax-exempt organization
7. a real estate investment trust, or
8. a trust.

Although these businesses cannot be partnerships, they can be partners in a partnership. Of course, whether your business is best operated as a partnership, as a corporation, or as another type of entity should not only be driven by short-term tax considerations. How you envision your business will develop over time, whether your business is asset or service intensive, and what personal financial stake you plan to take are all additional factors that should be considered.

Can a Taxpayer Assign Income to Someone Else?

Gross income is taxed to the person who earns it by performing services, or who owns the property that generates the income. Under the assignment of income doctrine, a taxpayer cannot avoid tax liability by assigning a right to income to someone else. The doctrine is invoked, for example, for assignments to creditors, family members, charities, and controlled entities. Thus, the income is taxable to the person who earned it, even if the person assigns the income to another and never personally receives the income. The doctrine can apply to both individuals and corporations.

A taxpayer cannot assign income that has already accrued from the property the taxpayer owns, and cannot avoid liability for tax on that income by assigning it to another person or entity. This result often applies to interest, dividends, rent, royalties, and trust income. The doctrine applies when the taxpayer's right to income has ripened so that the receipt of income is practically certain to occur. Once a right to receive income has ripened, the taxpayer who earned it or otherwise created that right will be taxed on the income.

Similarly, under the anticipatory assignment of income doctrine, a taxpayer cannot shift tax liability by transferring property that is a fixed right to income. However, a taxpayer can assign future income by making an assignment of property for value or a bona fide gift of the underlying property.

The doctrine does not apply if a right to income is sold or exchanged for value. If a gift of income-producing property is made, income earned after the date of the gift is taxed to the donee of the gift. If a taxpayer assigns a claim to income that is contingent or uncertain, the assignee of the right is taxable on income that the assignee collects on the claim. If a taxpayer transfers appreciated property prior to a sale or exchange, the appreciation is income to the person owning the property at time of sale or exchange.

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