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 evolved into a firm of 40 individuals who serve clients in many diverse engagements. We continuously expand our knowledge base and credentials to better serve our current and broadening clientele.

Our growth has given us the ability to better serve our clients and adapt to their needs. If you have questions about your business or personal tax situation, please contact us. We 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,

Spring has arrived and with that comes the end of another "busy" season. We would like to extend our sincere gratitude for the trust you have invested in us. Our clients and referral sources are the reason we had one of our busiest and most successful tax seasons. It would not have happened without each of you.

We continue to service our clients throughout the calendar year. As you read through *The Evergreen*, please do not hesitate to contact us at any time if you have questions regarding an article in *The Evergreen* 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/.

Post Filing-Season Checkup for 2014 Tax Savings

With the April 15th filing season deadline now behind us, it's not too early to turn your attention to next year's deadline for filing your 2014 return. That refocus requires among other things an awareness of the direct impact that many "ordinary," as well as one-time, transactions and events will have on the tax you will eventually be obligated to pay April 15, 2015. To gain this forward-looking perspective, taking a moment to look back at the filing season that has just ended, is particularly worthwhile. This generally involves a two-step process: (1) a look-back at your 2013 tax return to pinpoint new opportunities as well as "lessons learned;" and (2) a look-back at what has happened in the tax world since January 1st that may indicate new challenges to be faced for the first time on your 2014 return.

Your 2013 Form 1040

Examining your 2013 Form 1040 individual tax return can help you identify certain changes that you might want to consider this year, as well as encourage you to continue what you're doing right. These "key ingredients" to your 2014 return may include, among many others considerations, a fresh look at:

Your refund or balance due. While it is nice to get a big refund check from the IRS, it often indicates unnecessary overpayments over the course of the year that has provided the federal government with an interest-free loan in the form of your money. Now's the time to investigate the reasons behind a refund and whether you need to take steps to lower wage withholding and/or quarterly estimated tax payments.

If on the other hand you had to pay the IRS when filing your return (or requesting an extension), you should consider whether it was due to a sudden windfall of income that will not repeat itself; or because you no longer have the same itemized deductions, you had a change in marital status, or you claimed a one-time tax credit such as for energy savings or education. Likewise,

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examining anticipated changes between your 2013 and 2014 tax years—marriage, the birth of a child, becoming a homeowner, retiring, etc.—can help warn you whether you're headed for an underpayment or overpayment of your 2014 tax liability.

Investment income. One area that blindsided many taxpayers on their 2013 returns was the increased tax bill applicable to investment income. Because of the "great recession," many investors had carryforward losses that could offset gains realized for a number of years as markets gradually improved. For many, however, 2013 saw not only a significant rise in investment income but also a rise in realized taxable investment gains that were no longer covered by carryforward losses used up during the 2010–2012 period.

Furthermore, dividends and long-term capital gains for the first time in 2013 were taxed at a new, higher 20 percent rate for higher income taxpayers and an additional 3.8 percent net investment income tax surtax for those in the higher income brackets. Short-term capital gains saw the highest rate jump, from 35 percent to 43.4 percent rate, which reflected a new 39.6 percent regular rate and the new 3.8 percent net investment income tax rate. This tax structure remains in place for 2014.

Personal exemption/itemized deductions. Effective January 1, 2013, the American Taxpayer Relief Act (ATRA) revived the personal exemption phaseout (PEP). The applicable threshold levels are $250,000 for unmarried taxpayers; $275,000 for heads of households; $300,000 for married couples filing a joint return (and surviving spouses); and $150,000 for married couples filing separate returns (adjusted for inflation after 2013). Likewise, for it revived the limitation on itemized deductions (known as the "Pease" limitation after the member of Congress who sponsored the original legislation) for those same taxpayers.

Medical and dental expenses. Starting in 2013, the Affordable Care Act (ACA) increased the threshold to claim an itemized deduction for unreimbursed medical expenses from 7.5 percent of adjusted gross income (AGI) to 10 percent of AGI. However, there is a temporary exemption for individuals age 65 and older until December 31, 2016. Qualified individuals may continue to deduct total medical expenses that exceed 7.5 percent of adjusted gross income through 2016. If the qualified individual is married and only one spouse is age 65 or older, the taxpayer may still deduct total medical expenses that exceed 7.5 percent of adjusted gross income.

Filing Season Developments

So far this year, the IRS, other federal agencies and the courts have issued guidance on individual and business taxation, retirement savings, foreign accounts, the ACA, and much more. Congress has also been busy working up a "tax extenders" bill as well as tax reform proposals. All these developments can impact how you plan to maximize benefits on your 2014 income tax return.

Tax reform. President Obama, the chairs of the House and Senate tax writing committees, and individual lawmakers all made tax reform proposals in early 2014. The proposals range from comprehensive tax reform to more piece-meal approaches. Although only small, piecemeal proposals have the most promising chances for passage this year; taxpayers should not ignore the broader push toward tax reform that will be taking shape in 2015 and 2016.

Tax extenders. The Senate Finance Committee (SFC) approved legislation (EXPIRE Act) in April that would extend nearly all of the tax extenders that expired after 2013. Included in the EXPIRE Act are individual incentives such as the state and local sales tax deduction, the higher education tuition deduction, transit benefits parity, and the classroom teacher's deduction; along with business incentives such as enhanced Code 179 small business expensing, bonus depreciation, the research tax credit, and more. Congress may now move quickly on an extenders bill or it may not come up with a compromise until after the November mid-term elections. Many of these tax benefits are significant and will directly impact the 2014 tax that taxpayers will pay.

Individual mandate. The Affordable Care Act's individual mandate took effect January 1, 2014. Individuals failing to carry minimum essential coverage after January 1, 2014 and who are not exempt from the requirement will make an individual shared responsibility payment when they file their 2014 federal income tax returns in 2015. There are some exemptions, including a hardship exemption if the taxpayer experienced problems in signing up with a Health Insurance Marketplace before March 31, 2014. Further guidance is expected before 2014 tax year returns need to be filed, especially on how to calculate the payment and how to report to the IRS that an individual has minimum essential coverage.

Employer mandate. The ACA's shared responsibility provision for employers (also known as the "employer mandate") will generally apply to large employers starting in 2015, rather than the original 2014 launch date. Transition relief provided in February final regulations provides additional time to mid-size employers with 50 or more but fewer than 100 employees, generally delaying implementation until 2016. Employers that employ fewer than 50 full-time or full time equivalent employees are

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permanently exempt from the employer mandate. The final regulations do not change this treatment under the statute.

Other recent tax developments to be aware of for 2014 planning purposes include:

- *IRA rollovers*. The IRS announced that, starting in 2015, it intends to follow a one-rollover-per-year limitation on Individual Retirement Account (IRA) rollovers as an aggregate limit.
- *myRAs*. In January, President Obama directed the Treasury Department to create a new retirement savings vehicle, "myRA," to be rolled out before 2015.
- *Same-sex married couples*. In April, the IRS released guidance on how the Supreme Court's Windsor decision, which struck down Section 3 of the Defense of Marriage Act (DOMA), applies to qualified retirement plans, opting not to require recognition before June 26, 2013.
- *Passive activity losses*. The Tax Court found in March that a trust owning rental real estate could qualify for the rental real estate exception to passive activity loss treatment.
- *FATCA deadline*. The IRS has indicated that it is holding firm on the July 1, 2014, deadline for foreign financial institutions (FFIs) to comply with the FATCA information reporting requirements or withhold 30 percent from payments of U.S.-source income to their U.S. account holders.
- *Vehicle depreciation*. The IRS announced that inflation-adjusted limitations on depreciation deductions for business use passenger autos, light trucks and vans first placed in service during calendar year 2014 are relatively unchanged from 2013 (except for first year $8,000 bonus depreciation that may be removed if Congress does not act in time.
- *Severance payments*. In March, the U.S. Supreme Court held that supplemental unemployment benefits (SUB) payments made to terminated employees and not tied to the receipt of state unemployment benefits are wages for FICA tax purposes.
- *Virtual currency*. The IRS announced that convertible virtual currencies, such as Bitcoin, would be treated as property and not as currency, thus creating immediate tax consequences for those using Bitcoins to pay for goods

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IRS 2013 Audit Rates Vary Significantly Among Taxpayers

Recently-released statistics from the IRS show a drop in audits among all income groups for fiscal year (FY) 2013 with the overall individual audit coverage rate at its lowest level since FY 2006. At the same time, the number of IRS employees working audits has decreased. However, enforcement revenue increased.

Taxpayer groups
For statistical purposes, the IRS groups taxpayers into particular categories. The IRS generally defines higher income taxpayers as taxpayers with incomes over $200,000. The IRS also identifies taxpayers with incomes above $1 million for statistical purposes. Similarly, the IRS groups businesses into various categories; for example, corporations with assets under $10 million and corporations with assets above $10 million, $50 million, or $100 million. The IRS also identifies S corporations and partnerships for statistical purposes.

Audit types
As it does with taxpayers, the IRS groups different types of audits into various categories. Field audits are generally full audits. Correspondence audits are, as the name suggests, generally audits conducted by correspondence with the taxpayer. Keep in mind that these categories are very broad and a particular taxpayer's audit experience may be different.

Individuals
In FY 2013 (October 1, 2012 to September 30, 2013), the overall individual audit rate, that is audits of all individuals in all income groups, was less than one percent (0.96 percent). That compares to an overall individual audit rate of 1.03 percent for 2012 and 1.11 percent for 2011. The last time the overall individual audit rate was below one percent was in 2006.

To put the overall percentage in perspective, the IRS received 145,819,388 individual returns in 2013. The agency selected 1,404,931 individual returns for examination. The vast majority of these audits - 1,060,779 (75.5%) were correspondence audits. The number of field audits was 344,152 (24.5%).

Higher income individuals
As incomes climb, so does the audit coverage rate. The IRS selected 3.26 percent of returns for examination from taxpayers with incomes above $200,000 in 2013 compared to 0.88 percent for taxpayers with incomes under $200,000. Both percentages reflected a drop from 2012, when the IRS selected 3.70 percent of returns for examination from taxpayers with incomes above $200,000 and 0.94 percent of returns for examination from taxpayers with incomes under $200,000.

The audit rate for taxpayers with incomes over $1 million also fell in 2013. The IRS selected 10.85 percent of returns for examination from taxpayers with incomes above $1

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million compared to 12.14 percent in 2012 and 12.48 percent in 2011. In each of these years, the number of returns reporting incomes above $1 million increased but the audit rate declined.

Within the higher income groups, the number of field examinations actually increased in 2013 compared to 2012. However, the number of correspondence examinations decreased. Some of the increase in field examinations could be attributed to the IRS's emphasis on curbing tax evasion by hiding assets in unreported foreign accounts. The IRS has encouraged taxpayers with unreported foreign accounts to come forward in its offshore voluntary compliance program.

Businesses
Audits of all types of businesses also declined in 2013. The IRS reported that it selected 0.61 percent of all business returns for examination compared to 0.71 percent in 2012. For the first time in three years, the audit rate of both small and large corporations declined. The IRS selected 0.95 percent of returns for examination from corporations with assets under $10 million and 15.84 percent of returns from corporations with assets over $10 million.

S corporations and partnerships are among the most popular business entities for small and mid-size businesses. The IRS received 4,476,307 S corporation returns in 2013 and 3,550,071 partnership returns in 2013. The audit percentage rate for S corporations and partnerships was the same in 2013 at 0.42 percent compared to 0.48 percent for S corporations in 2012 and 0.47 percent for partnerships in 2012.

Enforcement revenue
Overall, the IRS' enforcement activities generated $53.35 billion in FY 2013, compared to $50.20 billion in FY 2012. In the previous year (2011), enforcement brought in $55.20 billion. The IRS reported that collections, appeals and document matching all showed increases in revenue. However, the amount collected through examination decreased to $9.83 billion for 2013 compared to $10.20 billion in 2012.

IRS staffing
The IRS reported that 19,531 employees - revenue agents, revenue officers and special agents - worked enforcement activities in FY 2013. That compares to 22,710 employees in FY 2010 - a decrease of 3,179 employees. Some of this decrease reflects normal separations from service, such as voluntary terminations of employment and retirements. Others reflect employee buyouts, which the IRS has offered several times in recent years in response to budgetary challenges.

What is a Cost-Segregation Study of Business Assets?

Investors in real estate often can generate significant tax savings and increase cash flow by using the technique of cost segregation. Cost segregation is the identification and separate depreciation of personal property components and land improvements. Like its predecessor, component depreciation, cost segregation allows a taxpayer to separately depreciate various elements of a building more rapidly than the underlying building itself.

Real and personal property
Under MACRS, a building must be depreciated over 27.5 years (residential rental property) or 39 years (nonresidential real property), using the straight-line method. Cost segregation allows depreciation and recovery of the cost of personal property elements of the building over five to seven years, using an accelerated depreciation method (200-percent declining balance). Components that are not classified as personal property must be included in the building's basis and depreciated over the appropriate period as real property.

Building elements are eligible for cost segregation if they are considered personal property under Code Sec. 1245 and under the former investment tax credit rules of Code Sec. 38. Classification as personal property under state law can also avoid state and local real property taxes.

Cost segregation study
To use cost segregation, the taxpayer must obtain a cost segregation study, which may be conducted by a cost segregation specialist. The specialist will conduct a feasibility study to determine whether a cost segregation study can provide tax savings. The building must be inspected, and the study must identify the components that may qualify as depreciable personal property. The actual installed cost of the component must be obtained.

The items of personal property must be identified in the study. The study should also provide the legal authority (regulations, cases, rulings, etc.) for treating an item as personal property or a land improvement, and should explain the methodology for determining the property's depreciable basis.

Ideally, the study should be conducted before the building is placed in service (e.g. when the building is under construction or at the time of purchase), although the study can be conducted after a building is placed in service. The building does not have to be new. If the building is being purchased, the sales contract can allocate the sales price between real and personal property.

IRS Clarifies IRA Rollover Rule After Tax Court Nixes Multiple Rollovers

In January 2014, the U.S. Tax Court threw a curve ball in many retirement planning strategies. The court held that a taxpayer could make only one nontaxable rollover contribution within each one-year period regardless of how many IRAs the taxpayer has. The court found that the one-year limitation under Code Sec. 408(d)(3)(B) is not specific to any single IRA owned by an individual but instead applies to all IRAs owned by a taxpayer. The court's decision was a departure from a long-time understanding of IRS rules and publications and, for several weeks after, it was unclear what approach the IRS would take. Now, the IRS has announced that it will follow the court's decision and revise its rules and publications. Everyone contemplating an IRA rollover needs to be aware of this important development.

Rollovers

Individuals have traditionally enjoyed flexibility in moving their retirement savings from one type of retirement plan to another type of plan. A rollover is a transfer of a distribution received from an IRA or other retirement plan by the recipient to another IRA or type of retirement plan owned by the same recipient. A rollover has important tax considerations. The amount distributed is not included in the recipient's income if the distribution is transferred to an eligible arrangement within 60 days after it is received. In certain cases, the 60-day period may be extended by the IRS.

Generally, only the owner of the IRA may roll over an amount. A surviving spouse who receives a distribution after the death of the account owner can make rollovers to the same extent as the account owner could have. There are also special rules for Roth IRAs and other retirement arrangements.

Tax Court case

In Bobrow, TC Memo. 2014-21, a married couple received distributions from more than one IRA in 2008. The couple claimed that they could make more than one tax-free rollover. The Tax Court disagreed.

The court found that Code Sec. 408(d)(3)(B) limits the frequency with which a taxpayer may make a nontaxable rollover contribution. The one-year limitation is not specific to any single IRA a taxpayer has but instead applies to all of the taxpayer's IRAs. If Congress had intended to allow individuals to take nontaxable distributions from multiple IRAs per year, the court found that Code Sec. 408(d)(3)(B) would have been worded differently.

Immediately after the decision, many benefits professionals pointed out that the IRS's rules and publications appeared to be contrary to the court's decision. In particular, many taxpayers noted that IRS Publication 590, Individual Retirement Plans, seemed to say that multiple rollovers were permissible if taken from different accounts.

IRS action

The IRS intends to amend the existing rules and revise Publication 590 to clarify that it will adopt the court's decision. Additionally, many IRA trustees, the IRS explained, may need time to make changes to reflect Bobrow. Therefore, in a relief measure, the IRS will not apply the Tax Court's decision to any rollover that involves an IRA distribution occurring before January 1, 2015.

Trustee-to-trustee transfers

A rollover must be distinguished from a trustee-to-trustee transfer. The Tax Court explained in its opinion that individuals who maintain more than one IRA may make multiple direct rollovers from the trustee of one IRA to the trustee of another IRA without triggering the one-year limit under Code Sec. 408(d)(3)(B). Transferring funds directly between trustees, the court found, does not result in a distribution within the meaning of Code Sec. 408(d)(3)(A). Since the funds are not within the direct control and use of the participant, they are not considered to be rollovers.

Planning

The court's decision and the IRS's action may impact your retirement planning. Keep in mind also that trustee-to-trustee transfers are not affected by the court's decision, which leaves some flexibility intact for planning. If you have any questions about IRA rollovers, please contact our office.

Firm Announcements

Rick Aufman Jr. transferred to the Tax Department in May 2014

Diane McKenna retired from the Administrative Department in May 2014

Kristen Paiano joined our Tax Department in February 2014 as a Staff Accountant

Leigh Ann Sobzack departed Lally & Co in April 2014 to become the CFO for one of our clients located in Robinson Township

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Important Dates

June 16, 2014 - 2014 2nd Quarter Estimated Payments Due

June 30, 2014 - Form 114, Report of Foreign Bank and Financial Accounts Due

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Solid Footing

Camp Kon-O-Kwee Spencer

On May 9th and May 16th, 30 Lally & Co., LLC employees volunteered for a "day of giving" at Camp Kon-O-Kwee Spencer in Fombel, PA (outside Zelienople). We assisted the 500 acre Camp with their annual "spring cleaning". Some of the projects we assisted with included power washing cabins, cleaning the insides of cabins, splitting wood, and picking up fallen trees. We concluded our day with a Spencer Express (two car wheeled train) tour of the Camp.

Camp Kon-O-Kwee Spencer, a branch of the YMCA of Pittsburgh, was founded in 1926 as a summer camp for children. In the 1970's, the Camp was winterized, renovated, and expanded to permit the extension of camp services beyond the summer months. New structures were added, a swimming pool was installed, a nature study center, and a small pond were added. In 1991, an adjacent Girl Scout Camp was acquired and the Camp was renamed Camp Spencer and dedicated primarily towards serving children and adults with disabilities. Throughout the years many volunteers have come together to make improvements to the camp. In 1993, hundreds of volunteers built a bridge across the Connoquesnessing Creek that united the campers of Kon-O-Kwee and Spencer. In 1998, the new Medical Center was completed which provides medical care for all campers including those with asthma, burns, and those requiring kidney dialysis. In June 2007, a new 36,000 square foot dining hall was completed and dedicated as Kramer Hall, in honor of "Uncle" Harry and "Aunt" Barbara Kramer for their 35+ years of service at the Camp.

The Camp has over 40 one room, ground level cabins that are used for the six-week summer camping season. Most of the cabins were built over 10 years ago and need cleaned and stained prior to the start of the camping season, which starts in mid-June.

We hope our time spent at Camp Kon-O-Kwee Spencer will allow the children and adults to enjoy their camping experience this season.

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