



**Lally & Co.**  
CPAs and Business Advisors

# The EVERGREEN

Quarterly Journal for Clients & Friends

## Summer 2012 – Volume III

This Issue:

- **The "Fiscal Cliff"**
- **Summer brings likely slowdown in progress of tax legislation in Congress**
- **Time for post-filing season checkup**
- **Private Company Council**
- **Supreme Court hands down landmark health care decision; now what?**

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### The Evergreen. Always Growing.

Why a leaf-bearing tree? For *The Evergreen* we've chosen the image of a live oak tree to represent the strength, stability, and resourcefulness of our clients. Remaining green throughout the year in most climates, the live oak has been a living symbol of strength and durability for centuries.

At Lally & Co., we strive to offer solid solutions that ensure our clients' financial strength and protection. We are always looking for ways to better serve you.

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Contact our office or visit our website for more information.

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[www.lallycpas.com](http://www.lallycpas.com)

## Dear Clients and Friends,

We trust that you are enjoying your summer and are keeping cool. We understand that tax and accounting might be the farthest thing from your mind. It is our goal to keep you up to date with the exciting and informative news happening in our world.

As you read through *The Evergreen*, please do not hesitate to contact us at any time. 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/>.

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## The "Fiscal Cliff"

**What is it?** The term "fiscal cliff" refers to a series of major U.S. fiscal policy changes that will become effective January 1, 2013 without further action from Congress. These changes include the expiration of the "Bush-era tax cuts", expiration of the payroll tax reduction, and the first installment of the \$1.2 trillion deficit reduction. The table on the next page summarizes the impact on individuals.

**What does it mean to you?** Individual income taxes on wages and investment income will increase across the board for nearly all taxpayers. Those taxpayers in the highest bracket will see their ordinary income (wages and most other income) taxed at 39.6% (up from 35%), capital gains taxed at 23.8% (up from 15%), and dividend income taxed at 43.4% (up from 15%); see table on page 2. We recommend you consult with your tax advisor and have a tax projection completed for 2012 and 2013 to personally budget the increases.

### What will happen to the economy?

Many economists believe that the fiscal cliff poses a threat to the economic recovery. It is estimated that the growth rate of the GDP next year could decrease by 3.9 percent if the United States falls off the fiscal cliff. This could be enough to make the total growth rate negative, which could force the country back into recession. If the payroll tax cut expires and the other provisions (tax cuts) are extended, growth will fall by about 2.3 percent.

**What could stop it?** Congress and the President need to agree on tax policy and spending. A good start would be approving an annual Federal budget and passing legislation that would allow businesses and individuals to be confident of future tax rates, tax policy, and the US government's spending. With this being a presidential election year and our two political parties at loggerheads on many areas, many anticipate that only

(continued on page 2)



### Did you know?

- Lally & Co. has been providing accounting and tax services to clients since 1983.
- You can find helpful financial tools on our website [www.lallycpas.com/financial-calculator/](http://www.lallycpas.com/financial-calculator/)
- This and past issues of *The Evergreen* are available on our website. [www.lallycpas.com/newsletter](http://www.lallycpas.com/newsletter)

### Firm Announcements

**Patrick Revay** is engaged to be married to Ellen Porter; no date has been set

**Tristin Simmons** became a licensed CPA in May 2012

**Sharon Welfer** earned her Bachelor of Science in Accounting degree in May 2012

**Lisa Wiegand** became a licensed CPA in July 2012

### Important Dates:

**July 31, 2012 -**  
2011 Annual Return/Report of Employee Benefit Plan Due

**August 15, 2012 -**  
2011 Extended Foundation Tax Returns Due

**September 15, 2012 -**  
2012 3<sup>rd</sup> Quarter Estimated Payments Due

after the election will Congress and the President agree on a temporary extension/solution and possibly major revisions to the tax code.

**What can you do to minimize the impact of the fiscal cliff on your personal taxes?** Rarely are their "quick fixes" and this is the case here. We will devote a major portion of our Fall 2012 newsletter to this topic and identify short-term and long-term strategies to minimize your personal taxes in a rising tax rate environment.

Income	2012	2013	Obama	Romney
\$17,400-70,700	15%	15%	15%	12%
\$70,700-142,700	25	28	25	20
\$142,700-217,450	28	31	28	22.4
\$217,450-388,350	33	36	36	26.4
Over \$388,350	35	39.6	39.6	28
Top dividend tax rate	15	43.4	43.4	15
Top capital gains tax rate	15	23.8	30	15
Estate tax rate	35	55	45	0
FICA tax rate	4.2	6.2		
Estate exemption	\$5.12 mil	\$1 mil		

### Summer brings likely slowdown in progress of tax legislation in Congress

As summer arrives in Washington, so does the usual slowdown in legislative activity and 2012 appears to be no exception. Lawmakers have a full plate of tax-related bills on their agenda but progress is slow at best as both parties prepare for the November elections. Among the pending tax bills are proposals to extend bonus depreciation, enact small business tax incentives, renew many expired extenders, and more.

**Bonus depreciation.** In 2010, the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act provided for temporary 100 percent bonus depreciation. Generally, 100 percent bonus depreciation was available for qualifying property placed in service after September 8, 2010 and before January 1, 2012 (or before January 1, 2013 in the case of property with a longer production period and certain noncommercial aircraft).

One hundred percent bonus depreciation is one of the few tax incentives on which Democrats and Republicans have found common ground. President Obama has indicated his support for extending 100% bonus depreciation one additional year. House Democrats introduced the Invest in America Now Act, which would extend 100% bonus depreciation through 2012 (through 2013 in the case of property with a longer production period and certain noncommercial aircraft). The cost of repeal would be offset by denying the Code Sec. 199 domestic production activities deduction to oil and gas producers.

**Reminder.** The 2010 Tax Relief Act also provided for 50 percent bonus depreciation for qualifying property placed in service before January 1, 2013 (or before January 1, 2014 in the case of property with a longer production period and certain noncommercial aircraft).

(continued on page 3)



**Small businesses.** Democrats and Republicans have unveiled competing small business tax bills. The House approved a GOP-written bill, the Small Business Tax Cut Bill (HR 9). Under the House bill, small businesses with fewer than 500 employees could claim a 20 percent deduction on qualified income in 2012. The deduction would be capped at 50 percent of qualified wages.

Meanwhile, Senate Democrats proposed their Small Business Jobs and Tax Relief Act of 2012 (Sen. 2237). The bill would generally provide a 10 percent income tax credit on new payroll added by a qualified small employer in 2012. The credit would be capped at \$500,000. The Senate has not yet voted on the Democratic bill.

Tax incentives for small businesses have enjoyed bipartisan support in the past. The GOP bill passed the House with Democratic support. However, the GOP bill is not expected to be approved by the Senate if the bill comes up for a vote.

**Bush-era tax cuts.** House Speaker John Boehner, R-Ohio, said in May that the House will vote on an extension of the Bush-era tax cuts before the November elections. No legislation has been introduced and no vote scheduled. It is unclear if House Republicans will propose extending the Bush-era tax cuts after 2012 without any offsets or if their bill will carry some revenue raisers. House Republicans may also link an extension of the Bush-era tax cuts to spending cuts and budget reforms. The Budget Control Act of 2011 mandates across-the-board spending cuts in 2013 and beyond. In May, the House passed the Budget Sequestration Bill (HR 5652). The bill provides a substitute for the Budget Control Act. The Senate is not expected to take up the Budget Sequestration Bill.

President Obama has reiterated his opposition to extending the Bush-era tax cuts for higher income taxpayers. The White House generally defines higher income taxpayers as individuals with incomes over \$200,000 and families with incomes over \$250,000. Recently, some Democrats have spoken of higher thresholds, in the neighborhood of \$1 million. Lawmakers have also voiced the idea of a six-month or one-year extension of the Bush-era tax cuts.

**Tax extenders.** It appears that lawmakers may not automatically renew all of the expired extenders as they have routinely done in past years. In June, the chair of the Senate Finance Committee, Sen. Max Baucus, D-Montana, said that lawmakers should look at each extender and decide whether to eliminate it or make it permanent. Baucus did not indicate which extenders should be made permanent and which should be jettisoned from the Tax Code. Among the likely candidates for being made permanent are the research tax credit, the higher education tuition deduction and the teachers' classroom expense deduction. All of these extenders have enjoyed bipartisan support.

Often included among the extenders is the so-called alternative minimum tax (AMT) patch. The patch provides higher exemption amounts so the AMT does not encroach on middle income taxpayers. The latest patch expired after 2011. Proposals to extend the patch for 2012 have stalled, again over cost. Lawmakers could leave the fate of the patch until after the 2012 elections. However, late enactment of a patch would likely delay the start of the 2013 filing season because the IRS would need to reprogram its processing systems.

**Pension funding.** Democrats and Republicans agree that the reduced interest rates on federal student loans should be extended one more year but

disagree on how to pay for the estimated \$6 billion cost of a one-year extension. Changes to pension funding rules have been discussed as one way to pay for an extension of reduced federal student loan interest rates.

**IRS budget.** The House and Senate are preparing for a showdown over the IRS' fiscal year (2013) budget. The House approved an \$11.8 billion FY 2013 budget for the IRS budget. The Senate is expected to approve a \$12.5 billion FY 2013 budget. Both amounts are, however, less than the funding levels requested by President Obama. IRS Commissioner Douglas Shulman has warned Congress that reduced funding will negatively impact enforcement and customer service. In FY 2012, Congress cut the IRS budget by \$305 million and the agency responded by offering buyouts and early retirements to approximately 4,000 employees.

**Transportation.** Agreement on a comprehensive transportation funding bill with tax offsets has eluded lawmakers. The Senate passed the Moving Ahead for Progress in the 21st Century Act (MAP-21) (Sen. 1813). MAP-21 would provide parity among transit benefits, which had expired after 2011; allow Treasury to take a variety of measures against foreign financial institutions that engage in money laundering; and deny passports to individuals with seriously delinquent tax debt. House Republicans have a transportation bill but have not been able to pass it. Lawmakers are reportedly preparing another temporary extension of current funding.

**Energy.** A number of energy tax incentives expired after 2011 and progress to renew them has stalled. They include popular incentives for wind energy production and biomass fuels. President Obama proposed to

(continued on page 4)



repeal oil and gas tax preferences to pay for an extension of some of the energy incentives but lawmakers have shown little interest.

**More proposals.** Many other tax bills are pending, including legislation to:

- Extend or make permanent the American Opportunity Tax Credit
- Repeal the excise tax on medical devices
- Revise health flexible spending arrangement rules for over-the-counter medications
- Extend the enhanced Work Opportunity Tax Credit for veterans
- Provide for tax rate parity among tobacco products
- Repeal the federal estate tax
- Enhance tax-exempt bonds
- And more

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## Time for post-filing season checkup

Your 2011 tax return has been filed, or you have properly filed for an extension. In either case, now it's time to start thinking about important post-filing season activities to save you tax in 2012 and beyond. A few loose ends may pay dividends if you take care of them sooner instead of later.

### Successful filing season

The IRS reported that the 2012 filing season moved along without significant problems. The IRS continued to upgrade its return processing programs and systems. Early in the filing season, some filers experienced a short delay in receiving refunds but the delay was quickly resolved. The IRS reported just before the end of the filing season that it had processed nearly 100 million returns and issued 75 million refunds.

### Extensions

Individuals are eligible for an automatic six-month extension until October 15 to file a return. To get the extension, taxpayers must estimate their tax liability and pay any amount due. When a taxpayer properly files for an extension, he or she avoids the late-filing penalty, generally five percent per month based on the unpaid balance, which applies to returns filed after the April 17 deadline. Any payment made with an extension request will reduce or eliminate interest and late-payment penalties that apply to payments made after April 17. The current interest rate is three percent per year, compounded daily, and the late-payment penalty is normally 0.5 percent per month.

### Installment agreements

Installment agreements generally can be set up quickly with the IRS and help to spread out payments to make them more management. In 2012, the IRS increased the threshold for a streamlined installment agreement from \$25,000 to \$50,000. Installment agreements however, come with some costs. The IRS charges a fee to set up an installment agreement. If you cannot pay the full amount within 120 days, the fee for setting up an agreement is:

- \$52 for a direct debit agreement;
- \$105 for a standard agreement or payroll deduction agreement; or
- \$43 for qualified lower income taxpayers.

It's important to make your scheduled payments timely and in full. The IRS expects you to pay the minimum amount agreed on; you can always pay more if you are able. If your installment agreement goes into default, the IRS can charge a reinstatement fee.

An installment agreement does not reduce the amount of the taxes, interest, or penalties owed, and penalties and interest will continue to accrue. In determining the amount of the penalty for failure to pay tax, the penalty is reduced from 0.5 percent per month to 0.25 percent per month during any month that an installment agreement for the unpaid tax is in effect.

You must specify the amount you can pay and the day of the month (1st-28th) on which you wish to make your payment each month. The IRS expects to receive your payment on the date you select. The IRS will respond to your request, usually within 30 days, to advise you as to whether your request has been approved or denied, or if more information is needed.

### Amended returns

Taxpayers can file an amended return if they find an error, uncover unreported income or discover an item that will generate a deduction. Amended returns are filed on Form 1040X, Amended U.S. Individual Income Tax Return, to correct a previously filed Form 1040, Form 1040A, Form 1040EZ, Form 1040NR, or Form 1040NR-EZ. If you are filing to claim an additional refund, wait until you have received your original refund. If you owe additional tax for a tax year for which the filing date has not passed, file Form 1040X and pay the tax by the filing date for that year to avoid penalties and interest.

Generally, to claim a refund, Form 1040X must be filed within 3 years from the date of your original return or within two years from the date you paid the tax, whichever is later. Returns filed before the due date (without regard to extensions) are considered filed on the due date. Taxpayers must file a separate Form 1040X for each year they are amending.

(continued on page 5)



### **Targeted penalty relief**

This year – for the first time – the IRS offered penalty relief to qualified individuals who were unable to pay their taxes by the April 17 deadline. Unemployed filers and self-employed individuals whose business income dropped substantially can apply for a six-month extension of time to pay, the IRS explained. Eligible taxpayers will not be charged a late-payment penalty if they pay any tax, penalty and interest due by October 15, 2012. Taxpayers qualify if they were unemployed for any 30-day period between January 1, 2011 and April 17, 2012. Self-employed people qualify if their business income declined 25 percent or more in 2011, due to the economy. However, income limits apply, which excluded many taxpayers from the program.

### **Records**

The IRS advises that taxpayers maintain tax records for three years. In many cases, especially for individuals with complex returns, records should be kept longer.

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## **Private Company Council**

In our last newsletter, we presented an article, “Private Company Financial Reporting Initiatives”, which examined how the extensive financial statement presentation and disclosure requirements required under U.S. generally accepted accounting principles (GAAP) are practically the same for large, publicly-held companies and small, privately-held companies. We looked at various initiatives for creating a modified set of standards for privately-held companies to reduce the amount of GAAP requirements to a reasonable level. Those initiatives have resulted in the creation of the Private Company Council.

The Financial Accounting Standards Board (FASB) is the standard setter for GAAP, and the Financial Accounting Foundation (FAF) is the entity that oversees FASB’s activities. In May 2012, the FAF issued its “Final Report” regarding the establishment of the Private Company Council (PCC), with the goal of improving the process of setting accounting standards for private companies.

The PCC will have two principal responsibilities: determining whether exceptions or modifications to existing non-governmental GAAP are warranted to address the needs of users of private company financial statements, and to serve as the primary advisory board to the FASB on the appropriate treatment for private companies for items under active consideration on the FASB’s technical agenda.

PCC members will include users, preparers, and practitioners who have had significant experience using, preparing, and auditing, reviewing, and/or compiling private company financial statements. The PCC will develop, deliberate, and formally vote on proposed exceptions or modifications to GAAP. If endorsed by the FASB, the exceptions or modifications will be exposed for public comment. Then, if the FASB makes a final decision to endorse, the exceptions or modifications will be incorporated into GAAP.

The American Institute of CPAs (AICPA) has expressed its support for the establishment of the PCC, and the AICPA is hopeful that the PCC will address the financial reporting needs of private companies to ensure that those accounting standards are more relevant and less complex. We are very excited about these changes, and we look forward to keeping you updated on the PCC’s activities and the impact on your business.

## **Supreme Court hands down landmark health care decision; now what?**

On June 28, the U.S. Supreme Court issued its long-awaited landmark decision on the Patient Protection and Affordable Care Act (PPACA) and its companion law, the Health Care and Education Reconciliation Act (HCERA). In a 5 to 4 decision of historic proportions, the nation’s highest court upheld the law – except for a certain Medicaid provision involving state funding. Key to the Court’s approval of President Obama’s signature health care law was the finding that the linchpin individual mandate was constitutional. The requirement under the individual mandate that individuals pay a penalty if they fail to carry minimum essential health insurance coverage was declared within the Constitution based upon Congress’s power to tax.

The Supreme Court’s decision preserves all of the far-reaching tax provisions and health insurance reforms that were part of the overall health care reform legislation as passed in 2010. In coming months, lawmakers and legal scholars will examine all of the nuances of the Court’s highly complex decision. More immediately, individuals and businesses are concerned about what steps they need to take next.

### **Role of taxes**

To a large extent, the Obama administration’s health care law is driven by tax provisions, to provide the carrot, the stick, and adequate funding in alternating quantities. The role played by taxes in the new health care provisions is also underscored by the predominate part that the IRS will play in its administration.

(continued on page 6)



Under the health care law, a number of tax provisions are scheduled to take effect in 2013 and beyond. The court's decision allows the numerous tax provisions within the health care laws to move forward on schedule. Some important provisions have already taken effect; others will take effect in 2013 and 2014. One provision, the excise tax on high-cost employer-sponsored coverage, will not take effect until 2018.

#### Main provisions/effective dates

PPACA and HCERA include the following tax provisions (not a complete list):

- Small employer Sec. 45R credit, effective for tax years beginning in 2010 – the government will provide a credit of 35 percent of health insurance premiums to small employers (25 percent for tax-exempt organizations). The credit expires after 2015.
- Economic substance doctrine, effective after March 30, 2010 – the economic substance test was codified as a two-prong test, requiring that the transaction change the taxpayer's economic position in a meaningful way, and that the taxpayer has a substantial business purpose for the transaction.
- Over-the-counter limitations for health accounts, effective for tax years beginning after December 31, 2010 – health accounts, such as flexible spending arrangements, health reimbursement arrangements, health savings accounts, and Archer Medical Savings Accounts, can only reimburse expenses for medicine and drugs if the item is a prescription drug (or insulin).
- Indoor tanning services excise tax, effective on or after July 1, 2010 – amounts paid for indoor tanning services are subject to a 10-percent excise tax. Tanning salons must collect the tax and pay it quarterly.
- Itemized deduction for medical expenses, effective for tax years beginning after December 31, 2012 – the threshold for deducting medical expenses as an itemized deduction is raised from 7.5 percent to 10 percent of adjusted gross income.
- Additional 0.9% Medicare tax, effective after December 31, 2012 – an additional 0.9 percent Medicare tax is imposed on wages and self-employment income of higher-income individuals: individuals – above \$200,000; married filing jointly – above \$250,000; married filing separately – above \$125,000.
- 3.8% Medicare contribution tax, effective after December 31, 2012 – a 3.8 percent Medicare tax is imposed on unearned income for higher-income individuals, including interest, dividends, annuities, royalties, rents and other passive income.
- Medical device excise tax, effective for sales after December 31, 2012 – a 2.3 percent excise tax is imposed on sales of certain medical devices by manufacturers, producers, and importers. Retail items such as eyeglasses are excluded from the tax.
- Employer shared responsibility, effective after December 31, 2013 – the "employer mandate": any applicable large employer (50 or more full-time employees) must make a payment if any full-time employee can receive the premium tax credit. The payment is required if the employer does not offer minimum essential coverage, or offers coverage that is not affordable.
- Branded prescription drug fees, effective for calendar years beginning after December 31, 2010 – an annual fee imposed on manufacturers and importers with receipts from branded prescription drug sales.
- Sec. 36B premium assistance credit, effective for tax years ending after December 31, 2013 – lower-income individuals who obtain health insurance coverage through an insurance exchange may qualify for the credit, unless they are eligible for other minimum essential coverage.
- Excise tax on high-dollar insurance, effective for tax years beginning after December 31, 2017 – employer-sponsored health coverage whose cost exceeds a threshold amount (\$10,200 for self-on coverage; \$27,500 for other coverage) will be subject to a 40-percent excise tax.

#### Looking ahead

Employers, taxpayers – indeed everyone – must prepare for sweeping changes in health care in coming years. Many of the provisions in the PPACA have already been implemented or are in the process of being implemented. Other provisions, as the above list indicated, are scheduled to take effect after 2012. The Supreme Court's upholding of the PPACA clears the way for full implementation of the new law (unless a future Congress votes to repeal the law, which at this point would be an uphill battle). Our office will keep you posted of developments and the steps you need to take in the coming months.