Lally&Co.
CPAs and Business Advisors

The EVERGREEN

Quarterly Journal for Clients & Friends

Summer 2013 – Volume VII

This Issue:

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. The name "live oak" comes from the fact that evergreen oaks remain green throughout the winter, when other oaks are dormant, leafless, and "dead"-looking. The live oak has been a living symbol of strength and durability for centuries. The southern live oak is the official state tree of Georgia.

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.

Contact our office or visit our website for more information.

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Dear Clients and Friends,

We trust that you are enjoying your summer. 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.

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. 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/.

Using Your 2012 Tax-Year Return to Plan for the Future

Did you owe tax on your 2012 tax return? Did you receive a sizeable refund? Or, conversely, did you receive a smaller refund than you expected? If so, take another look at your tax return from this past year. It is quite possible that by making a few changes, you could put more money in your pocket in the short term. And by examining your investments as they are reported on your tax return, you may be able to strategize for the long-term future. Trying to implement this type of plan may seem difficult at first. However, just by looking at your tax return, you can start the critical planning that can lead you to broader goals of financial independence and a comfortable retirement.

Suggestion: An annual Personal Financial Statement at year end is a good practice to measure your net worth and progress toward your goals. Let us know if we can assist you in this endeavor.

Federal withholding - If you received a large tax refund, it might be time for you to adjust the amount of tax the federal government withholds from your paycheck. Although next year your refund check may not be as large, you will have the advantage of seeing a larger sum deposited directly into your pocket every month. To adjust your withholding, fill out and sign a Form W-4, and submit it to your employer. You would want to do this in cases where your adjustments to income, exemptions, and deductions remain relatively steady from year-to-year, and where the government consistently is required to give you a large refund.

If you do not change your withholding allowances, the government essentially is holding your money for a year without paying any interest on it. You may lose some potential investment opportunity or, at the very least, the ability to increase your monthly discretionary income. On the other hand, many taxpayers prefer to receive the large refund check after tax filing season because it is a no-hassle way to ensure large savings at the end of the year.

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Conversely, many taxpayers may want to change their withholding allowances because they owe the government a significant amount of money at the end of the year. Taxpayers who expect to owe at least $1,000 in tax for the 2013 tax year, after subtracting withholding and any refundable credits, and who also expect their 2013 withholding and credits to be significantly less than the projected tax owed for 2013, may need to file estimated taxes. Failure to do so could result in penalties. Alternatively, taxpayers should consider making quarterly estimated tax payments, especially if they anticipate a significant amount of investment gains for the year or other income unrelated to wage compensation.

Caution: Your federal withholdings may not occur rateably throughout the year. Your bonus and commission payment may have larger federal withholding percentages than your salary. Please contact us to determine if adjustments should be made to your withholding.

State withholding - Some people are entirely exempt from state tax, but it is withheld from their paychecks nevertheless. At the end of each year, they may include the amount of their state taxes in their itemized deductions, but then receive a refund which they have to declare as income in the next year. A higher adjusted gross income (AGI), even if it is subsequently reduced by itemized deductions, can erode other adjustments to income, such as a deduction for student loans, IRA contributions, higher education expenses, and more because of certain AGI caps on these benefits.

Tax rates and adjusted gross income - As you may have heard, Congress allowed the Bush-era tax cuts to expire for higher-income earners. That means joint filers with more than $450,000 of adjusted gross income ($400,000 for single individuals) are now in the 39.6-percent tax bracket. Taxpayers at this level of income or above are also subject to a higher long-term capital gains tax rate: 20 percent, up from 15 percent paid by other taxpayers.

In addition, for tax years beginning in 2013, the 33-percent tax bracket for individual taxpayers ends at $398,350 for married individuals filing joint returns, heads of households, and single individuals. If you were hovering near the bottom of the 35-percent bracket for the 2012 tax year, then you might want to see if you can adjust your income so that you fall within the 33-percent category.

Higher-income taxpayers also have two new taxes to worry about for 2013 and beyond. Joint-filing taxpayers with modified adjusted gross income of $250,000 ($200,000 for single filers) are also subject to the 3.8-percent surtax on net investment income and a .9-percent Additional Medicare Tax. Look at your adjusted gross income for last year. Does it approach these figures? Is it on the edge of the income brackets? Will stock market increases this year put you over the top of those income thresholds? If so, it may be time to find ways to reduce your income for 2013.

Investments - At some point in your efforts over the years to accumulate a savings nest egg, you will need to consider diversification, the process of putting your money in the right kind of investment vehicles to satisfy your personal risk strategy and achieve your goals. Looking at your tax return will help you decide whether the investments you now have are the right ones for you. For example, if you are in a high tax bracket and need to diversify away from common stocks, investing in tax-exempt bonds might help, especially if you have state income taxes to worry about, too.

Reviewing the Schedule D and Form 8949, which cover Capital Gains and Losses from last year's return and from the past three or four years, can be an eye-opener for many. Did you hold stocks long enough to be entitled to the long-term capital gains rate? Please note that Schedule D and Form 8949 only captures *realized* gains.

Did you try to balance short-term gains with short-term losses? Are you bouncing from one investment trend to another without a long-term investment plan that achieves long-term needs? Are your mutual funds "tax smart"? Become familiar with different types of banking institutions and their products. Find out about CDs, money-market funds, government securities, mutual funds, index funds, and sector funds and how they interrelate with the determination of your tax liability each year. You may want to put that knowledge to work in your investment strategy.

Medical costs - Should you be taking advantage of the medical expense deduction? Many people assume that with the 10 percent adjusted gross income floor on medical expenses now imposed for tax years starting in 2013 (7.5 percent for seniors) that it doesn't pay for them to keep track of expenses to test whether they are entitled to itemize. But with the premiums for certain long-term care insurance contracts now counted as a medical expense, some individuals are discovering that along with other health insurance premiums, deductibles and timing of elective treatments, the medical tax deduction may be theirs for the taking.

Tip: You may want to consider "bunching" your medical expenses in a certain year in order to realize a tax benefit. For example, you may pay for your child's braces up front to claim the full medical deduction in one year.

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Retirement planning - Don't forget to protect for eventualities. Are you maximizing the amount that Uncle Sam allows you to save tax-free for retirement? A look at your W-2 for the year, and at the retirement contribution deductions allowed in determining adjusted gross income should tell you a lot. Should your spouse set up his or her own retirement fund, too? Are you over-invested in tax-deferred retirement plans? If so, you may lose a significant amount of your nest egg to tax after retirement.

Tip: You may want to consider setting up a Roth 401(k) or Roth IRA to pay the tax up-front and avoid tax on the earnings. Please contact our office for more information.

Tax Planning Questions Arise After Supreme Court's DOMA Decision

On June 26, the U.S. Supreme Court held that Section 3 of the federal Defense of Marriage Act (DOMA) is unconstitutional *(E.S. Windsor, SCt., June 26, 2013).* Immediately after the decision, President Obama directed all federal agencies, including the IRS, to revise their regulations to reflect the Court's order. How the IRS will revise its tax regulations and when remains to be seen; but in the meantime, the Court's decision opens a number of tax planning opportunities for same-sex couples.

Background - The Supreme Court agreed in 2012 to hear an appeal of a federal estate tax case. Due to DOMA, the surviving spouse of a same-sex married couple was ineligible for the federal unlimited marital deduction under Code Sec. 2056(a). The survivor sued for a refund of estate taxes. A federal district court and the Second Circuit Court of Appeals found unconstitutional Section 3 of DOMA, which defines marriage for federal purposes as only a legal union between one man and one woman as husband and wife.

Supreme Court's decision - In a 5 to 4 decision, the Supreme Court held that Section 3 of DOMA is unconstitutional as a deprivation of the equal liberty of persons that is protected by the Fifth Amendment. Writing for the five-justice majority, Justice Anthony Kennedy said that "DOMA rejects the long-established precept that the incidents, benefits, and obligations of marriage are uniform for all married couples within each State, though they may vary, subject to constitutional guarantees, from one State to the next." Kennedy explained that "by creating two contradictory marriage regimes within the same State, DOMA forces same-sex couples to live as married for the purpose of state law but unmarried for the purpose of federal law, thus diminishing the stability and predictability of basic personal relations the State has found it proper to acknowledge and protect."
Chief Justice John Roberts, who would have upheld DOMA, cautioned that "the Supreme Court did not decide if states could continue to utilize the traditional definition of marriage." Roberts noted that the majority held that the decision and its holding "are confined to those lawful marriages-referring to same-sex marriages that a State has already recognized."

Tax planning - The Supreme Court's decision impacts countless provisions in the Tax Code, covering all life events, such as marriage, employment, retirement and death. The affect on the Tax Code cannot be overstated. It is expected that the IRS will move quickly to clarify how the decision impacts many of the more far-reaching provisions, such as filing status and employee benefits. Other provisions, especially the complex estate and gift tax provisions, will likely require more time from the IRS to issue guidance.

For federal tax purposes, only married individuals can file their returns as married filing jointly or married filing separately. Because of DOMA, the IRS limited these married filing statuses to opposite-sex married couples. The IRS is expected to issue guidance.

Among the other provisions in the Tax Code affected by the Supreme Court's decision are:

- Adoption benefits
- Child tax credit
- Education tax credits and deductions
- Estate tax marital deduction
- Estate tax portability between spouses
- Gifts made by spouses
- Retirement plans

Looking ahead - Will the federal government look to where the same-sex couple was married (state of celebration) or where the same-sex couple reside (state of residence) for purposes of federal benefits? The Supreme Court did not rule on Section 2 of DOMA, which provides that no state is required to recognize a same-sex marriage performed in another state. At the time of the Supreme Court's decision, 12 states and the District of Columbia recognize same-sex marriage.

In some cases, the rules for marital status are determined by federal regulations, which can be changed without action by Congress. In other cases, the rules are set by statute, which would require Congressional action. Sometimes, a federal agency follows one rule for some purposes

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but another rule for other purposes. Generally, the IRS has used place of domicile for determining marital status.

How are vacation homes taxed?

Vacation homes offer owners many tax breaks similar to those for primary residences. Vacation homes also offer owners the opportunity to earn tax-advantaged and even tax-free income from a certain level of rental income. The value of vacation homes are also on the rise again, offering an investment side to ownership that can ultimately be realized at a beneficial long-term capital gains rate.
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Homeowners can deduct mortgage interest they pay on up to $1 million of "acquisition indebtedness" incurred to buy their primary residence and one additional residence. If their total mortgage indebtedness exceeds $1 million, they can still deduct the interest they pay on their first $1 million. If one mortgage carries a substantially higher rate than the second, it makes sense to deduct the higher interest first to maximize deductions.

Vacation homeowners don't need to buy an actual house (or even a condominium) to take advantage of second-home mortgage interest deductions. They can deduct interest they pay on a loan secured by a timeshare, yacht, or motor home so long as it includes sleeping, cooking, and toilet facilities.

Capital gain on vacation properties - Gains from selling a vacation home are generally taxed as long-term capital gains on Schedule D. As with a primary residence, basis includes the property's contract price (including any mortgage assumed or taken "subject to"), nondeductible closing costs (title insurance and fees, surveys and recording fees, transfer taxes, etc.), and improvements. "Adjusted proceeds" include the property's sale price, minus expenses of sale (real estate commissions, title fees, etc.). The maximum tax on capital gain is now 20 percent, with an additional 3.8 percent net investment tax depending upon income level. There's no separate exclusion that applies when selling a vacation home as there is up to $500,000 for a primary residence.

Vacation home rentals - Many vacation home owners rent those homes to draw income and help finance the cost of owning the home. These rentals are taxed under one of three sets of rules depending on how long the homeowner rents the property.

1. Income from rentals totaling not more than 14 days per year is nontaxable.

2. Income from rentals totaling more than 14 days per year is taxable and is generally reported on Schedule E of Form 1040. Homeowners who rent their properties for more than 14 days can deduct a portion of their mortgage interest, property taxes, maintenance, utilities, and other expenses to offset that income. That deduction depends on how many days they use the residence personally versus how many days they rent it.

3. Owners who use their home personally for less than 14 days and less than 10% of the total rental days can treat the property as true "rental" property, which entitled them to a greater number of deductions.

IRS Ruling Highlights Benefits of Like-Kind Exchange, Deferred Tax Arrangements

Gain or loss is not recognized when property held for productive use in a trade or business or for investment is exchanged for like-kind property. Instead, the taxpayer's basis and holding period in the property transferred carries over to the property acquired in the exchange. Deferring taxable gain makes more sense than ever after the recent rise in tax rates for many taxpayers under the American Taxpayer Relief Act of 2012. In particular, Code Section 1031 like-kind exchanges deserve a close second look by many businesses and investors.

Flexibility - More than two properties can be exchanged and more than two parties can participate in a transaction that qualifies for non-recognition treatment. Intermediaries may be used to purchase other property before completing like-kind exchange. Taxpayers can participate in acquisition of other property and qualify for like-kind treatment if there is no actual or constructive receipt of cash proceeds from sale of their property.

It is not required that the properties be given up and received on the same day. However, if the exchange of properties is not simultaneous, the property to be received must be identified within 45 days after the date the relinquished property is transferred. In addition, the identified

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property must be received within 180 days after the date of transfer or the due date for the return for the tax year in which the transfer occurred, whichever date is earlier.

Certain limitations - Property not qualifying for this treatment includes inventory, securities, foreign real estate and foreign personal property. In an otherwise qualifying exchange, the receipt of boot, in the form of cash, relief from liability, or other non-qualifying property, results in the recognition of realized gain or loss to the extent of the boot received. However, gain so recognized can be postponed if the installment sale rules apply. Depreciation recapture may also result from a like-kind exchange. Losses are not recognized on the acquisition of like-kind property. To recognize a loss, the transaction must be arranged so that the non-recognition provision does not apply. Literal conformity to the requirements of the non-recognition provisions may not be sufficient to prevent recognition of gain. The substance of the transaction must also satisfy the underlying purpose of the statute. Continuity of investment purpose continues to be emphasized as the primary rationale for non-recognition in a like-kind exchange.

Latest success story - IRS Chief Counsel just this past month approved a taxpayer's exchange of properties as tax-free under Code Sec. 1031 even though the taxpayer used proceeds from the sale of relinquished property to pay down its liabilities. Chief Counsel determined that such use did not trigger constructive receipt. Although taking a look at this winning arrangement may get a bit technical, it is worthwhile if only to provide another example of how like-kind exchange transactions can help your business's tax expenses.

The arrangement - The taxpayer rents equipment to customers. The taxpayer has implemented a like-kind exchange (LKE) program to defer gain from the sales of its rental equipment. The taxpayer has engaged in multiple exchanges under a Master Exchange Agreement (MEA) with a qualified intermediary (QI). Under the MEA, the taxpayer transfers relinquished property to the QI. The QI transfers the relinquished property and acquires replacement property, which it transfers to the taxpayer.

The taxpayer maintains two lines of credit, which are used to purchase replacement property. The taxpayer also uses the lines of credit for general business operations. The lines of credit are secured by the taxpayer's rental properties, accounts receivable, and new equipment sold to customers. The full value of the rental property secures the entire balance on the lines of credit.

The QI must deposit sales proceeds from relinquished property into a joint taxpayer/QI account, and must use the proceeds to pay down the line-of-credit balances. The QI does not use proceeds from the account receivables or the new equipment sales to pay down the lines of credit. The taxpayer then uses borrowed funds to acquire replacement property and complete its exchange. The taxpayer finances the acquisition with new debt in an amount that equals or exceeds the debt that encumbered the relinquished property. Under the MEA, the taxpayer does not have the right to receive, pledge, borrow or otherwise use the money held by the QI.

Chief Counsel's analysis - The IRS field attorney argued that the debt pay-down arrangement gives the taxpayer actual or constructive receipt of the proceeds from the relinquished property before the deadline for the taxpayer to obtain replacement property. IRS Chief Counsel's Office, however, disagreed. It concluded that the taxpayer was not in constructive receipt of the proceeds received for the relinquished property. This conclusion was not affected by the use of the debt to purchase replacement property and for general business operations, or the QI's use of the proceeds to pay down the lines of credit.

If a taxpayer receives, in part, non-like-kind property, the taxpayer must recognize gain (boot) for the amount of this property. The assumption of a liability, or the transfer of property subject to a liability, is treated as boot. If the relinquished property and the replacement property are both subject to a liability (such as a mortgage), the liabilities are netted and the difference is boot to the party being relieved of the larger mortgage.

Chief Counsel concluded that the taxpayer's transaction was permitted by the regulations where the taxpayer is relieved of debt on the transfer of relinquished property and incurs debt on the acquisition of the replacement property. Under the boot netting rules, there is no gain to the taxpayer.

What Can I Deduct Doing Volunteer Work for a Charity?

For many individuals, volunteering for a charitable organization is a very emotionally rewarding experience. In some cases, your volunteer activities may also qualify for certain federal tax breaks. Although individuals cannot deduct the value of their labor on behalf of a charitable organization, they may be eligible for other tax-related benefits.

Before claiming any charity-related tax benefit, whether for a donation or volunteer activity, you must determine if the charity is a "qualified organization." Under the tax rules, most charitable organizations, other than churches, must apply to the IRS

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Did you know?

- Did you know that in addition to traditional accounting and tax services, Lally & Co. also provides litigation and valuation support services?

  Our litigation support team can assist your legal team with expert testimony, forensic accounting, and litigation consultation roles regarding the financial aspects of a case.

  We have significant experience with business valuations, economic loss assessments, contract disputes, shareholder/partner disputes, and assessment of the opponent's expert.

- You can find helpful financial tools on our website www.lallycpas.com/financial-calculator/

- This and past issues of *The Evergreen* are available on our website. www.lallycpas.com/newsletter

Important Dates:

August 15, 2013 -
2012 Extended Foundation Tax Returns Due

September 16, 2013 -
2013 3rd Quarter Estimated Payments Due

to become a qualified organization. If you are uncertain about an organization's status as a qualified organization, you can ask the charity.

Time or services - An individual may spend 10, 20, 30 or more hours a week volunteering for a charitable organization. Precisely because the individual is a volunteer, he or she receives no remuneration for his or her time or services and cannot deduct the value of his or her time or services spent on activities for the charitable organization. Unpaid volunteer work is not tax deductible.

Vehicle expenses - Vehicle expenses associated with volunteer activity should not be overlooked. For example, many individuals use their personal vehicles to transport others to medical treatment or to deliver food to shut-ins. Taxpayers can deduct as a charitable contribution qualified unreimbursed out-of-pocket expenses, such as the cost of gas and oil, directly related to the use of their vehicle in giving services to a charitable organization. However, certain expenses, such as registration fees, or the costs of tires or insurance, are not deductible. Alternatively, taxpayers can use a standard mileage rate of 14 cents per mile to calculate the amount of their contribution. Do not confuse the charitable mileage rate, which is set by statute, with business mileage rate (56.5 cents per mile for 2013), which generally changes from year to year. Parking fees and tolls are deductible whether the taxpayer uses the actual expense method or the standard mileage rate.

Uniforms - Some volunteers are required to wear a uniform, such as a jacket that identifies the wearer as a volunteer for the charitable organization, while engaged in activity for the charity. In this case, the tax rules generally allow taxpayers to deduct the cost and upkeep of uniforms that are not suitable for everyday use and that the taxpayer must wear while performing donated services for a charitable organization.

Hosting a foreign student - Qualifying expenses for a foreign student who lives in the taxpayer's home as part of a program of the organization to provide educational opportunities for the student may be deductible. The student must not be a relative, such as a child or stepchild, or dependent of the taxpayer and also must be a full-time student in secondary school or any lower grade at a school in the U.S. Among the expenses that may be deductible are the costs of food and certain transportation spent on behalf of the student. The cost of lodging is not deductible. If you are planning to host a foreign-exchange student, please contact our office and we can explore the possible tax benefits.

Travel - Volunteers may be asked to travel on behalf of the charitable organization, for example, to attend a convention or meeting. Generally, qualified unreimbursed expenses may be deductible subject to complicated rules. Very broadly speaking, there must not be a significant element of personal pleasure, recreation, or vacation in the travel. Special rules apply if the charitable organization pays a daily travel allowance to the volunteer. There are also special rules for attendance at a church meeting or convention and the capacity in which the volunteer attends the church meeting or convention.