Lally&Co.
CPAs and Business Advisors

The Evergreen

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This Issue:

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,

We trust that you are enjoying your summer. We understand that tax and accounting concerns might be the farthest thing from your mind. It is our goal to keep you up to date with timely 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 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/.

IRS Unveils Taxpayer Bill of Rights

The Tax Code contains many taxpayer rights and protections. However, because the Tax Code is so large and complex, many taxpayers, who do not have the advice of a tax professional, are unaware of their rights. To clarify these protections, the IRS recently announced a Taxpayer Bill of Rights, describing 10 rights taxpayers have when dealing with the agency.

Taxpayer education

The idea for a Taxpayer Bill of Rights has been percolating for several years. One of the leading proponents has been National Taxpayer Advocate Nina Olson. In January 2014, Olson told Congress that a Taxpayer Bill of Rights was long overdue. Even though the rights already existed, many taxpayers did not know about them. More taxpayer education was needed, Olson emphasized. Olson proposed that either Congress pass legislation or the IRS take administrative action to set out a Taxpayer Bill of Rights.

Olson proposed that a Taxpayer Bill of Rights be based on the U.S. Bill of Rights. Olson also recommended that the IRS describe taxpayer rights in non-technical language. Olson's proposal won support from IRS Commissioner John Koskinen earlier this year.

Taxpayer Bill of Rights

In June, Koskinen and Olson together unveiled a 10-point Taxpayer Bill of Rights.

1. The Right to Be Informed
2. The Right to Quality Service
3. The Right to Pay No More than the Correct Amount of Tax
4. The Right to Challenge the IRS's Position and Be Heard
5. The Right to Appeal an IRS Decision in an Independent Forum
6. The Right to Finality
7. The Right to Privacy
8. The Right to Confidentiality
9. The Right to Retain Representation
10. The Right to a Fair and Just Tax System

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"The Taxpayer Bill of Rights contains fundamental information to help taxpayers," Koskinen said. "These are core concepts about which taxpayers should be aware. Respecting taxpayer rights continues to be a top priority for IRS employees, and the new Taxpayer Bill of Rights summarizes these important protections in a clearer, more understandable format than ever before."

As the IRS Commissioner noted, the Taxpayer Bill of Rights does not create new rights. Rather, the Taxpayer Bill of Rights is intended to serve an educational purpose to help taxpayers understand better their existing rights.

IRS Publication 1
The Taxpayer Bill of Rights is highlighted prominently in IRS Publication 1, Your Rights as a Taxpayer. The IRS reported that updated Publication 1 will be sent to taxpayers when they receive notices on issues ranging from audits to collections. Updated Publication 1 initially will be available in English and Spanish, and later in Chinese, Korean, Russian and Vietnamese.

Additionally, the IRS created a special page on its website to highlight the Taxpayer Bill of Rights, which will also be displayed in all IRS offices.

Supreme Court Helps Taxpayers Challenge IRS Summonses.

A recent decision by the U.S. Supreme Court clarifies how taxpayers may challenge an IRS summons where the taxpayer claims the summons was issued for an improper purpose. A taxpayer has a right to conduct an examination of IRS officials regarding their reasons for issuing a summons when the taxpayer points to specific facts or circumstances plausibly raising an inference of bad faith, the Court held. The U.S. Supreme Court took a different approach than one adopted by the Eighth Circuit Court of Appeals, which had brought the case to the Supreme Court.

IRS summons power
The IRS has many tools in its investigative toolbox. One tool is the power to issue administrative summonses to taxpayers and third parties. The IRS may issue a summons to direct a taxpayer to testify or to produce certain documents. If a taxpayer or third party declines to comply with the summons, the IRS may ask a federal district court to enforce the summons.

The IRS must jump through several hoops to persuade a court to enforce a summons. The IRS must show that the summons was issued for a legitimate purpose, the IRS sought information not already in its possession, and the summons met all the administrative steps required by the Tax Code. Once the IRS makes its prima facie showing to enforce a summons, the burden shifts to the third party opposing the summons.

Like any power, there is the possibility that the summons power can be abused and the courts have developed some protections for taxpayers. A court will not permit its process to be abused by enforcing a summons that was issued for an improper purpose. An improper purpose may include any purpose reflecting on the good faith of the investigation.

Clarke case
The case before the U.S. Supreme Court involved a summons issued for an alleged improper purpose. The case began when the IRS investigated a partnership. The IRS issued summonses to third parties, seeking certain records related to the partnership and tax deductions it had claimed. One third party declined to give the IRS the records sought by the summons and the IRS asked a federal district court to enforce the summons.

Before the federal district court, the third party argued that the IRS had issued the summons for an improper purpose. One allegation the court noted was that the summons reflected retribution for the partnership's refusal to extend the statute of limitations. The district court rejected the third party's argument and he appealed to the Eleventh Circuit. There, he was successful.

The Eleventh Circuit found that the third party was entitled to a hearing to explore the allegation of improper purpose. The decision by the Eleventh Circuit created a split among the courts of appeal. Other circuits had taken a less expansive view of when a taxpayer would be entitled to a hearing when improper purpose is alleged. The IRS appealed to the U.S. Supreme Court, which agreed to review the case.

Supreme Court's decision
The U.S. Supreme Court heard arguments on April 23, 2014 and announced its decision on June 19. Justice Kagan delivered the Court's unanimous opinion. Justice Kagan explained that as part of the process concerning a summons's validity, the taxpayer is entitled to examine an IRS agent when he can point to specific facts or circumstances plausibly raising an inference of bad faith. "Naked allegations of improper purpose are not enough: The taxpayer must offer some credible evidence supporting his charge," Justice Kagan wrote.

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According to Justice Kagan, when the Eleventh Circuit reviewed this case, it did not apply this standard. "We have no doubt that the Court of Appeals viewed even bare allegations of improper purpose as entitling a summons objector to question IRS agents. The court applied a categorical rule, demanding the examination of IRS agents even when a taxpayer made only conclusory allegations," Justice Kagan wrote. The Court vacated and remanded the case to the Eleventh Circuit with instructions to consider the taxpayer's argument in light of the standard set by the Court.

This Year's FBAR Deadline: What Changed and What Hasn't.

U.S. taxpayers with foreign financial accounts must file an FBAR (Report of Foreign Bank and Financial Accounts) if the aggregate value of their accounts exceeds $10,000 at any time during the calendar year. The FBAR must be filed by June 30 of the current year to report the taxpayer's financial accounts for the prior year.

A U.S. taxpayer must report the account not only if the taxpayer has a financial interest in the account, but also if the taxpayer has signature authority over the account. The account must be reported even if it produces no income, and whether or not the taxpayer receives any distributions from the account.

FinCEN
Reporting is required by the Bank Secrecy Act (BSA), not by the Internal Revenue Code. Taxpayers submit the proper form to Treasury's Financial Crimes Enforcement Network (FinCEN), not the IRS. The form is not submitted with a tax return. However, FinCEN has delegated FBAR enforcement authority to the IRS.

New Form 114
In the past, taxpayers reported their accounts on Form TD F 90-22.1. However, effective for 2014 and subsequent years, taxpayers must report their accounts on new FinCEN Form 114. The June 30 deadline is firm; there is no extension for filing the form late. However, persons who belatedly discover the need to file an FBAR for a previous year can file on Form 114.

In the past, taxpayers reported their accounts on a paper form, but Form 114 is only available online, through the BSA E-Filing System website. Paper Form TD F 90-22.1 has been discontinued. This BSA E-Filing System allows the taxpayer to designate the year being reported, so taxpayers may use the same form to file late reports for a prior year. In addition, persons can now authorize a tax professional, such as an attorney, CPA, or enrolled agent, to file on their behalf by designating an agent on BSA Form 114a.

If two persons jointly maintain an account, each must file an FBAR. However, spouses now qualify for an exception, and can file only one FBAR, provided the nonfiling spouse only owns accounts jointly with the filing spouse. The couple can complete a Form 114a, to authorize one spouse to file for the other, because the electronic system only accepts one signature for an FBAR.

Signature authority
Signature authority is authority to control the disposition of assets held in a foreign financial account. A person with a power of attorney over a foreign account must file an FBAR, even if the person never exercises the power of attorney.

FinCEN has considered amending the rules regarding signature authority. In the meantime, because there is some uncertainty about the meaning of signature authority, FinCEN has deferred FBAR filing by certain individuals that only have signature authority over, but no financial interest in, foreign financial accounts of their employer or a closely related entity. FinCEN Notice 2011-1 first provided an extension for these persons. In Notice 2013-1, FinCEN extended the due date for these persons to file, to June 30, 2015, while FinCEN further considers changes to the rules.

IRS will Treat Virtual Currency as Property for Tax Purposes.

As virtual currencies such as Bitcoin rise in prominence and use, the IRS has for the first time described how virtual currency will be treated for tax purposes. The agency concluded in new guidance (Notice 2014–21) that Bitcoin and other virtual currencies like it are not to be treated as currency, but as property.

Definition of virtual currency
Actual (or "real") currency is commonly defined as a system of money in general use in a particular country. The U.S. dollar is an example of actual currency. A single definition of virtual currency, on the other hand, has not yet achieved widespread acceptance. Virtual currency (sometimes referred to as "cryptocurrency") is a medium of exchange that operates like actual currency under some circumstances. Currently, virtual currency does not have legal tender status in any jurisdiction.

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How virtual currency works

Virtual currency that has an equivalent value in real currency, or that acts as a substitute for real currency, is referred to as "convertible" virtual currency. Currently, the most prominent example of a convertible virtual currency is Bitcoin, which can be digitally traded between users and can be purchased for, or exchanged into, U.S. dollars, Euros, and other real currencies.

A Bitcoin is created, or "mined," electronically, according to a purely mathematical process. A complex computer algorithm is applied. As more and more Bitcoins are mined, the difficulty of doing so will increase, as it becomes computationally more difficult to create them. This process was designed to mimic the production rate of a commodity such as gold.

Companies like BitPay or Coinbase act as intermediaries in Bitcoin transactions. According to Adam White, the Director of Business Development and Sales at Coinbase, over a million customers use Coinbase as their "Bitcoin wallet," allowing Coinbase to accept Bitcoin payments on their behalf using its payment tools. This includes over 28,000 merchants.

Fees associated with virtual currency transactions are relatively small in contrast with higher fees charged to businesses accepting credit cards. Credit card companies generally charge businesses a fee per card swipe, plus two to four percent of the total transaction. On the other hand, businesses that accept Bitcoins and use a merchant processor pay fees of one percent, or less. However, virtual currencies are volatile and involve high risk. For example, the value of a Bitcoin went from pennies to $1,200 in a five-year period, and then back down to around $620 in July, 2014.

U.S. tax treatment

The IRS acknowledged that virtual currency may be used to pay for goods or services, or held for investment. The IRS issued guidance providing answers to frequently asked questions (FAQs) about virtual currency, offering Bitcoin as an example. The FAQs at present provide only basic information on the tax implications of transactions in, or using, virtual currency.

Property. Notice 2014–21 states that virtual currency will be treated as property for U.S. federal tax purposes. As such, it is governed by the same general principles that apply to property transactions. The sale or exchange of convertible virtual currency, or its use to pay for goods or services in a real-world economy transaction, has immediate tax consequences that would not apply if it were considered pure "legal tender."

Conversion required. A taxpayer who receives virtual currency in payment for goods or services is required to include the fair market value of the virtual currency in computing gross income. This value must be measured in U.S. dollars as of the date the virtual currency was received. The tax basis in the virtual currency is its fair market value on the date of receipt.

Capital gain or ordinary income. The character of gain or loss from the sale or exchange of virtual currency depends on whether the virtual currency is a capital asset in the hands of the taxpayer. If the virtual currency is held as inventory, for example, for sale to customers in a trade or business, gain or loss on its disposition will be ordinary gain or loss. If the virtual currency is held as an investment, gain or loss on its disposition will be capital in nature. It remains unclear whether Bitcoins will be treated as "coins" for purposes of the 28 percent capital gains rate on collectibles; or whether they will be considered a permitted investment within Individual Retirement Accounts or in other, similar circumstances. A taxpayer who creates, or mines, virtual currency realizes gross income on receipt of the virtual currency resulting from that activity. The fair market value of the virtual currency as of that date is includible in gross income.

Information reporting. A payment made using virtual currency is subject to information reporting to the same extent as any other payment made in property. Thus, a person who makes a payment of fixed and determinable income using virtual currency with a value in excess of $600 to a U.S. non-exempt recipient is required to report the payment to the IRS and to the payee. This includes payment of rent, salaries, wages, premiums, annuities, and compensation. Wages paid to employees using virtual currency are taxable to the employee, must be reported by an employer on a Form W–2, and are subject to federal income tax withholding. Also, payments using virtual currency made to independent contractors and other service providers are taxable, and self-employment tax rules generally apply to such payments. Payers using virtual currency must normally issue Form 1099 to the payee.

Penalties. Taxpayers who fail to report their income from virtual currency may potentially be subject to tax penalties. At the April 2 House Committee’s Bitcoin hearing, L. Michael Couvillion, Professor, Plymouth State University, New Hampshire, pointed out that taxpayers who treated virtual currencies inconsistently with IRS Notice 2014–21 before it was issued will not receive penalty relief unless they can establish that their underpayment or failure to properly file information returns was due to reasonable cause.

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This will require many businesses and individuals to go back and determine the existence of gain or loss on transactions that occurred in the past, perhaps several years in the past.

Compute Depreciation for Tax Purposes

The simple concept of depreciation can get complicated very quickly when one is trying to determine the proper depreciation deduction for any particular asset. Here's only a summary of some of what's involved.

Identifying the asset
The modified accelerated cost recovery system (MACRS) is generally, but not always, used to depreciate tangible depreciable property placed in service after 1986. The MACRS deduction is computed on Form 4562, Depreciation and Amortization.

Intangible property may not be depreciated under MACRS, but it may be amortized in certain situations. Real estate (i.e. land) may not be depreciated, but buildings situated on it may. Sound recordings, films, and videotapes are specifically excluded from MACRS, but may be depreciated using the income forecast method. Deprecation for financial accounting book purposes is generally not the same as tax depreciation. Under MACRS, property placed in service and disposed of in the same tax year is not depreciable. Property converted from business use to personal use in the tax year of acquisition is not depreciable.

The cost of tangible depreciable property also may be deducted immediately if the business and the asset qualifies for Code Section 179 expensing.

Bonus depreciation, in years that Congress makes it available, is also available, taken first before the asset's remaining value is depreciated under MACRS.

Computing depreciation under MACRS
In order to compute depreciation under MACRS, the asset's MACRS property class must be determined. The asset's recovery period (i.e., its depreciation period), applicable depreciation method, and applicable convention depend on the asset's property class. Under MACRS, an asset's property class is based on either the type of asset or the business activity in which the asset is primarily used. The key resource for determining an asset's property class is the asset classification table contained in Revenue Procedure 87-56.

The cost of property in the 3-, 5-, 7-, and 10-year classes is recovered using the 200-percent declining-balance method (i.e., the applicable depreciation method) over three, five, seven, and ten years, respectively (i.e., the applicable recovery period), and the half-year convention (unless the mid-quarter convention applies), with a switch to the straight-line method in the year that maximizes the deduction.

The cost of 15- and 20-year property is generally recovered using the 150-percent declining-balance method over 15 and 20 years, respectively, and the half-year convention, with a switch to the straight-line method to maximize the deduction. The cost of residential rental and nonresidential real property is recovered using the straight-line method and the mid-month convention over 27.5- and 39-year recovery periods, respectively.

Firm Announcements

Daniel Barkey joined our A&A Department in June of 2014 as an Audit Manager

Lisa Wiegand became a first-time mother to baby girl, Madelyn Mae Wiegand, born July 6, 2014

Important Dates

August 15, 2014 - 2013 Extended Foundation Tax Returns Due

September 15, 2014 - 2014 3rd Quarter Estimated Payments Due