Lally&Co.
CPAs and Business Advisors

The EVERGREEN

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The Evergreen. Always Growing.

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

Contact our office or visit our website for more information.

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Dear Clients and Friends,

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.

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/.

Proposed Department of Labor Rule Regarding Overtime Pay for Salaried Workers

On July 6, 2015, the U.S. Department of Labor (DOL) issued a Notice of Proposed Rulemaking (NPRM) that included an important rule change requiring the payment of overtime to certain workers previously exempt from overtime pay.

As background, the Fair Labor Standards Act of 1938 (the Act) guarantees a minimum wage and overtime pay at not less than one and one-half times the employee's regular hourly rate. Overtime is defined in the Act as working in excess of 40 hours in a week. The Act applies to most workers but does provide for a number of exemptions, one of which is referred to as the "white collar" exemption. To be included in the white collar exemption, employees must be paid a minimum weekly salary of $455, equivalent to an annual salary of $23,660 or approximately $11.38 an hour; this minimum threshold amount was last updated in 2004.

The proposed rule has several aspects:

- Update the minimum salary level;
- Implement rules for automatic updates to the minimum salary level; and
- Assess whether a "duties test" is necessary in order to ensure compliance with the exemption

The DOL states the following in their July 6th release:

> "The DOL believes that a standard salary level at the 40th percentile of all full-time salaried employees will accomplish the goal of setting a salary threshold that adequately distinguish between employees who may meet the duties requirements of the white collar exemption and those who likely do not, without necessitating a return to the more detailed long duties test."

The DOL projects the 40th percentile weekly salary level in the final rule will be $970, equivalent to an annual salary of $50,440 or approximately $24.25 an hour. The proposed amount

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Firm Announcements

Anna M. Sella earned her Master of Business Administration degree from Robert Morris University in May 2015

Drew Kretz, CPA completed a six-week active duty training in Ft. Gordon, Georgia on June 11th related to his duties in the U.S. Army Reserve. Drew is currently a First Lieutenant serving as the battalion S6 OIC (communications-officer-in-charge) for the 336 Military Police Battalion HHD

Important Dates

August 15, 2015 - 2014 Extended Foundation Tax Returns Due

September 15, 2015 - 2015 3rd Quarter Estimated Payments Due

represents an increase of 113.19% over the current one set in 2004. According to the DOL's Consumer Price Index inflation calculator (http://data.bls.gov/cgi-bin/cpicalc.pl), inflation over the same period has been 28.86%, allowing for a 2.0% inflation rate between June 2015 and the first quarter of 2016. As one would expect, an increase in the threshold at nearly four times the rate of inflation over the same 11-year period has been a point of contention. Interested parties are requested to submit written comments regarding the proposed rule change by September 4, 2015.

What does the proposed rule mean to your business?

If your white collar staff does not work much or any overtime, the direct impact on your business may be negligible. However, we expect the effects of the proposed rule will provide challenges in recruiting and maintaining your workforce especially when compensation packages from different employers are being compared against each other. Conceivable, an employee could earn more annual wages by accepting a lower salary with overtime pay than had the potential employer offered a higher salary package.

If your white collar staff works considerable overtime and they are paid below the $970 weekly level, managing your office staff will begin to resemble managing the overtime worked by a "blue collar" staff. Management will need to focus their attention to better monitor the office staff's work schedules and require advance approval for overtime hours. In situations where the position does require more than a 40-hour week, employers will consider hiring additional staff to job-share the position and that may result in more employees working a part-time schedule once the proposed rule is instituted. So at first blush, a possible reaction to the proposed rule may accomplish just the opposite intention of the proposed rule.

If you wish to discuss the proposed rule's implications on your business, feel free to give us a call. We would love hearing from you.

How the IRS Resolves An Identity Theft Case

The IRS has responded to criticism from the Treasury Inspector General for Tax Administration and the National Taxpayer Advocate, among others, that resolution of identity theft accounts takes too long by increasing its measures to flag suspicious tax returns, prevent issuance of fraudulent tax refunds, and to expedite identity theft case processing. As a result, the IRS's resolution time has experienced a moderate improvement from an average of 312 days, as TIGTA reported in September 2013, to an average of 278 days as reported in March 2015. (The 278-day average was based on a statistically valid sampling of 100 cases resolved between August 1, 2011, and July 31, 2012.) The IRS has recently stated that its resolution time dropped to 120 days for cases received in filing season 2013.

Even with a wait time of 120 days, taxpayers who find themselves victims of tax refund identity theft likely find the road to resolution a frustrating and time consuming process. This article

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seeks to explain the various pulleys and levers at play when communicating with the IRS about an identity theft case.

Initiating an ID theft case

A taxpayer may become aware that he or she is a victim of tax-related identity theft when the IRS rejects their tax return because someone has already filed a return using the taxpayer's name and/or social security number. A taxpayer may also receive correspondence directly from the IRS that informs them, prior to filing, that someone has filed a suspicious return under their information. In other cases, a taxpayer may have had his or her identity information compromised and wishes to alert the IRS as to the possibility that he or she may be targeted by an identity thief.

For all such cases, the IRS has created Form 14039, Identity Theft Affidavit. Taxpayers who are actual or potential victims of tax-related identity theft may complete and submit the affidavit to ensure that the IRS flags the tax account for review of any suspicious activity. Taxpayers who have been victimized are asked to provide a short explanation of the problem and how they became aware of it.

The Identity Theft Affidavit may also be submitted by taxpayers that have not yet become victims of tax-related identity theft, but who have experienced the misuse of their personal identity information to obtain credit or who have lost a purse or wallet or had one stolen, who suspect they have been targeted by a phishing or phone scam, etc. The form asks these taxpayers to briefly describe the identity theft violation, the event of concern, and to include the relevant dates.

Once the Form 14039 has been completed and submitted, the taxpayer should expect to receive a Notice CP01S from the IRS by mail. The Notice CP01S simply acknowledges that the IRS has received the taxpayer's Identity Theft Affidavit and reminds the taxpayer to continue to file all federal tax returns.

IDVerify.irs.gov

The IRS has implemented a pre-screening procedure for suspicious tax returns. Rather than halt the refund process entirely, which can prevent a refund claimed on a legitimately filed return, the IRS has provided taxpayers with the opportunity to verify their identity.

Now when the IRS receives a suspicious return, it will send a Letter 5071C or Notice CP01B to the taxpayer requesting him or her to either visit idverify.irs.gov or call the toll-free number listed on the header of the letter (1-800-830-5084) within 30 days. When the taxpayer does this, the taxpayer will encounter a series of questions asking for personal information. If the taxpayer fails to respond to the verification request or responds and answers a question incorrectly the IRS will flag the return as fraudulent and follow the prescribed procedures for resolving identity theft cases.

Resolving the case

After a tax return has been flagged with the special identity theft processing code, the IRS will assign the case to a tax assistor. TIGTA reported that the IRS assigns each case priority based first on its age and then by case type—for example, with cases nearing the statute of limitations placed first, followed by cases claiming disaster relief, and then identity theft cases. However, TIGTA has reported that cases are frequently reassigned to multiple tax assistors, and there are often long lag times where no work is accomplished toward resolution. National Taxpayer Advocate Nina Olson also noted in her recent "Identity Theft Case Review Report" on a statistical analysis of 409 identity theft cases closed in June 2014 that a significant number of cases experience a period of inactivity averaging 78 days.

After resolution

The IRS has also created the Identity Protection Personal Identification Number (IP PIN) project, which is meant to prevent taxpayers from being victimized by identity thieves a second time after the IRS has resolved their cases and closed them. The IP PIN is a unique six-digit code that taxpayers must entered on their tax return instead.

The IRS assigns an IP PIN to a taxpayer by sending him or her a Notice CP01A. Generally this Notice is issued in December in preparation for the upcoming filing season. The taxpayer then enters it into the appropriate box of his or her federal tax return (i.e. Forms 1040, 1040A, 1040EZ or 1040 PR/SS). On paper returns, this box is located on the second page, near the signature line. When e-filing, the tax software or tax return preparer will indicate where the taxpayer should enter the IP PIN, social security number or taxpayer identification number (TIN) at time they file their tax return. The IP PIN is only good for one tax year.

Taxpayers who have been assigned an IP PIN, but who have lost or misplaced it cannot electronically file their tax returns until they have located it. Previously such taxpayers had no way to retrieve their IP PIN and had to file on paper. Beginning on January 14, 2015, however, taxpayers

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who had lost their IP PINs were able to retrieve them by accessing their online accounts and providing the IRS with specific personal information and answer a series of questions to verify identity.

Latest breach

The IRS announced on May 26th that 100,000 taxpayers became victims of a new identity theft scheme discovered in mid-May 2015. Identity theft criminals used stolen personal identification information to access the IRS's online "Get Transcript" application and illegally download these taxpayers' tax transcripts. The IRS is concerned that the criminals intend to use taxpayers' past-year return information to file false tax returns claiming tax items and refunds that look legitimate and that do not trigger the IRS's filters for finding suspicious returns.

Within this latest breach of security, identity thieves had attempted to download a total of 200,000 transcripts, but had only been successful half of the time, according to an announcement by IRS Commissioner John Koskinen. Because the IRS has yet to see how many taxpayers were actually victimized, the IRS may not provide IP PINs to all of these 200,000 taxpayers. However, the 100,000 taxpayers whose tax transcripts were downloaded will receive free credit monitoring services at the IRS's expense, Koskinen stated.

Liability for the "Nanny" Tax.

Employers of course have to pay employment taxes on the wages they pay to their employees. A nanny who takes care of a child is considered a household employee, and the parent or other responsible person is her household employer. Housekeepers, maids, babysitters, and others who work in or around the residence are employees. Repairmen and other business people who provide services as independent contractors are not employees. An individual who is under age 18 or who is a student is not an employee.

Payments and Withholding

As a household employer, the parent must withhold and pay Social Security and Medicare taxes if the cash wages paid to the nanny exceed the threshold amount for the year. If the amount paid is less than the threshold, the parent does not owe any Social Security or Medicare taxes. The threshold for 2015 is $1,900. If the employer earns more than $1,000 in any calendar quarter, the parent must also pay federal unemployment (FUTA) tax on wages paid, up to $7,000. Publication 926, Household Employer's Tax Guide, has more information about withholding and paying employment taxes.

If the amount paid is more than the threshold, the parent must withhold the employee's share of Social Security and Medicare taxes unless the parent chooses to pay both the employee's and the employer's share. The taxes are 15.3 percent of cash wages, 7.65 percent each for the employee and the employer. This includes 6.2 percent for Social Security and 1.45 percent for Medicare (hospitalization insurance).

The parent is not required to withhold income tax from the nanny's wages. However, the parent and the nanny may agree to withholding income tax from the nanny's wages. The nanny must provide a filled-out Form W-4, Employee's Withholding Allowance Certificate, to the employer.

The employment taxes amounts are part of the parent's tax liability and can trigger an estimated tax penalty if not enough is paid during the year. The parent submits estimated tax payments on Form 1040-ES, Estimated Tax for Individuals.

Forms to File

If the parent must pay Social Security and Medicare taxes, or if the parent withholds income tax, the parent must file Schedule H, Household Employment Taxes, with the parent's Form 1040. The parent may also need to file a Form W-2, Wage and Tax Statement, and furnish a copy of the form to the nanny. To complete Form W-2, the parent must obtain an employer identification number (EIN) from the IRS, either by applying online or by submitting Form SS-4, Application for Employer Identification Number.

Supreme Court's Same-Sex Marriage Decision Affects Federal, State Taxation

The Supreme Court's decision in *Obergefell v. Hodges* (2015-1 ustc ¶50,357) on June 26, 2015 continues what was set in motion in 2013: the expansion of tax benefits to same-sex married couples. In Obergefell, the Court ruled 5 to 4 that the Fourteenth Amendment requires a state to license

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a marriage between two people of the same sex. The Court further held that states must recognize a marriage between two people of the same sex when a marriage was lawfully licensed and performed out of state.

Background

In 2013, the Supreme Court decided *Windsor v. U.S* (2013-2 ustc ¶50,400). Windsor was an estate tax case, which challenged Section 3 of the federal Defense of Marriage Act (DOMA). Section 3 defined marriage as a man-woman relationship for federal purposes. The Court in *Windsor* struck down Section 3 as unconstitutional.

After *Windsor*, the IRS issued Rev. Rul. 2013-17. The IRS announced that it would take a place of celebration approach to same-sex marriage. The IRS would recognize, for federal tax purposes, a marriage of same-sex individuals that was validly entered into even if the married couple is domiciled in a state that did not recognize the validity of same-sex marriages. In Notice 2014-19, the IRS issued guidance for retirement plans, reflecting *Windsor*. Since *Windsor*, a number of cases challenging state bans on same-sex marriage moved through the federal courts, including *Obergefell*. The Supreme Court agreed to hear *Obergefell*.

Obergefell decision

Justice Anthony Kennedy delivered the Court's opinion in *Obergefell*. Kennedy wrote that the "the Fourteenth Amendment requires a State to license a marriage between two people of the same sex and to recognize a marriage between two people of the same sex when their marriage was lawfully licensed and performed out-of-State."

State prohibitions on same-sex marriage, Kennedy added, "abridge central precepts of equality. Same-sex couples are denied all the benefits afforded to opposite-sex couples and are barred from exercising a fundamental right. The Equal Protection Clause, like the Due Process Clause, prohibits this unjustified infringement of the fundamental right to marry."

However, four justices dissented. The dissenting judges would have held that the fundamental right to marry does not include a right to make a State change its definition of marriage. "The people of a State are free to expand marriage to include same-sex couples, or to retain the historic definition."

Going forward

For federal tax purposes, the treatment of same-sex couples as on par with opposite-sex couples since the Windsor decision will continue unchanged. The IRS is likely to issue more guidance to reflect the Court's decision in *Obergefell*. Many other federal agencies, such as the Social Security Administration, also are expected to issue guidance reflecting *Obergefell*. The *Obergefell* decision also impacts retirement, pension and health care benefits of many same-sex married couples.

For state tax purposes, same-sex married couples in states that did not recognize their marriages have had to file as single individuals for state tax purposes. Under the *Obergefell* decision, these couples have a Constitutional right to file amended returns as married at the state level. Whether the normal three-year limitations period for filing these amended returns will apply remains to be tested. Also uncertain may be whether same-sex married couples must now retroactively file jointly or whether re-filing will be made optional, either state-by-state or nationwide.

If you have any questions about the Supreme Court's decision in *Obergefell* and its impact on taxes, please contact our office.

How Do I? Determine When the "At Risk" Rules Apply to My Business

Taxpayers that invest in a trade or business or an activity for the production of income can only deduct losses from the activity or business if the taxpayer is at risk for the investment. A taxpayer is at risk for the amount of cash and the basis of property contributed to the activity. Taxpayers are also at risk for amounts borrowed if the taxpayer is personally liable to pay the liability, or if the taxpayer has pledged property as security for the loan (other than property already used in the business).

At-risk or not?

A taxpayer is not at risk for a nonrecourse loan, since there is no personal liability. However, amounts at risk include "qualified nonrecourse financing" used in connection with the holding of real estate. A taxpayer also is not at risk for contributions that are protected against loss by a guarantee, stop loss arrangement, or other similar arrangement. For certain activities, such as farming, oil and gas exploration, motion pictures, and the leasing of Code Sec. 1245 property, a taxpayer is not at risk for amounts

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borrowed from related persons or from persons who have an interest in the activity (other than as a creditor).

Scope of at-risk rules

The at-risk rules apply to all trade or business activities and to activities for the production of income. The rules apply to individuals, partners, S corporation shareholders, estates, trusts, and certain closely-held corporations. The at-risk rules generally do not apply to widely-held C corporations, whether public or private. There also is an exception for equipment leasing activities of closely-held corporations.

Deduction of losses

The taxpayer's amount at risk limits the allowable loss from the activity. The loss subject to the at-risk limitation is the excess of allowable deductions over the income received from the activity for that year. Under proposed regulations under Code Sec. 465, losses that are allowed as deductions for the tax year reduce the taxpayer's at-risk amount for the activity for the succeeding year. Losses that are denied under the at-risk rules can be carried over to subsequent years and deducted against amounts at risk in the subsequent years.

Adjustment of amount at risk

The amount at risk must be adjusted each year. At the close of the tax year, the following procedures are used to determine the amount at risk:

- As stated above, amounts at risk at the end of the prior year must be reduced by the amount of loss allowed in that prior year;
- Amounts at risk are increased by items, such as contributions of money or property, that add to the amount at risk; and
- Amounts at risk are decreased by items, such as withdrawals of money or property, which reduce the amount at risk.

FAQ…Can I Deduct the Cost of Sending My Child to Summer Camp?

Now that summer 2015 is officially here and the main filing season is out of the way, tax planning may be far from your mind. However, typical summer traditions can yield tax benefits. For example, when school lets out for the summer, some parents may decide to send their young children to summer camp. Whether parents do this to supplement their children's education, enhance their athletic skills, provide social opportunities, or simply to get them out of the house, some working parents may be able to deduct certain expenses associated with the cost of sending children to day camp. That's where the child care and dependent credit under Code Sec. 21, might especially come into play.

Child Care and Dependent Credit Basics

A taxpayer, who incurs expenses to obtain day care for child under age 13 so that the taxpayer and his or her spouse can be gainfully employed (or look for gainful employment), may be able to claim the child care and dependent tax credit on Form 1040, (line 49), Form 1040A (line 31), or Form 1040NR (line 47). Taxpayers may also claim the credit for expenses paid for care for certain other qualifying individuals, such as physically or mentally incapacitated dependents.

Taxpayers who qualify for the child and dependent care tax credit must claim it by completing and filing Form 2441, Child and Dependent Care Expenses, along with their tax returns. Taxpayers may not claim the credit if they file a Form 1040EZ, Income Tax Return for Single and Joint Filers With No Dependents, or Form 1040NR-EZ, U.S. Income Tax Return for Certain Nonresident Aliens With No Dependents.

A taxpayer who qualifies may claim a credit in an amount between 20 to 35 percent of employment-related child care expenses. Such expenses can include the cost of sending a child to day camp, something that can run up a hefty bill of more than $100 or $500 per week!

In general, to claim the child and dependent care credit, the taxpayer must meet the following requirements:

- The taxpayer must live with the child(ren) or qualifying person(s) for more than half of the tax year;
- The child and dependent care expenses must be incurred to allow the taxpayer to work or look for work. (If the taxpayer or the spouse is a stay-at-home parent, unfortunately, the child care costs are nondeductible);
- The taxpayer must have income from work during the year. (The amount of the employment-related expenses taken into account in calculating the child and dependent care credit may

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not exceed the lesser of the taxpayer's earned income or the earned income of his spouse if the taxpayer is married at the end of the tax year);

- The taxpayer must have made payments for child and dependent care to someone the taxpayer or his spouse could not claim as a dependent. If the person to whom payments were made was the taxpayer's child, the child must have been 19 or over by the end of the year;
- If married, the taxpayer must file a joint return (unless an exception applies);
- The taxpayer must include the taxpayer identification number of the qualifying individual on the return;
- The taxpayer must provide specified information regarding service providers, including the name, address and taxpayer identification number (TIN) of the provider (no TIN is required if the provider is a tax-exempt organization);
- A taxpayer must substantiate any child and dependent care credit claimed by providing adequate records or other sufficient evidence of work-related expenses, etc.

Summer Camp Costs

Because day camp is comparable to day care, the IRS allows taxpayers to factor in the costs of sending a child to day camp when determining the amount of the child and dependent care credit they may claim. The cost of sending a child to a day camp may be a work-related expense, even if the camp specializes in a particular activity, such as computers, music, football, or soccer. Furthermore, taxpayers are not required to seek out the least expensive day camp option in order to claim the credit. The IRS regulations provide that "the manner of providing care need not be the least expensive alternative available to the taxpayer."

Reg. §1.21-(1)(d)(6) provides that the cost of sending your child to an overnight camp, however, is not considered a work-related expense. Similarly, summer school and tutoring programs are not considered to be for the care of a qualifying individual and the costs are not employment-related expenses.

The regulations under Code Sec. 21 provide two examples intended to outline the distinction between a summer day camp, for which expenses are deductible, and a tutoring program, for which expenses are nondeductible. They state: To be gainfully employed, N sends her 9-year old child to a summer day camp that offers computer activities and recreational activities such as swimming and arts and crafts. The full cost of the summer day camp may be for deductible care. In contrast, to be gainfully employed, O sends her 9-year old child to a math tutoring program for two hours per day during the summer. The cost of the tutoring program is not for deductible care.

According to the IRS, the question of whether or not an expense qualifies for the dependent care credit depends on the nature and primary purpose of the services provided and is primarily a question of fact. In order for an expense to qualify in full for the dependent care credit, any portion of the expense for purposes other than care must be minimal or insignificant and inseparable from the portion of the expense for care. If a significant portion of the expense is for purposes other than care, an allocation must be made as to which portion of the costs are for deductible care and which portion of the costs are for other purposes. An expense that is primarily for a purpose that is not care, such as education, does not qualify for the dependent care credit.

Amounts paid for clothing, schooling and entertainment are not considered qualified expenses for purposes of calculating the child care and dependent credit. However, if these amounts are incidental to and cannot be separated from the cost of caring for the qualifying person, the regulations provide that these expenses can be counted toward the credit for qualified dependent care. This means that costs to purchase clothing, horseback riding chaps, soccer cleats, football padding, violin strings, or other gear that may be used by the child while at the day camp are nondeductible because they are technically personal in nature and not for the well-being of the child. However, if the day camp provides a lunch and snacks to the children attending the day camp, the regulations provide that the cost of this lunch and the snacks may be included in the cost of care for the child if they are incidental to and inseparably a part of the care.

The cost of transporting a qualifying individual to a place where care is provided is not generally a qualifying expense unless it is provided by a dependent care provider. If a day camp takes a child or qualifying person to or from the day camp location, that transportation is for the care of the child. This includes transportation by bus, subway, taxi, or private car.

Forfeited amounts

A taxpayer may include the cost of fees paid to an agency to get the services of a day camp provider, including deposits and application

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fees. However, if the taxpayer changes his or her mind and either does not send the child to day camp or selects another program, any forfeited deposit will not be considered "for the care of a qualifying person" and will therefore become nondeductible.

Credit Amount

The amount of the child care and dependent credit is subject to a cap calculated as a percentage of the taxpayer's employment-related expenses, as well as a dollar limit. A maximum credit of 35 percent of employment-related expenses is available to taxpayers with adjusted gross income (AGI) of $15,000 or less. The credit percentage is reduced by one percentage point for each $2,000 of adjusted gross income, or fraction thereof, above $15,000. The minimum credit percentage is 20 percent, and it applies to a taxpayer with AGI in excess of $43,000.

In addition, the maximum amount of eligible expenses that may be used to calculate the final credit amount is $3,000 for taxpayers with one qualifying individual and $6,000 for taxpayers with two or more qualifying individuals.

Therefore, the maximum credit amount is $1,050 for taxpayers claiming expenses for one child and $2,100 for taxpayers claiming expenses related to two or more children.

Any child care benefits provided by an employer will reduce dollar-for-dollar the amount of expenses a taxpayer may use to calculate the credit.

The child care and dependent credit is nonrefundable, meaning that if the taxpayer already has no tax liability for the year in which he or she incurred qualified expenses for purposes of the credit, he or she will receive no tax benefit from claiming the credit.

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