The Evergreen
Lally&Co. CPAs and Business Advisors
Quarterly Journal for Clients & Friends

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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.

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/.

Federal Overtime Rule Change and the Consequences

The Rule

In Legislative news, the United States Department of Labor recently released a finalized rule that amends the requirements for overtime pay. The rule will cause a dramatic increase in the exemption thresholds for certain businesses. The new rule, entitled, "Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees," will go into effect on December 1, 2016.

Businesses and their employees will be significantly affected by the changes to overtime pay exemption. These significant effects have caused professional organizations such as the AICPA and the Partnership to Protect Workplace Opportunity (PPWO) to take a stance against these changes. The PPWO's stance is that employees and employers are best served with a pay system that enables the most flexibility in structuring employee hours, opportunities for career advancement, and clarity in classifying employees.

Changes

Currently, the Fair Labor Standards Act states that employees who work in excess of 40 hours per week are entitled to receive overtime pay, unless they meet the exemption requiremnts for the duties and wage-level tests. In the new rule, the minimum salary threshold will double from its current level of $23,660 to its new level of $47,476 annually. In addition, for "highly compensated individuals," the threshold under the new rule will be raised from $100,000 to $134,004 annually. The DOL estimates that approximately 4.2 million workers throughout the U.S. who are not currently eligible for overtime will be directly impacted and that approximately 8.9 million salaried workers may be reclassified as nonexempt.

Issues and Concerns

With respect to the public accounting profession, the new rule fails to take into account seasonal spikes that occur during certain times of the year and other nuances that affect the industry. The DOL states, "Private employers

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cannot satisfy their overtime obligations by providing comp time and must pay overtime-eligible employees an overtime premium for hours over 40 in a workweek." Aditionally, it should be noted that the DOL did not offer a specific proposal which would modify the "duties tests" that effectively determine whether and employee is considered executive, professional, or administrative.

The new rule will cause employers to put extra emphasis on tracking work hours for millions of new non-exempt employees, so that these employers can ensure that they are in compliance with the requirements regarding overtime pay. The result of this may likely be that many workers will have less autonomy and fewer opportunities to partake in employee-sponsored trainings and other events. Another unintended consequence will likely be that those workers which are reclassified to non-exempt status are unlikely to receive a pay increase. In addition, the truth of the matter is that just because an employee is eligible for overtime pay, there is no guarantee that an employee will actually earn any overtime pay.

There has been additional concern regarding how the new rule may negatively affect smaller entities, such as nonprofits which many times operate on a "shoe-string" budget. Many claim that the DOL has mistakenly ignored the potential costs that will have to be incurred by these smaller entities, which may cause them to have to cut critical services. These concerns, along with other developing issues, will be cornerstones for the AICPA, PPWO, and other organizations in urging Congress to intervene in the process and ultimately reaching a resolution that governs overtime pay without having a negative economic effect.

Tax Legislation Moves Forward Before Congress' August Recess

As Congress' August recess nears, lawmakers are moving tax legislation for individuals and businesses. Bills targeted to tax reform, small business tax relief, and more have been introduced and are working their way to votes in the House and Senate. Congress is also grappling with the IRS's budget for fiscal year (FY) 2017.

Tax Reform

Just before recessing for the Independence Day holiday, House Republicans unveiled a tax reform blueprint. Since January, the House Ways and Means Committee has been exploring different approaches to tax reform. House Ways and Means Chair Kevin Brady, R-Texas, outlined six principles for tax reform:

1. The tax code must be simpler, fairer, and flatter;
2. Loopholes must be closed and special interest provisions eliminated for lower rates for everyone;
3. Businesses of all size must have a fair and competitive tax rate;
4. The current world-wide tax system must be replaced with a permanent, modern, territorial-type system;
5. Reform should be bold, ambitious and pro-growth;
6. A 21st century tax system should not raise taxes to bail out Washington's spending problem.

The GOP blueprint would consolidate the individual tax rates into three brackets (12, 25 and 33 percent). Additionally, the blueprint would repeal the alternative minimum tax (AMT). The blueprint also calls for a simplified return for individuals.

For businesses, the blueprint would lower the top corporate tax rate to 20 percent. The blueprint also would create a new 25 percent business tax rate for small businesses organized as sole proprietorships or pass-through entities. Tax rates on capital gains and dividends also would be reduced.

House Republicans said they will spend the remainder of 2016 developing the blueprint into legislative proposals. While Republicans likely have enough votes to pass the proposals in the House,

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they lack the 60 votes needed to pass tax legislation in the Senate. Congress will also be on recess during most of August. Democratic lawmakers in both the House and Senate have been cool to the GOP's tax reform proposals.

Small Businesses

Many small businesses have traditionally provided a health benefit to their employees through a health reimbursement arrangement (HRA). Following passage of the Affordable Care Act (ACA), the IRS determined that these should be treated as employer payment plans subject to market reforms under the ACA. Failure to comply with the ACA's market reforms triggers excise taxes. The IRS provided transition relief (Notice 2015-17) from the penalties but the relief has expired.

In June, the House approved the Small Business Health Care Relief Act, (HR 5447), intended to provide permanent relief for small employers. Under the legislation, small employers (employers with less than 50-full-time and full-time equivalent employees) would be able to have stand-alone HRAs and reimburse expenses without violating the ACA's market reforms. A similar bill has been introduced in the Senate, which could take up the bill before July 4th.

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Lally&Co. The EVERGREEN

Firm Announcements

ToniMarie Dunker joined our Administrative Staff in June 2016

Important Dates

August 15, 2016 – Extended 2015 Foundation Tax Returns Due

September 15, 2016 – Extended 2015 Trust, S-Corp, and Partnership Returns Due

September 15, 2016 – 2016 3rd Quarter Estimated Payments Due

Energy Tax Policy

Both leaders of the Senate Finance Committee (Orrin Hatch, R-Utah and Ron Wyden, D-Oregon) have taken an interest in simplifying energy tax incentives. The Senate Finance Committee held a hearing in June to examine the role taxation plays in energy policy. Wyden reiterated his proposal to consolidate the more than 40 separate energy tax credits and deductions into as few as three. The incentives, Wyden explained, would be built around three goals: energy, cleaner transportation, and energy efficiency. Wyden also noted that many of the energy incentives extended by the Protecting Americans from Tax Hikes Act of 2015 (PATH Act) were only extended temporarily.

In related energy news, the House approved in June a resolution signaling opposition to President Obama's proposal to impose a $10 fee on every barrel of oil produced. The House also passed a resolution opposing the White House's proposed carbon tax, to reduce greenhouse gas emissions.

Individuals

The ACA made a significant change to the individual deduction for medical expenses. After December 31, 2012, the threshold to claim an itemized deduction for unreimbursed medical expenses increased from 7.5 percent of adjusted gross income (AGI) to 10 percent of AGI for regular income tax purposes. The ACA did carve out a temporary exception for senior citizens. In June, the House Ways and Means Committee approved legislation to resurrect the pre-ACA rules. The Halt Tax Increases on the Middle Class and Seniors Act (HR 3590) would replace the current 10 percent threshold with the old 7.5 percent threshold for all taxpayers.

IRS Budget

The IRS's current fiscal year is scheduled to end after September 30, 2016. In June, House appropriators unveiled a $10.9 billion budget for the agency for FY 2017. The bill cuts overall funding for the IRS but includes an additional $290 million to improve customer service, fraud prevention and cybersecurity. Senate appropriators, meanwhile, have proposed to fund the IRS at $11.2 billion for FY 2017.

Recent Tax Changes Reflected in New IRS Statistics

The IRS recently released its Spring 2016 Statistics of Income (SOI) Bulletin containing a treasure-trove of useful information. The bulletin contains data gleaned from more than 148 million individual income tax returns filed for the 2014 tax year (TY). The data for 2014 reveal a corresponding increase in tax liability across all tax brackets. The SOI bulletin presents the most recent figures available for the 2014 tax year from various tax and information returns filed by U.S. taxpayers. In addition, the report compares the data to similar statistics measured in 2013. In general, the latest report shows a continued improvement in the national economy, year over year.

Tax Changes in 2014

Many effects felt by taxpayers in 2014 were extensions of tax law changes implemented in CY 2013. In TY 2014, the inflation-adjusted caps for each income tax bracket were raised, which meant that taxpayers whose income did not increase significantly from the previous year may have fallen into a

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lower tax bracket. The alternative minimum tax experienced a slight increase.

As was the case in 2015 when the Bush-era tax cuts officially expired, the top tax rate for taxpayers remained at 39.6 percent. Taxpayers making more than $200,000, or $250,000 for married taxpayers, were subjected to a Medicare surtax of 0.9 percent. "Pease limitations," which place limitations on certain higher-income taxpayers, remained in effect for 2014. In addition, the Patient Protection and Affordable Care Act affected many taxpayers by imposing a "shared responsibility payment' for taxpayers who did not have health insurance in 2014.

Income Tax

According to the Spring 2016 bulletin, the number of individual income tax returns filed for tax year 2014 increased from the previous year for a total of 148.7 million, reflecting a 0.6 percent increase. Adjusted gross income (AGI) increased from $9.1 trillion to $9.7 trillion. Taxable income rose 8.0 percent to $6.9 trillion. The alternative minimum tax experienced a 9.4 percent increase, for a total of $24.6 billion. The bulletin reported that total income tax and total tax liability both increased by 10 percent to $1.4 trillion.

In addition, the preliminary data for 2014 show that taxable income increased 8.0 percent to $6.9 trillion. The IRS reported that the average AGI on all 2014 individual income tax returns was $65,021, and average taxable income was $61,328, both representing increases from the 2013 amounts, by 5.4 percent and 6.1 percent respectively.

Tax Liability

The IRS's preliminary data indicate that total tax liability for the 2014 tax year rose to $1.4 trillion owed, as reflected on more than 101 million returns. This figure increased from the $1.3 trillion reported for some 98.8 million returns filed in TY 2013. Although total tax liability increased for all income categories, taxpayers with adjusted gross income of $250,000 or more experienced the steepest percent change in tax liability, with a 15.9% increase from 2013 to 2014 (calculated from the $622.2 billion owed for 2013 versus the $721.2 billion owed for 2014), the IRS reported. Overall, total tax liability increased by 10 percent over 2013's figure, for a total of $1.4 trillion.

The increase in tax liability is likely the result of continued growth in capital gains distribution. For TY 2014, the capital gains distribution rose to nearly $79 billion, up nearly 75% from TY 2013's $45.2 billion. In addition, net capital gains increased 34.4 percent to $586.5 billion. The amount of net capital gains reported on tax returns with $250,000 or more in adjusted gross income increased by $120.89 billion (from $323.42 billion for 2013 to $444.31 billion for 2014).

The continued increase in net capital gains may have likely contributed to the increase in the number of taxpayers in the highest tax brackets, which may, in part, explain the overall increase in tax liability between 2013 and 2014. For example, the preliminary data for 2014 indicates that there were 431,477 more taxpayers in the $250,000 and up income category who reported net capital gains than there were for 2013. In addition, the corresponding increase in taxpayers for the $200,000 to $250,000 income category was 273,322 for 2014. The data show that all income categories, except that for AGI from $30,000 to under $50,000, experienced an increase in the number of tax returns reporting net capital gains.

Latest IRS Data Book Gives Insight into Audit Activities

The IRS has issued its annual Data Book for fiscal year (FY) 2015, which provides statistical information on activities such as examinations and collections conducted by the IRS from October 1, 2014 to September 30, 2015. For FY 2015, the Data Book shows the total number of audits conducted by the IRS was 1.37 million, down from the 1.38 million examined in FY 2014.

Returns Filed

Categories reflecting the main functions of the IRS, processing federal tax returns and collecting revenue, saw a marked increase in FY 2015 in comparison to the same time last year. The information in the Data Book shows that the IRS processed more than 243 million tax returns and related forms and issued more than 199 million refunds, amounting to $403.3 billion. The IRS collected more than $3.3 trillion in gross taxes.

Audit Coverage

In total, the IRS audited 0.7 percent of all returns filed in calendar year (CY) 2014. The data shows that the number of audited returns has been decreasing since 2010, the IRS reported.

A majority of the audits, nearly 73 percent, were conducted via correspondence. The remainder was field audits. The IRS reported that 28,000 taxpayers did not agree with the examiner's determination. The amount disputed across those who disagreed with the IRS was approximately $7.4 billion.

For FY 2015, the Data Book states that examinations protected approximately $2.1 billion in refund

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payments for taxpayers. Of that amount, $2.0 billion came from field examinations and $122.3 million from correspondence examinations.

Individuals

Individual returns filed in 2014, including both business and nonbusiness taxpayers, were audited at 0.8 percent, which amounted to approximately 1.2 million returns, during FY 2015, based on more than 146.8 million individual returns filed. The audit rate rose significantly for income levels of $1 million or more. The audit rate for individuals in the $10 million or more level rose to 34.69 percent, more than double the audit rate reported in FY 2014.

The IRS noted that the total number of individual tax return examinations has decreased by 22 percent over the last five years. The agency attributes the decrease to the fact that FY 2015 marks the fifth consecutive year that the IRS budget has been decreased, which brought about a 15-percent reduction in full-time staff as compared to five years ago. Accordingly, operations across a number of areas, including return examinations, were downsized. Of the 1.2 million individual income tax returns examined, almost 40,000 resulted in additional refunds to taxpayers, totaling more than $1.1 billion.

Although the audit rate for higher income individual taxpayers experienced a considerable jump in CY 2014, the number of returns filed for this category, as a percentage of the total returns filed, remained fairly constant.

Partnerships

Partnerships and S corps filed a total of approximately 8.4 million returns during FY 2015, a slight increase from FY 2014 when these types of entities filed almost 8.2 million returns. In addition, the audit rate increased slightly from 0.39 percent in FY 2014 to 0.45 percent in FY 2015. In FY 2014, IRS officials announced that the agency intended to concentrate more heavily on partnership audits. The data appears to reflect this movement, as the audit rate rose 0.1 percent to 0.5 in FY 2015.

Corporations

The IRS examined nearly 1.3 percent of all corporate returns (other than S corps) during FY 2015, based on a total of nearly 1.9 million returns and 24,761 examinations. The IRS reported that during FY 2015, it recommended more than $10.36 billion in additions to tax for corporate returns. The additions to tax recommended for returns filed by corporate taxpayers with more than $20 billion in assets comprised approximately 38 percent of the total additions to tax. Large corporations with total assets between $5 billion and $20 billion experienced an audit rate of 36.1 percent, showing a decrease from FY 2014 when the audit rate for this same category was 44.3 percent. In addition, large corporations with total assets greater than $20 million experienced a substantial decrease in terms of audit rate with 64 percent, whereas in FY 2014, the audit rate was 84.2 percent, the IRS added.

Tax-Exempt Organizations

The IRS reported that it received 787,339 returns from tax-exempt organizations in CY 2014 and examined 6,392 tax-exempt entities and related taxable returns in FY 2015. This shows a decrease over the 8,084 tax-exempt entities examined out of 765,395 returns filed in CY 2013.