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 evolved into a firm of 40 individuals who serve clients in many diverse engagements. We have added four more to our staff for this upcoming "busy season". We continuously expand our knowledge base and credentials to better serve our current and broadening clientele.

Our growth has given us the ability to better serve our clients and adapt to their needs. 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,

With the holidays behind us and tax season upon us, we have devoted this edition to addressing common concerns related to the 2013 Tax Filing Season.

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/.

New Year Begins With Delayed Filing Season, Continuing Tax Reform Discussions and New IRS Leader

Taxpayers will experience a short delay to the start of the 2014 filing season, but passage of the Bipartisan Budget Act of 2013 averted the possibility of an IRS shutdown in January. The budget agreement, however, did not include any tax provisions, and tax reform must find a new vehicle to move forward in Congress. Meanwhile, the IRS starts 2014 with a new leader, who promised to restore public trust in the agency after a troubled 2013.

2014 Filing Season

To end the October government shutdown, Congress passed a stop-gap funding bill to keep the IRS and other federal agencies open through January 2014. Many tax professional groups warned that a government shutdown in January, even for a few days, would result in significant delays in tax return processing and refunds. The Bipartisan Budget Act of 2013 authorizes funding for the federal government for two years. The start of the 2014 filing season, however, will be slightly delayed because of the October shutdown. The IRS needs additional time to reprogram its return processing systems. The IRS will not process any returns (electronic or paper) before January 31, 2013.

Tax Legislation

Many tax reform proposals were introduced in Congress in 2013 but lawmakers deferred action until 2014. The leaders of the House and Senate tax writing committees have both said they want to move tax reform legislation in 2014 but the extent of any reform—and overall enthusiasm in Congress for reform—is unclear. Some lawmakers want a complete overhaul of the Tax Code (the last major tax reform was in 1986); others want a more piece-meal approach. Lawmakers are also divided over whether reform should be revenue neutral or if reform should raise new revenues.

There had been some expectation that the budget agreement would include tax provisions, especially the so-called tax extenders. These are popular but

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temporary incentives, such as the higher education tuition deduction, state and local sales tax deduction, transit benefits parity, teacher's classroom expense deduction, research tax credit, and more. The budget agreement negotiators decided not to include the extenders, which have now expired. Congress is likely to extend the incentives retroactive to January 1, 2014.

President Obama, in his State of the Union Address again called for a reduction in the corporate tax rate in exchange for eliminating some business tax incentives. The President made the same proposal last year but it failed to gain traction in Congress. The President also urged Congress to renew tax incentives that encourage employers to hire military veterans and individuals from economically-disadvantaged groups, consolidate some taxpayer penalties, extend enhanced small business expensing (and possibly bonus depreciation) and more.

New IRS Commissioner

In May, after news broke of the IRS selecting applications from conservative groups for tax-exempt status for extra scrutiny, President Obama appointed Daniel Werfel to serve as Acting Commissioner. The President instructed Werfel to launch a top-down review of the agency. Since May, several senior IRS executives resigned or retired and Werfel appointed new top managers. Werfel also instituted cost-saving measures, such as eliminating employee conferences, curbing employee travel and not paying bonuses. Werfel, however, never intended to serve permanently at the IRS and President Obama nominated John Koskinen to be Commissioner. The Senate approved Koskinen's nomination in December.

Koskinen comes to the IRS after serving as the non-executive chair of Freddie Mac from 2008 to 2011. Previously, Koskinen was deputy mayor of Washington, D.C. and also was a senior manager at the Office of Management and Budget (OMB). At his confirmation hearing, Senate Finance Committee (SFC) Chair Max Baucus, D-Montana, called Koskinen "the type of leader we need at the IRS." SFC Ranking Member Orrin Hatch, R-Utah, reminded Koskinen that he has a "difficult job ahead" and "it is vital that the IRS maintain its credibility with taxpayers." Koskinen told lawmakers that "trust is the most important asset the IRS has."

Higher-Income Taxpayers Brace for Higher Tax Bill With 2013 Returns

Many higher-income taxpayers will be in for a big surprise when they finally tally up their 2013 tax bill before April 15th. The higher amount of taxes that may be owed will be the result of the combination of several factors, the cumulative effect of which will be significant for many. These factors include a higher income tax rate, a higher capital gains rate, a new net investment income tax, and a new Medicare surcharge on earned income, as well as a significantly reduced benefit from personal exemptions and itemized deductions for those in the higher income tax brackets.

Higher Top Income Tax Rate

The American Taxpayer Relief Act of 2012 made permanent for 2013 and beyond the lower Bush-era income tax rates for all, *except* for taxpayers with taxable income above $400,000 ($450,000 for married taxpayers filing jointly, $425,000 for heads of households). Income above these levels has now been taxed at a 39.6 percent rate rather than at the top 35 percent rate since January 1, 2013. Those amounts are adjusted for inflation after 2013 (for 2014, those threshold levels are $432,200, $457,600, and $406,750, respectively. Taxpayers with $150,000 of income above the threshold amounts, for example, must pay an additional $6,900 in tax in 2013 because of the additional tax rate of 4.6 percent).

Capital Gains and Dividends

The American Taxpayer Relief Act also raised the top rate for long-term capital gains and dividends to 20 percent, up from the Bush-era maximum 15 percent rate again, applicable to all net long-term capital gains from transactions made on or after January 1, 2013. That top rate will apply to the extent that a taxpayer's income exceeds the thresholds set for the 39.6 percent rate ($400,000 for single filers; $450,000 for joint filers and $425,000 for heads of households). Especially applicable to those investors who have been riding the recent stock market rally, a jump in the rate from 15 percent to 20 percent represents a 33.33 percent tax increase.

Medicare Taxes

Set into motion on January 1, 2013 by the Affordable Care Act of 2010, higher-income taxpayers have been required to pay an additional 3.8 percent on net investment income as well as a 0.9 percent Additional Medicare Tax on earned income.

In both cases, the income threshold levels for being subject to these new taxes are considerably lower than the 39.6 percent bracket and 20 percent capital gain rates. The threshold amount is $200,000 in the case of a single individual, head of household (with qualifying person) and qualifying widow(er) with dependent child. The threshold amount is $250,000 in the case of a married couple filing jointly and $125,000 in the case of a married couple filing separately. For the 3.8 percent net investment income tax, the threshold

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Firm Announcements

Richard Aufman Jr. joined our A&A Department in November 2013 as a Staff Accountant

Nicole Bransford joined our Administrative Staff in January 2014

Lindsey M. Burchell, CPA earned her Master of Business Administration degree from Robert Morris University in October 2013

Courtney Cannon joined our Administrative Staff in December 2013

Christine Fromlak joined our Tax Department in January 2014 as a Part-Time Staff Accountant

Justin Gartner is engaged to be married to Katelyn Kennedy

Thomas Lutz joined our Tax Department in January 2014 as a Staff Accountant

Jeffrey Wilson joined our A&A Department in November 2013 as a Staff Accountant

Important Dates

February 28, 2014 - 2013 Form 1099 Due

March 17, 2014 - 2013 Corporate Tax Returns Due

April 15, 2014 - 2013 Partnership, Individual, Trust, and Gift Tax Returns Due and 2014 1st Quarter Estimated Payments Due

May 15, 2014 - 2013 Foundation Tax Returns Due

is adjusted gross income (modified for certain foreign-based income). For the 0.9 percent Additional Medicare Tax, the threshold is measured against compensation earned for the year (including self-employment income).

Net investment income tax. The 3.8 percent tax not only covers capital gains and dividends, but also passive-type income flowing from real estate, investments in businesses, and the like. The rules are complex, and many taxpayers will struggle with the extent to which income on their 2013 tax returns will be subject to the new net investment income tax. For income subject to this tax, the effective rate will increase to 23.8 percent on net capital gain and dividends and 43.4 percent on short-term capital gain and all other passive-type income.

Additional Medicare Tax. For tax years beginning after December 31, 2012, the 0.9 percent Additional Medicare Tax applies to employee compensation and self-employment income above the threshold amounts noted above. Covered wages for purposes of the Additional Medicare Tax include not only regular salary or payments for services rendered to someone self-employed, but also tips, commissions that are part of compensation, bonuses, reimbursements under nonaccountable plans, back pay awards, gifts by employers to employees and more.

An employer's withholding obligation for the Additional Medicare Tax applies only to the extent the employee's wages are in excess of $200,000 in a calendar year. For some dual-income couples with combined earned income above the $250,000 threshold but with no one earning more than $200,000, they may find themselves under withheld and subject to an estimated tax penalty as a result. Couples should remember that to prevent a reoccurrence in the future, an employee may request additional income tax withholding, which will be applied against all taxes shown on the individual's return, including any liability for the Additional Medical Tax.

Itemized Deductions Limitation
The American Taxpayer Relief Act is known officially as the "Pease" limitation on itemized deductions. The new thresholds, first applied in 2013, are $300,000 for married couples and surviving spouses; $275,000 for heads of households; $250,000 for unmarried taxpayers; and $150,000 for married taxpayers filing separately.

The Pease limitation reduces the total amount of a higher-income taxpayer's otherwise allowable itemized deductions by three percent of the amount by which the taxpayer's adjusted gross income exceeds this applicable threshold. The amount of itemized deductions may be reduced up to 80 percent under this formula. Certain items, such as medical expenses, investment interest, and casualty, theft or wagering losses, are excluded.

Personal Exemption Phaseout
The American Taxpayer Relief Act also revived the personal exemption phaseout rules, at the same levels of adjusted gross income revived for the Pease limitation. Under the phaseout, the total amount of exemptions that may be claimed by a taxpayer is reduced by two percent for each $2,500, or portion thereof (two percent for each $1,250 for married couples filing separate returns) by which the taxpayer's adjusted gross income exceeds the applicable threshold level. At the full phase out level, therefore, a family with four personal exemptions in 2013 will lose $15,600 in exemptions, creating $6,178 in additional tax at the 39.6 percent bracket.

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Federal Estate and Gift Taxes
One bright spot for higher-income taxpayers is the change that took place starting in 2013 directly applicable to estate planning strategies. The American Taxpayer Relief Act permanently provided for a maximum federal estate tax rate of 40 percent with an annual inflation-adjusted $5 million exclusion for estates of decedents dying after December 31, 2012. Couples can combine exclusions and effectively exempt $10 million from estate tax (for 2013, the inflation-adjusted level is $10.5 million, rising to $10.68 million in 2014).

Keeping Good Records for Tax Season and Beyond

Good recordkeeping is essential for individuals and businesses before, during, and after the tax filing season.

First, the law actually requires taxpayers to retain certain records for a specified number of years, for example tax returns or employment tax records (for employers).

Second, good recordkeeping is essential for taxpayers while preparing their tax returns. The Tax Code frequently requires taxpayers to substantiate their income and claims for deductions and credits by providing records of various profits, expenses and transactions.

Third, if a taxpayer is ever audited by the IRS, good recordkeeping can facilitate what could be a long and invasive process, and it can often mean the difference between no change and a hefty adjustment. Finally, business taxpayers should maintain good records that will enable them to track the trajectory of their success over the years.

Here you will find a sample list of various types of records it would be wise to retain for tax and other purposes:

Individuals
Filing status:
Marriage licenses or divorce decrees – Among other things, such records are important for determining filing status.

Determining/Substantiating income:
State and federal income tax returns – Tax records should be retained for at least three years, the length of the statute of limitations for audits and amending returns. However, in cases where the IRS determines a substantial understatement of tax or fraud, the statute of limitations is longer or can remain open indefinitely.

Paystubs, Forms W-2 and 1099, Pension Statements, Social Security Statements – These statements are essential for taxpayers determining their earned income on their tax returns. Taxpayers should also cross reference their wage and income reports with their final pay stubs to verify that their employer has reported the correct amount of income to the IRS.

Tip diary or other daily tip record – Taxpayers that receive some of their income from tips should keep a daily record of their tip income. Under the best circumstances, taxpayers would have already accurately reported their tip income to their employers, who would then report that amount to the IRS. However, mistakes can occur, and good recordkeeping can eliminate confusion when tax season arrives.

Military records – Some members of the military are exempt from state and/or federal tax; combat pay is exempt from taxation, as are veteran's benefits. (In many cases, a record of military service is necessary to obtain veteran's benefits in the first place.)

Copies of real estate purchase documents – Up to $500,000 of gain from the sale of a personal residence may be excludable from income (generally up to $250,000 if you are single). If you own a home that sold for an amount that produces a greater amount of gain, or if you own real estate that is not used as your personal residence, you will need these records to prove your tax basis in your home; the greater your basis, the lower the amount of gain that must be recognized.

Individual Retirement Account (IRA) records – Funds contributed to Roth IRAs and traditional IRAs and the earnings thereon receive different tax treatments upon distribution, depending in part on when the distribution was made, what amount of the contributions were tax deferred when made, and other factors that make good recordkeeping desirable.

Investment purchase confirmation records – Long-term capital gains receive more favorable tax treatment than short-term capital gains. In addition, basis (generally the cost of certain investments when purchased) can be subtracted from gain from any sale. For these reasons, taxpayers should keep records of their investment purchase confirmations.

Substantiating deductions:
Acknowledgments of charitable donations – Cash contributions to charity cannot be deducted without a bank record, receipt, or other means. Charitable contributions of $250 or more must be substantiated by a contemporaneous written acknowledgment from the qualified organization that also meets the IRS requirements.

Cash payments of alimony – Payments of alimony may be deductible from the gross income of the paying spouse

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if the spouse can substantiate the payments.

Medical records – Disabled taxpayers under the age of 65 should keep a written statement from a qualified physician certifying they were totally disabled on the date of retirement.

Records of medical expenses – Certain unreimbursed medical expenses in excess of 10 percent of adjusted gross income may be deductible.

Current health insurance policy – The new health care law requires most individuals to obtain minimum essential health coverage. If your employer has not provided you with records of coverage because you have your own policy, or for some other reason, you should be able to substantiate the amount of your coverage.

Mortgage statements and mortgage insurance – Mortgage interest, premiums paid toward mortgage insurance, and real estate taxes are generally deductible for taxpayers who itemize rather than claim the standard deduction.

Receipts for any improvements to real estate – Part or all of the expense of certain energy efficient real estate improvements can qualify taxpayers for one or more tax credits.

Businesses

Taxpayers are required by law to keep permanent books of account or records that sufficiently substantiate the amount of gross income, deductions, credits and other amounts reported and claimed on any their tax returns and information returns.

Although, neither the Tax Code nor its regulations specify exactly what kinds of records satisfy the record-keeping requirements, here are a few suggestions:

State and federal income tax returns – These and any supporting documents should be kept for at least the period of limitations for each return. As with individual taxpayers, the limitations period for business tax returns may be extended in the event of a substantial understatement or fraud.

Employment taxes – The Tax Code requires employers to keep all records of employment taxes for at least four years after filing for the 4th quarter for the year. Generally, these records would include wage payments and other payroll-related records, the amount of employment taxes withheld, reported tip income, identification information for employees and other payees; employees' dates of employment; income tax withholding allowance certificates (Forms W-4, for example), fringe benefit payments, and more.

Business income – These would go toward substantiating income, and could include cash register tapes, bank deposit slips, a cash receipts journal, annual financial statements, Forms 1099, and more.

Inventory costs – Businesses should keep records of inventory purchases. For example, if an electronics company purchases a certain number of widgets for resale or a manufacturer purchases a certain number of ball bearings for use in the production of industrial equipment that it manufactures and sells. The costs of these goods, parts, or other materials can be deducted from sales income to significantly reduce tax liability.

Business expenses – Ordinary and necessary expenses for carrying on business, such as the cost of rental office space, are also generally deductable from business income. Such expenses can be substantiated through bank statements, canceled checks, credit card receipts or other such records. The cost of making certain improvements to a business, such as through buying equipment or renovating property, can also be deductible.

Electronic back-up

Paper records can take up a great deal of storage space, and they are also vulnerable to destruction in fires, floods, earthquakes, or other natural phenomena. Because records are required to substantiate most income, deductions, property values and more, taxpayers (and especially business taxpayers) should digitize their records on an electronic storage system and keep a back-up copy in a secure location.

Keeping so many records can be tedious, but come tax season it can result in large tax savings. And in the case of an audit, evidence of good recordkeeping can get you off to a good start with the IRS examiner handling the case, can save time, and can also save money.

Solid Footing

Greater Pittsburgh Community Food Bank

During the holiday season many people strive to contribute back to the community. This past holiday season, Lally and Co. decided to give back in a new way. On December 9th, 2013, we closed the office to spend the day at the Greater Pittsburgh Community Food Bank, working in their repack center.

Approximately 7.2 million U.S. households are food insecure. This means they do not know where their next meal will come from. In addition, 6.4 million U.S. households suffer from hunger. In Pennsylvania, 494,600 households are food insecure. In an estimated 168,164 of these households, at least one member experiences hunger.

The Greater Pittsburgh Community Food Bank is an organization that collects and distributes food to southwestern Pennsylvania. Through an almost 400-member network, the Food Bank serves 11 counties and distributes 27 million pounds of food each year. The Food Bank serves 120,000 people per month in the greater Pittsburgh area. All of the food collected through various activities, such as food drives and fund raising, is collected and sorted in the 94,000 square foot warehouse, known as the repack center. The repack center is located in Duquesne, PA and this is where we spent our day repackaging food and household supplies to be distributed throughout the city.

We packaged a total of 14,360 pounds of products for those in need, which included 10,800 pounds of food, 1,080 pounds of cereal, 480 pounds of paper products, and 2,000 pounds of household items, such as soap and cleaning supplies. We also brought with us several donations from a food drive held within the office. Although just a small dent in the total amount of food needed, we hope our contributions touched at least some lives.

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