Lally&Co.
CPAs and Business Advisors

The EVERGREEN

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Winter 2015 – Volume XIII

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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 2014 Tax Filing Season.

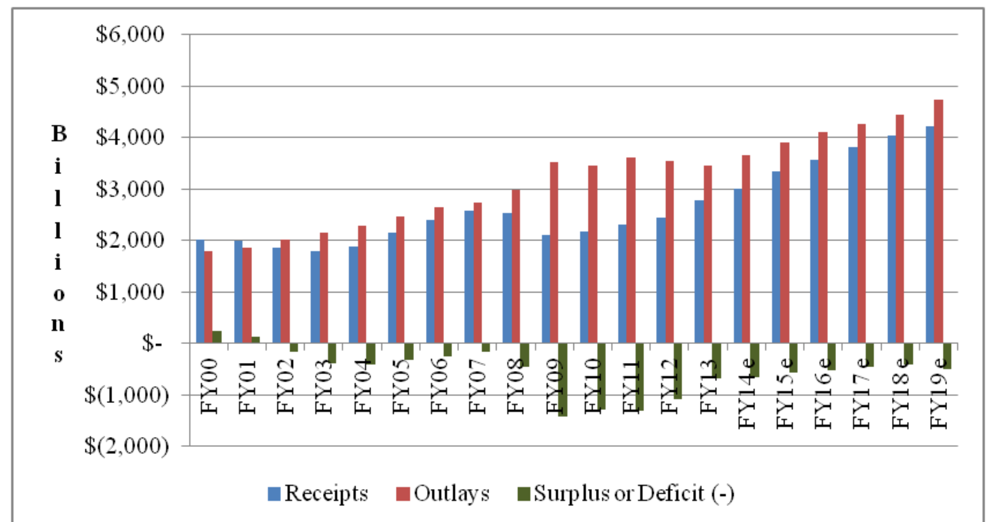
As you read through *The Evergreen*, please do not hesitate to contact us at any time. We would be happy to hear from you! This and past issues of *The Evergreen* are available on our website at http://lallycpas.com/newsletters/.

Deep Dive: US Government Receipts

In the Fall 2014 edition of *The Evergreen*, we promised a series of articles to explain the past and current economics of our great country. In that newsletter, we discussed our Federal government annual deficits (expenditures in excess of receipts) and debt (obligations of the Federal government to finance deficits and spending plans). In this article, we will be taking a deep dive into our Federal government's receipts and, in future editions we will discuss government spending, "quantitative easing", balances of trade, and other topics of interest. Our goal is to provide you with a basic understanding of the facts while minimizing political commentary that may otherwise cloud your understanding.

From 10,000 Feet

Actual receipts, outlays (expenditures), and deficits from FY00 through FY13, along with projections for FY14 through FY19 are depicted in the following chart.



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Firm Announcements

Anthony Jordan joined our Tax Department in November 2014

Drew Kretz, CPA joined our A&A Department in October 2014

Steven Kustra joined our Tax Department in January 2015

Kari Miller transferred from the A&A Department to the Tax Department as Administrative Support in September 2014

Important Dates

February 28, 2015 - 2014 Form 1099 Due

March 15, 2015 - 2014 Corporate Tax Returns Due

April 15, 2015 - 2014 Partnership, Individual, Trust, and Gift Tax Returns Due and 2015 1st Quarter Estimated Payments Due

May 15, 2015 - 2014 Foundation Tax Returns Due

Year-End Tax Legislation Renews Extenders, Cuts IRS Funding

The eleventh-hour votes of Congress in December renewed a package of tax extenders for 2014, created new savings accounts for individuals with disabilities, and cut the IRS' budget. At the same time, the votes helped to set the stage for the 114th Congress that convenes this month. Republicans have majorities in the House and Senate and have indicated that taxes are one of the top items on their agenda for 2015.

Extenders
The Tax Increase Prevention Act of 2014, signed into law by President Obama in December extends more than 50 individual, business and energy tax incentives retroactively to January 1, 2014. As a result, taxpayers can claim these incentives on their 2014 returns filed in 2015. The Act includes all of the popular incentives for individuals, such as the state and local sales tax deduction and higher education tuition deduction, as well as many business incentives, including the research tax credit, bonus depreciation and enhanced Code Sec.179 expensing. A handful of extenders were not renewed, mostly targeted to energy efficiency.

ABLE Act As part of the extenders package, Congress approved the Achieving a Better Life Experience (ABLE) Act of 2014. The Act establishes ABLE accounts for individuals with disabilities. Funds in ABLE accounts may be used for qualified expenses of persons with disabilities. To fund these accounts, the Act:

- Adjusts for inflation some civil tax penalties
- Authorizes the IRS to certify qualifying professional employer organizations
- Excludes dividends from controlled foreign corporations from the definition of personal holding company income
- Increases the IRS' levy authority on payments to Medicare providers
- Raises the Inland Waterways Trust Fund financing rate

IRS budget
The IRS goes into the 2015 filing season with a reduced budget. The omnibus spending agreement, signed into law by President Obama on December 16, cuts the IRS' fiscal year (FY) 2015 budget by some $345 million. The omnibus spending agreement also instructs the IRS to improve its response times in helping victims of identity theft and reduce refund fraud. In response to the budget cuts, IRS Commissioner John Koskinen said the agency will freeze hiring and take other steps to reduce expenses. Koskinen also cautioned that revenue collection and tax enforcement could be impaired by the budget cuts as the agency will have to make do with less. Taxpayer audits were singled out by Koskinen as one area where cutbacks could have a negative effect.

Affordable Care Act
Congress also clarified the status of so-called expatriate health plans under the Affordable Care Act. These plans cover very specific groups of people; including participants in a group health plan who are aliens residing outside the United States and U.S. nationals about whom there is a good faith expectation of being abroad, in connection with his or her employment, for at least 180 days in a 12-month period.

The omnibus spending agreement exempts expatriate health plans,

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employer sponsors of these plans, and insurance issuers providing coverage under these plans from the health care coverage requirements of the Affordable Care Act. Additionally, the omnibus spending agreement treats these plans as providing minimum essential coverage for purposes of the Affordable Care Act's individual mandate.

Multi-employer pension plans
The extenders package and the omnibus spending agreement amend the rules governing multi-employer pension plans. The provisions, supporters argued, are intended to shore-up many struggling plans. Opponents countered that the changes weaken protections for beneficiaries. The amendments to the multi-employer pension rules are very technical.

114th Congress
The Tax Increase Prevention Act did not extend the extenders beyond 2014. As of January 1, 2015, they all expired again. During 2014, proposals to extend the incentives for two years or make them permanent were floated in Congress. The GOP-controlled House vote to make permanent bonus depreciation, enhanced Code Sec. 179 expensing and some charitable giving breaks, but these bills were not taken up by the Democratic-controlled Senate. This could change in the 114th Congress. The new leaders of the tax-writing committees, Rep. Paul Ryan, R-Wisc., chair of the House Ways and Means Committee, and Sen. Orrin Hatch, R-Utah, chair of the Senate Finance Committee, have both indicated their interest in addressing the extenders as part of comprehensive tax reform.
Any movement toward comprehensive tax reform will require cooperation between the White House and the Republican-controlled Congress. In December, President Obama said that he would be willing to work with Republicans on corporate tax reform but any decrease in the corporate tax rate would need to be paid for by revenue raisers elsewhere. The President also said that he wants to preserve and make permanent some temporary enhancements to individual tax breaks, such as the earned income credit. New Senate Majority Leader Mitch McConnell, R-Ky., also said in December that he could work with the White House.

Top 10 Tax Developments of 2014 With Impact on 2015

2014 was a notable year for tax developments on a number of fronts. Selecting the "top ten" tax developments for 2014 necessarily requires judgment calls based upon uniqueness, taxpayers affected, and forward-looking impact on 2015 and beyond. The following "top ten" list of 2014 tax developments is such a prioritization. Nevertheless, other 2014 developments may prove more significant to any particular client, depending upon circumstances.

Passage of the Extenders Package
2014 was not a year for major tax legislation in Congress. In fact, Congress even failed to pass its usual two-year Extenders package, instead settling on a one-year retroactive extension to January 1, 2014. As one Senator put it, "This tax bill doesn't have the shelf life of a carton of eggs," referring to the fact that the 50-plus extenders provisions, signed by the President on December 19, 2014, expired again on January 1, 2015. Instead, it has been left to the 114th Congress to debate the extension of these tax breaks in 2015 and beyond, and for taxpayers to guess what expenses in 2015 will again be entitled to a tax break.

Affordable Care Act
In many ways, 2014 was a transition year for the Affordable Care Act. One of the most far-reaching requirements, the individual shared responsibility provision, took effect on January 1, 2014. Another key provision, the employer shared responsibility, was delayed (in 2013) to 2015. However, employer reporting under Code Sec. 6605 was not delayed. The IRS also issued guidance on the Code Sec. 36B premium assistance tax credit and other provisions of the Affordable Care Act. Meanwhile, the Supreme Court announced it would review a decision by the Fourth Circuit Court of Appeals upholding IRS regulations on the Code Sec. 36B premium assistance tax credit, a critical component to making the Affordable Care Act viable nationwide.

International Compliance
The IRS and Treasury increased their focus on requirements that U.S. taxpayers report foreign income and assets. The government took the final steps to implement the requirements for U.S. taxpayers and foreign financial institutions to report foreign assets under the Foreign Account Tax Compliance Act (FATCA). The government also tweaked its programs to induce U.S. taxpayers to report undisclosed income and assets from prior past years. At the same time, the IRS and the Department of Justice went to court to seek civil and criminal penalties, including jail time, against willful tax evaders.

Repair Regulations
In 2014, the IRS finished issuing the necessary guidance on the treatment of costs for tangible property under the sweeping so-called "repair" regulations, which impact most businesses. The most important development was the issuance of final regulations on the treatment of dispositions of tangible property under MACRS and under Code Sec. 168, including the identification of assets, the treatment of dispositions, and the

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computation of gain and loss, particularly in the context of general asset accounts (TD 9689). The IRS also issued several revenue procedures that granted automatic consent for taxpayers to change to the accounting methods allowed by the final regulations (including Rev. Proc. 2014-16 & 54).

IRS Operations
IRS Commissioner John Koskinen predicted a complex and challenging filing season due to cuts in the Service's funding. Koskinen highlighted the Service's having to do more with less because of reduced funding. In addition, the IRS is funded at $10.9 billion for FY 2015, which is $1.5 billion below the amount requested by the White House. The FY 2015 budget reduction "undercuts our ability to enforce the Tax Code," Koskinen said. "We will do everything we can to protect the integrity of the filing season." More budget cuts could cause "the wheels to start to fall off," he noted.

Net Investment Income (NII) Tax
Many higher-income individuals were surprised to learn the full impact of the net investment income (NII) tax on their overall tax liability only during the 2014 filing season when their 2013 returns were filed. Starting in 2013, taxpayers with qualifying income have been liable for the 3.8 percent net investment income (NII) tax. The threshold amounts for the NII tax are: $250,000 in the case of joint returns or a surviving spouse, $125,000 in the case of a married taxpayer filing a separate return, and $200,000 in any other case. Recent run ups in the financial markets, and the fact that the NII thresholds are not adjusted for inflation, have increased the need to implement strategies that can avoid or minimize the NII tax. Issues persist that reduce certainty surrounding NII tax liability, in particular determining how a taxpayer "materially participates" in an activity to the extent it is exempt from the NII tax.

Retirement Planning
A number of changes have been made during 2014 affecting IRAs and other qualified plans which, cumulatively, rise to the level of a "top tax development" for 2014:

- Notice 2014-54 now permits a distribution from a 401(k), 403(b) or 457(b) account to have the taxable and non-taxable portions of the distribution directed to separate accounts.

- TD 9673 now permits IRA holders and defined contribution plan participants to obtain a "longevity" annuity to help insure that they will not outlive their required minimum distributions (RMDs).

- Notice 2014-66 now permits 401(k) plans to offer deferred annuities through target date funds (TDFs).

- *Bobrow*, TC Memo. 2014-21, held that, in contrast to the IRS guidance in Publication 590, a taxpayer is limited to one 60-day rollover per year for all IRA accounts under the tax code rather than one 60-day rollover per year for each IRA account. The IRS in Announcement 2014-32 stated that the new interpretation of the rollover rules would be applied to rollover distributions received on or after January 1, 2015.

- *Clark v. Rameker,* a 2014 Supreme Court decision, found that inherited IRA accounts were not retirement assets and therefore not subject to creditor protection under the Bankruptcy Code.

Identity Theft
Although clearly not confined to the area of federal tax, identity theft has been a major issue for both the IRS and taxpayers. In 2014, the IRS put new filters in place and took other measures to curb tax-related identity theft. The agency also worked with software developers, financial institutions and the prepaid debit card industry to combat identity theft. "We rejected 5.7 million suspicious returns last year that may have been tied to identity theft," IRS Commissioner Koskinen said. Nevertheless, few believe that the IRS has yet turned the tide.

Same-sex Marriage
After the Supreme Court struck down Section 3 of the *Defense of Marriage Act* in *Windsor,* the IRS issued guidance in 2013 adopting a place of celebration approach to recognizing same-sex marriage. The IRS followed-up with additional guidance in 2014 that required employers to take note of *Windsor* with regard to workplace tax benefits. Notably, the IRS focused on what changes needed to be made to retirement plan benefits in light of *Windsor.*

Tax Reform
Although 2014 was clearly not the year for tax reform (despite some 2013 forecasts that it would be), the foundations for serious tax reform discussions were laid in 2013 and 2014, when Congressional hearings and studies took place. Looking ahead to 2015 and beyond, there is optimism that Congress will complete some form of tax reform in 2015 or 2016. The major difference of opinion, however, surrounds whether or not the reform would only address corporate tax provisions or also include individual provisions. Corporate reform has been pushed into the spotlight lately both by the controversy surrounding corporate inversions in changing foreign headquarters and by the general concern that American international business competitiveness is lessened by high U.S. corporate tax rates. House Ways and Means Committee Chairman Dave Camp, R-Mich., on

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the other hand has called for tackling comprehensive tax reform on both the business and individual side.
His Tax Reform Bill of 2014 (HR 1) would make the Code "more effective and efficient," according to Camp, by getting rid of narrowly targeted provisions to lower tax rates across the board. "This will enable small and large businesses alike to expand operations, hire new workers, and increase benefits and take-home pay," he said.

FAQ: What is the Business Standard Mileage Rate for 2015?

The IRS has announced an increase in the optional business standard mileage reimbursement rate for 2015. The business standard mileage rate increased by one and a half cents, to 57.5 cents (up from 56 cents for 2014). The 2015 standard mileage rate for medical and moving expenses decreased slightly to 23 cents (down from 23.5 cents for 2014). The charitable mileage rate, however, is set by statute at a flat 14 cents per mile without inflation adjustment each year. The revised rates apply to deductible transportation expenses paid or incurred for business or medical/moving expenditures, or qualified charitable miles driven, on or after January 1, 2015.

The IRS works with an independent contractor to establish the business, medical and moving expense standard rates. The IRS and the independent contractor take into account the fixed and variable costs of operating an automobile, such as fuel costs and maintenance expenses. The decline in fuel prices during 2014, however, was not reflected in the business standard mileage rate for 2015. Some practitioners have speculated this could indicate that the IRS does not expect the low gas prices to last. Alternatively, if prices continue to decline, the IRS could issue a mid-year adjustment of the rate during 2015.

Some background
The standard mileage rates for business use, medical and moving expenses, and charitable usage, may be used by an employee or self-employed taxpayer to compute the allowable deduction attributable to his or her business use of a car. Taxpayers also have the option of calculating the actual cost of operating a vehicle for business and deducting that amount, but using the standard mileage rate is the simplest method of computing automobile expenses because it simplifies the amount of required recordkeeping. This is because business standard mileage rate is designed to take into account costs such as maintenance and repairs, gas and oil, depreciation, insurance, and license and registration fees. For example, the depreciation component of the business standard mileage rate for 2015 will be 24 cents-per-mile, a two-cent increase from the 22-cents-per-mile rate that was effective for 2014.

Because depreciation and other costs are already factored into the standard rate, taxpayers using the standard mileage rate may not deduct depreciation, maintenance and fees, gasoline, insurance, or vehicle registration costs. The plus side is that standard mileage rate taxpayers do not need to maintain detailed records on these costs.

The taxpayer using the standard mileage rate need only keep a log of his or her business miles. To calculate the deduction, the taxpayer will multiply the standard mileage rate by the number of business miles traveled. Taxpayers using the standard rate may also deduct any business-related parking fees and tolls.

Requirements
Taxpayers must meet several requirements before they may use the business standard mileage rate. First, they must be either self-employed or an employee who has incurred automobile costs for business that were not reimbursed by the employer. The taxpayer must either own or lease the car. Additional requirements are listed in IRS Publication 463, Travel, Entertainment, Gift, and Car Expenses.

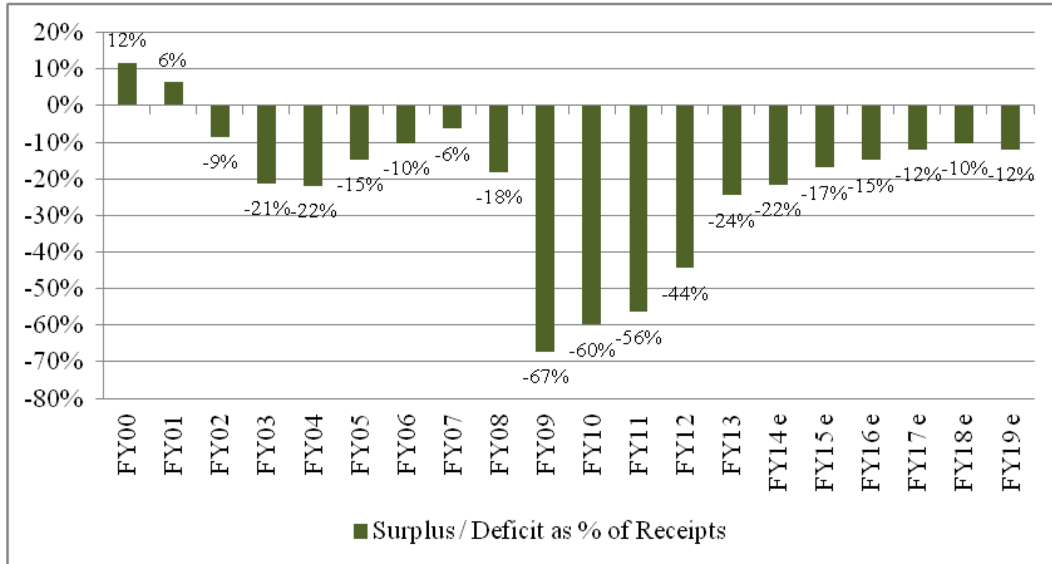
Certain types of travel are not considered deductible, however. For example the cost of commuting from the taxpayer's home to his or her place of business is considered nondeductible. In general, deductible transportation expenses are deemed ordinary and necessary costs of:

- Traveling from one workplace to another in the course of your business;
- Visiting clients or customers;
- Attending a business meeting away from your regular workplace; or
- Traveling from your home to a temporary workplace when a taxpayer has one or more regular places of work.

Fixed and variable rate (FAVR) allowance

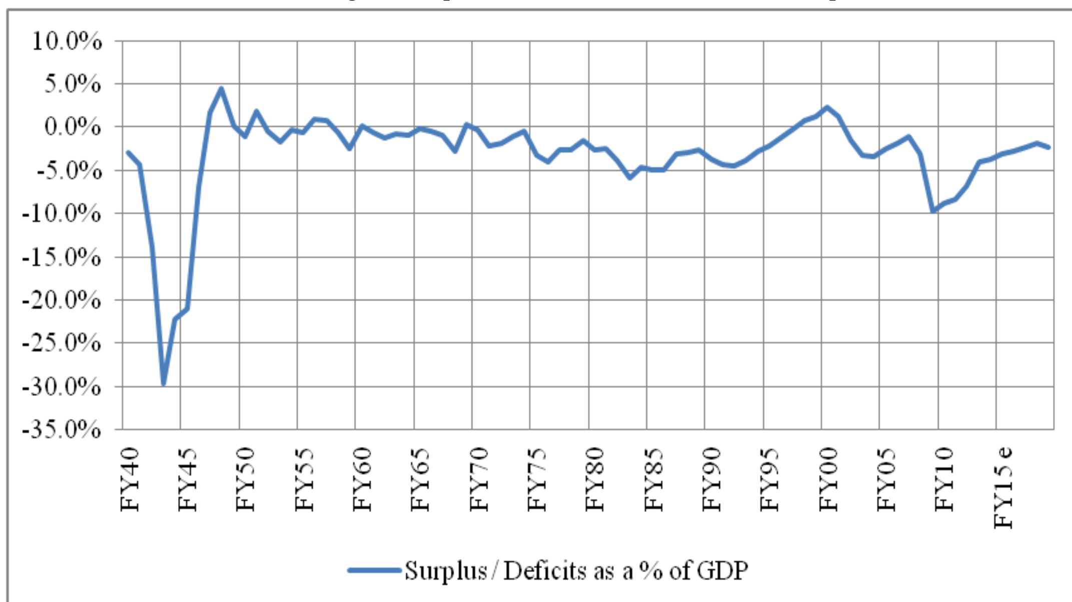
Taxpayers may also use the fixed and variable rate allowance to substantiate automobile expenses. Under the FAVR method, an employer reimburses the employee's expenses with a mileage allowance using a flat rate or stated schedule that combines periodic fixed and variable payments. For purposes of computing the allowance under a FAVR plan, the standard automobile cost may not exceed $28,200 for automobiles; but the rate increases to $30,800 for trucks and vans (up from $30,400 for 2014).

Annual surpluses / deficits, when expressed as a percentage of annual receipts, provide an additional measurement of the Federal government's finances.



For the 74 years from 1940 to 2013, the Federal government has experienced average annual deficits of 20.9% of annual receipts. During WWII (1940 to 1946), deficits were incurred to finance the pre-war production and war operations; deficits in these years averaged 103.4% of receipts (i.e. the US government spent twice as much as it collected). From post war through 1967, net deficits averaged 0.7% ("breakeven" budgets). In the 1970s, net deficits averaged 11.6% reflecting the impact of inflation and rises in oil prices. From 1980 through 1995, net deficits averaged 21.4% reflecting tax cuts early in President Reagan's administration and spending increases on defense ("Star Wars"). From 1996 through 2001, the Federal government ran cumulative surpluses of $4.0B which averaged 3.4% of receipts. The rise in the stock market flooded the US Treasury with tax revenues, and defense and welfare spending was slowed. Post 9/11 (2002 through 2008) has seen deficits returning due in large part to government expansion for Homeland Security and the two wars in the Middle East. Over the period, deficits averaged 14.5%. The "Great Recession" (2009-2013) put further pressure on the US government's finances with several stimulus spending initiatives resulting in average deficits at 50.4% of annual receipts.

In order for Federal deficits to be financed or reduced, the US economy (as measured by the Gross Domestic Product (GDP)) must be strong and expanding, which then promotes business profits and the resultant taxes on profits and taxable wages paid to employees. As such, another way to view Federal deficits is through a comparison with the GDP. For this comparison, our chart will go back to 1940.



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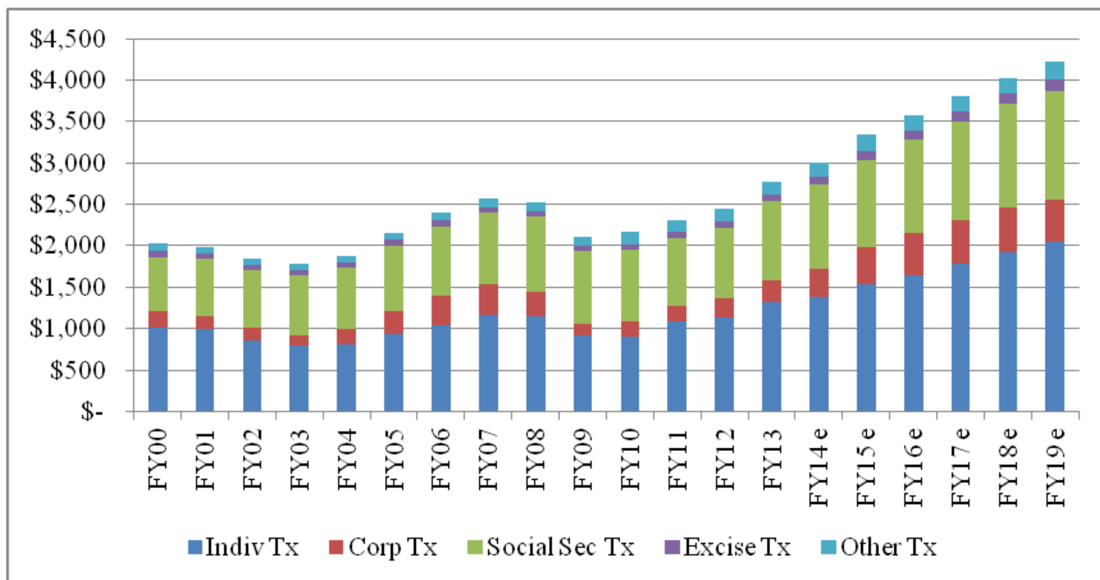
Over the same 74 years (1940 to 2013), the Federal government's annual deficits have averaged 3.2% of GDP. During WWII (1940 to 1946), deficits averaged 14.4% of GDP. From post war through 1967, deficits averaged 0.1%. In the 1970s, deficits averaged 2.0% and from 1980 through 1995 they averaged 3.7%. From 1996 through 2001, the Federal government's annual deficits averaged 0.7% of GDP and from 2002 through 2008 they averaged 2.4% of GDP. However, from 2009 to 2013, average annual net deficits have grown to 7.6% of GDP, the highest since the WWII buildup.

Let's take another look at the 2009 to 2013 period. The FY09 deficit was $1.4T (rounded from $1,412,700,000,000) and it remains the largest deficit in our history. Actual revenues ($2.1B) fell short of budget ($2.7B) due primarily to the failing economy. Business profits fell as unemployment skyrocketed resulting in lower business tax receipts and lower wages subject to taxes. On the expenditure side, FY09 had several un-budgeted spending plans which included the Troubled Asset Relief Program ("TARP" spending of $151B), American Recovery and Reinvestment Act of 2009 ("The Stimulus Package" spending of $253B), Car Allowance Rebate System ("Cash for Clunkers" spending of $3.0 B), and sundry other one-time spending ($14B). The Stimulus Package passed in FY09 provides for a total of $831B in spending from FY09 through FY19. FY10 through FY12 had roughly the same receipts and similar spending resulting in annual deficits exceeding $1.0B. FY13 had a 13.3% increase in receipts (see below) and 2.3% decrease in expenditures resulting in a $679.5T deficit.

Federal Receipts

In order to reduce deficits, the US government needs to either increase receipts or decrease outlays, or both. The components of actual receipts from FY00 through FY13, along with projected receipts for FY14 through FY19 are depicted in the following chart.



It is clear to see the relationship between expanding economies (FY04-FY08) and contracting economies (FY09-FY13) and their impact upon Federal receipts. Regarding FY13, individual and corporate tax receipts increased 16.3% and 12.9%, respectively, over FY12 due in part to increased business profits, wages, and tax rates. Individual income tax rates were increased for 2013 with the 39.6% incremental tax bracket and various new taxes as part of the "fiscal cliff" resolution.

The following chart depicts each component's percentage proportion of annual receipts over the same time period.

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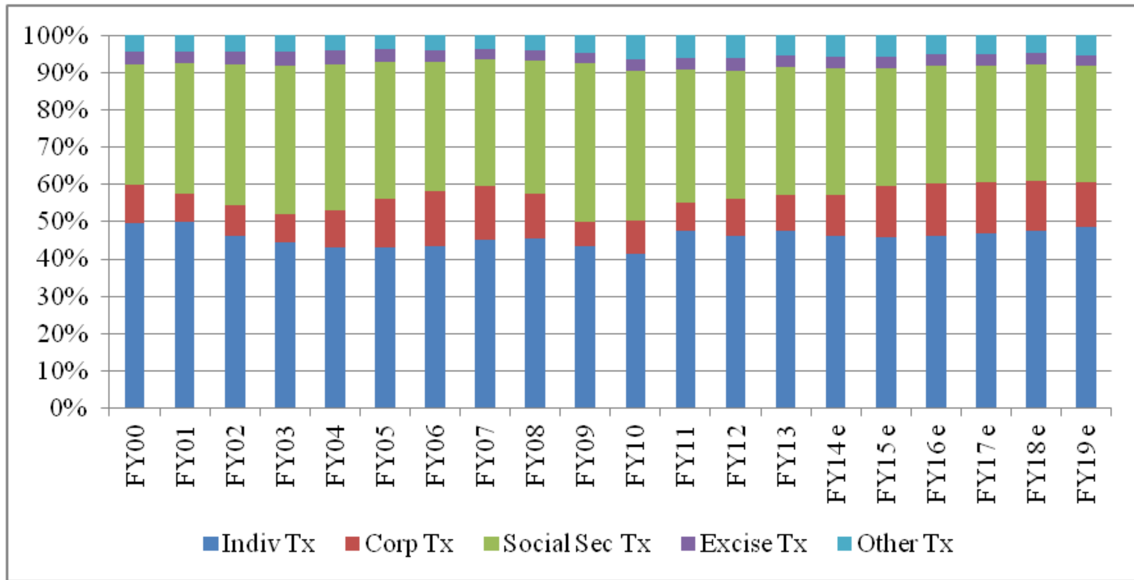
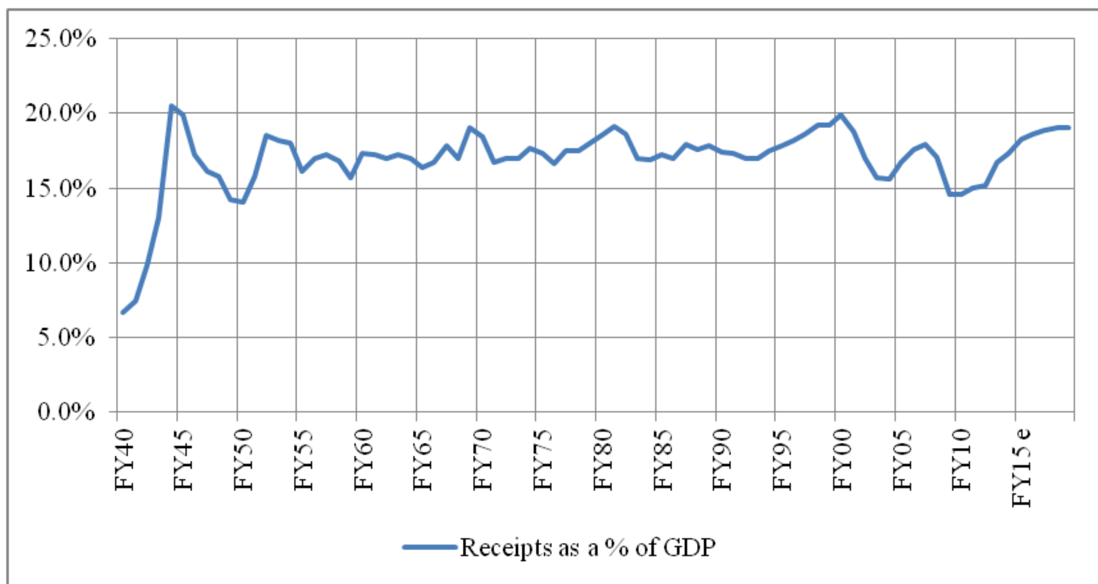


From FY00 through FY13, individual, corporate, and social security tax receipts have averaged 45.5%, 10.0%, and 36.5% respectively of total annual receipts. By FY19, the Office of Management and Budget (OMB) projects individual, corporate, and social security tax receipts to represent 48.4%, 12.2%, and 31.1%, respectively, of projected receipts.

For Federal receipts to be sustained the US economy needs to be strong and expanding, which promotes business profits and an increase in the standards of living. As such, another way to view Federal receipts is through a comparison with the GDP.



From 1940 to 2013, the Federal government's receipts have averaged 16.8% of GDP. During WWII (1940 to 1946), receipts averaged 13.5% of GDP. From post war through 1967, receipts averaged 16.7%. In the 1970s, receipts averaged 17.4% and from 1980 to 1995, they averaged 17.6%. From 1996 through 2001, the Federal government's receipts averaged 19.0% of GDP and contributed to the surpluses in those years. From 2002 through 2008, receipts averaged 16.8%, right on the 74-year average. However, the effects of the Great Recession (2009-2013) saw receipts drop to 15.2% of GDP.

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Getting Back to Normalcy

First of all, let's define "normal" as returning to the "norm", or acceptable behavior. In this discussion, we propose annual surpluses / deficits at +/- 0.5% of GDP is "acceptable behavior". To achieve this, current annual deficits must be reduced with expectations of generating annual surpluses in the next five years. Should you choose to believe them, the OMB is forecasting deficits of 2.7% of GDP over the next six years based on the key assumption of an expanding economy. If the economy stalls, the deficit will increase. If the economy grows faster than projected and expenditures remain steady, we can expect deficits to shrink.

So, just how long can we wait for the economy to make it back? How strong and for how long? Will deficits be reduced, taxes increased, or spending cut? While we ponder the answers to these questions, the US national debt stands at $18.1T (http://www.usdebtclock.org/) and the only viable means to paying that debt down is to run annual surpluses.

As I concluded last quarter, the trends of Federal deficits and debt growth are disturbing and need to be addressed. In certain circumstances, there are solid economic reasons why a country incurs both. However, most all economists agree now that the US government needs to return at least to historic levels before too long. Stay tuned.

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