TRADERS HAVE UNIQUE ISSUES FOR YEAR-END TAX PLANNING

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Robert Green's content

- Mr. Green is a leading authority on trader tax.

- He is the author of Green's 2018 Trader Tax Guide, which GreenTraderTax published as an annual tax guide every year since 1997. The 2018 edition discusses the Tax Cuts and Jobs Act's impact on investors, traders, and investment managers.

- Mr. Green has been a contributor to Forbes since 2010. Leading brokerage firms and other financial media feature Mr. Green's blog posts and Webinar content.

Webinar disclaimers

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Webinar description

- While the 2017 Tax Cuts and Jobs Act did not change trader tax status, Section 475 MTM, wash-sale loss rules on securities, and more, there is still plenty to consider.
- Our last Webinar How Traders Can Save Taxes Before Year-End covered critical moves to make before the calendar year expires.
- Join Robert A. Green, CPA in this Webinar for more action items to initiate sooner, rather than later.
- Learn how trader S-Corps must execute year-end payroll to unlock 2018 health insurance and retirement plan deductions. And, if you missed the boat for 2018, how to form an LLC with an S-Corp election that's ready for trading on January 1, 2019.

HOW TO AVOID WASH SALE LOSSES

Don’t get stuck with a higher tax liability caused by deferring wash sale losses to 2019.

Wash sale loss rules on securities

- Securities traders must comply with wash-sale loss rules, but the IRS makes it difficult by applying different standards for taxpayers vs. brokers on tax reports and Form 1099-Bs.

- Taxpayers must report wash sales on substantially identical positions across all accounts, whereas brokers report only identical positions per account.

- Active securities traders should use a trade accounting program or service to identify potential wash sale loss problems going into year-end.

How to avoid wash sale losses

- Break the chain by selling the position before year-end and not repurchasing a substantially identical position 30 days before or after in any of your taxable or IRA accounts.
- Starting a new entity effective January 1, 2019, can break the chain on individual account wash sales at year-end 2018 provided you don't purposely avoid wash sales with the related party entity.
- Avoid wash sales between taxable and IRA accounts throughout the year, as that is otherwise a permanent wash sale loss.

Converting 2018 wash sale losses into 2019 ordinary losses

- Wash sale losses might be preferable to capital loss carryovers at year-end 2018 for TTS traders.

- A Section 475 MTM election in 2019 converts year-end 2018 wash sale losses on TTS positions (not investment positions) into ordinary losses in 2019.

- That's better than a capital loss carryover into 2019, which might then give you pause to making a Section 475 election.

Prior year unrealized gains and losses

- If you elect Section 475 on securities for 2019 as an existing TTS trader, then unrealized gains and losses at year-end 2018 on TTS positions are a Section 481(a) adjustment with ordinary gain or loss treatment on January 1, 2019.

- That's another way to convert (unrealized) capital losses into ordinary losses in the subsequent tax year.

TAX-LOSS SELLING

Should you sell open positions before year-end?

- If you own an investment portfolio, you have the opportunity to reduce capital gains taxes via "tax-loss selling."

- You may wish to sell winning positions to accelerate income, perhaps to use up a capital loss carryover or an NOL or to use the standard deduction.

- TTS traders want a "clean slate" — meaning no capital loss carryovers — so they can make a Section 475 election in the subsequent tax year.

Avoid wash sale losses on tax-loss selling

- If you realized significant short-term capital gains year-to-date in 2018 and had open positions with substantial unrealized capital losses, you should consider selling (realizing) some of those losses to reduce 2018 capital gains taxes.
- It's commonly referred to as "tax-loss selling."
- Don’t repurchase the losing position 30 days before or after, as that would negate the tax loss with wash-sale-loss rules.

The 0% long-term capital gains bracket

- If you are in the lowest two “ordinary” tax brackets for 2018 (10% or 12%), try to take advantage of the 0% long-term capital gains rate.
- The 0% long-term capital gains rate applies on taxable income up to $38,600/$77,200 (single/married).
- For example, if your single taxable income is $30,000, you can realize $8,000 of long-term capital gains with zero federal income tax. (State tax rates may apply.)

Rules to prevent deferral of income

- The IRS has rules to prevent deferral of income and acceleration of losses in offsetting positions that lack sufficient economic risk.

- These rules include straddles, the constructive sale rule, and shorting against the box.

- Also, be aware of “constructive receipt of income” — you cannot receive payment for services, turn your back on that income, and defer it to the next tax year.

When tax-loss selling is not needed

- Tax-loss selling is inefficient for short-term positions that reduce long-term capital gains unless you want to avoid current year taxes at any cost.

- Tax-loss selling is a moot point with Section 1256 MTM and Section 475 MTM positions since they are mark-to-market positions reporting realized and unrealized gains and losses.

TRADER TAX STATUS

Trader tax status

- If you qualify for TTS (business expense treatment — no election needed) in 2018, accelerate trading expenses into that qualification period as a sole proprietor or entity.
- If you don't qualify until 2019, try to defer trading expenses until then.
- You may also capitalize and amortize (expense) Section 195 startup costs and Section 248 organization costs in the new TTS business, going back six months before commencement.
- TTS is a prerequisite for electing and using Section 475 MTM.

Section 475 MTM

- TTS traders choose Section 475 on securities for exemption from wash-sale rules and the $3,000 capital loss limitation. And, perhaps for the 20% QBI deduction if under the taxable income cap for a service business.
- Existing individual taxpayers had to elect Section 475 by April 17, 2018, for 2018 (March 15 for existing S-Corps and partnerships).
- If you missed the 2018 election deadline, then consider a 475 election for 2019. Capital loss carryovers are a concern.

Section 475 for a new entity

- A “new taxpayer” entity can elect Section 475 within 75 days of inception.
- But it’s too late to form a new trading entity by the middle of November 2018, and still qualify for TTS in that short period before year-end.
- Elect 475 once, and it applies in subsequent years in which you are eligible for TTS unless you revoke the election.

Net operating losses

- Section 475 ordinary losses and TTS business expenses contribute to net operating loss (NOL) carryforwards, which are limited to 80% of taxable income in the subsequent year(s).

- Get immediate use of NOLs with a Roth IRA conversion before year-end and other income acceleration strategies.

Excess business losses

- TCJA introduced an "excess business loss" (EBL) limitation of $500,000/$250,000 (married/other taxpayers), per tax year.

- Aggregate EBL from all pass-through businesses: A profitable company can offset another business with losses to remain under the limit.

- EBL is an NOL carryforward. For example, if a single TTS/475 trader has an ordinary loss of $300,000, his EBL is $50,000, and it's an NOL carryforward.

2018 S-CORP

If you have an S-Corp in 2018, there are several vital transactions to execute before year-end.

2018 S-Corp year-end planning

- TTS traders use an S-Corp trading company to arrange health insurance and retirement plan deductions.

- The S-Corp must execute officer compensation, in conjunction with these employee benefit deductions, through formal payroll tax compliance before year-end.

- TTS is an absolute must since an S-Corp investment company cannot have tax-deductible wages, health insurance, and retirement plan deductions.

Health insurance, retirement plan, and QBI deductions

- The S-Corp may only deduct health insurance for the months the entity was operational and qualified for TTS. The health insurance component of officer wages is not subject to payroll taxes.

- An S-Corp formed later in the year can unlock a retirement plan deduction for an entire year by paying sufficient officer compensation in December when results for the year are evident.

- Another reason to create officer compensation is to increase the potential 20% QBI deduction if you are in the phase-out range subject to the 50% wage limitation.

Sole proprietors and partnerships

- TTS traders organized as a sole proprietorship (an unincorporated business), cannot have health insurance and retirement plan deductions because they don't have self-employment income (SEI) from trading income.

- A TTS partnership faces obstacles in attempting to arrange health insurance and retirement plan deductions because the partnership passes through expenses for reducing SEI, whereas, an S-Corp does not pass through expenses or losses for SEI — that's why the S-Corp works for traders.

SOLO 401(K) RETIREMENT PLAN

A Solo 401(k) retirement plan for a TTS S-Corp must be established with a financial intermediary before year-end.

Solo 401(k) retirement plan: elective deferral

- Plan to pay the 2018 elective deferral (ED) up to a maximum $18,500 (or $24,500 if age 50 or older) executed with December payroll. The ED payment is due by January 31, 2019.

- The ED portion is 100%-deductible, so you only need wages up to $18,500. This portion of gross wages is subject to payroll taxes: 12.4% FICA on the SSA limit of $128,400, and 2.9% Medicare tax is unlimited.

- With a tax-deductible Solo 401(k), income tax savings should exceed payroll tax costs.

- You can also choose a Solo 401(k) Roth without an income limit. Sacrifice a tax deduction on the contribution for permanent tax-free status.

Solo 401(k) retirement plan: profit-sharing plan

- Plan to pay the 25%-deductible profit-sharing plan (PSP) up to a maximum of $36,500, by the due date of the 2018 S-Corp tax return, including extensions, which means Sept. 15, 2019.

- The maximum PSP contribution requires wages of $146,000 for 2018 ($36,500 divided by 25% defined contribution rate.)

- The maximum 2018 Solo 401(k) ED and PSP contribution is $55,000; and $61,000 including the age 50 catch-up provision.

- For 2019, the ED limit is $19,000, and PSP is $37,000 for a total of $56,000; and $62,000 including the age 50 catch-up provision. 2019 wages required for the limit are $148,000.

2019 ENTITY FORMATION

If you want an entity for 2019, consider getting started in December 2018 to be ready to trade on January 1, 2019.

2019 S-Corp formation

- If you missed out on employee benefits in 2018, then consider an LLC with S-Corp election for 2019.
- Starting 2019 with trading in the new S-Corp is beneficial. That breaks the chain on wash sales with your individual account at year-end 2018.
- If you start later, you will have tax compliance for your individual return and S-Corp return in dealing with broker 1099-Bs and more.

Strategy to be ready to trade on January 1, 2019

- If you wait to start your entity formation process on January 1, 2019, you won't be ready to trade in an entity account on January 1, 2019.

- Instead, you can form a single-member LLC (SMLLC) in December 2018, obtain the employee identification number (EIN) at irs.gov, and open the entity brokerage account before year-end.

- The SMLLC is a "disregarded entity" for 2018, which means you don't have to file an entity tax return for the 2018 short-year.

Partnership or S-Corp for 2019

- If desired, add your spouse as a member of the LLC on January 1, 2019, which means the LLC will file a partnership tax return.

- If you want health insurance and retirement plan deductions for 2019, then your LLC should submit an S-Corp election for 2019 by March 15, 2019.

- The partnership or S-Corp should consider making an internal Section 475 MTM election on securities for 2019 by March 15, 2019. (It qualifies as a new taxpayer for 2019.)

QUESTIONS & ANSWERS

Closing Remarks

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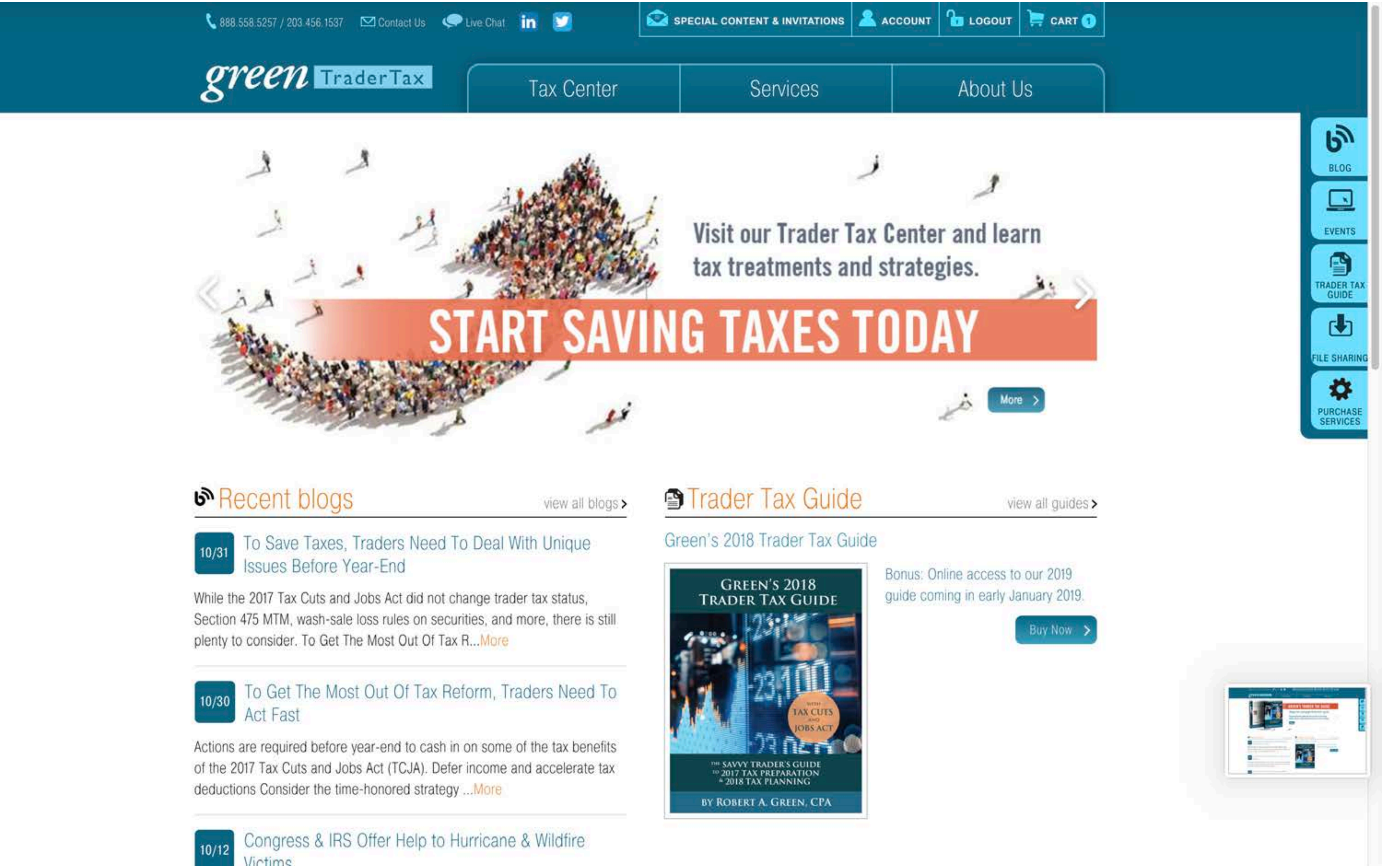
- Email us your questions at info@greentradertax.com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