# TAX PLANNING AT YEAR-END GENERATES THE MOST SAVINGS

green TraderTax

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# Robert A. Green bio

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GNM TraderTax

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# Webinar description

- Join Robert A. Green, CPA of GreenTraderTax.com, in his informational Webinar on year-end tax planning for traders, individuals, and entities.
- Don’t ignore 2019 taxes until tax-time in March and April.
- For investors seeking to reduce 2019 tax liabilities, they should consider various transactions and strategies before the year-end.
- That’s when it counts the most!

 

# DEFER INCOME

# Defer income

- Consider the time-honored strategy of deferring income and accelerating tax deductions if you don't expect your taxable income to decline in 2020.

- Taxpayers with trader tax status in 2019 should consider accelerating trading business expenses, such as purchasing business equipment with full expensing.

# Itemized deductions

- Don’t assume that accelerating itemized deductions is also a smart move; there may be two problems.

- TCJA suspended and curtailed various itemized deductions after 2017, so there is no sense in expediting a non-deductible item.

- Consider “bunching” itemized deductions into one year and take the standard deduction in other years.

# ACCELERATE INCOME

# Accelerate income to use NOLs

- A TTS trader with substantial ordinary losses under the "excess business loss limitation" should consider accelerating income to soak up the allowable business loss, instead of having an NOL carryover.

- Convert a traditional IRA into a Roth IRA before year-end to accelerate income to offset with the allowed business loss. Otherwise, Roth IRA conversion income is taxable income.

# Example

- A taxpayer filing single has a $405,000 TTS/475 ordinary loss.

- However, the excess business loss limitation is $255,000, and $150,000 is an NOL carryover.

  Consider a Roth conversion to soak up most of the $255,000 allowed business loss, and leave enough income to use the standard deduction and lower tax brackets.

- This taxpayer did not have any wage income, which could be used to offset EBL before the limitation.

# Sell winning investment positions

- Consider selling long-term capital gain positions.

- The 2019 long-term capital gains rates are 0% for taxable income under $39,375 single, and $78,750 married filing jointly.

- The 15% capital gains rate applies to taxable income up to $434,550 for filing single and $488,850 married filing jointly.

- The top bracket rate of 20% applies above those amounts.

# BUSINESS EXPENSES AND ITEMIZED DEDUCTION VS. STANDARD DEDUCTION

# Business expenses

- TTS traders are entitled to deduct business expenses and home-office deductions from gross income.

- TCJA expanded full expensing of business property; traders can deduct 100% of these costs in the year of acquisition, providing they place the item into service before year-end.

- If you have TTS in 2019, considering going on a shopping spree before January 1. There is no sense deferring TTS expenses because you cannot be sure you will qualify for TTS in 2020.

# Employee business expenses

- Ask your employer if they have an “accountable plan” for reimbursing employee-business costs.
- You must “use it or lose it” before the year-end.
- TCJA suspended unreimbursed employee business expenses.
- A TTS S-Corp should use an accountable plan to reimburse employee business expenses since the trader/owner is an employee of the S-Corp.

# Standard deduction

- The 2019 standard deduction is $12,200 single, $24,400 married, and $18,350 head of household.
- There is an additional standard deduction of $1,300 for the aged or the blind.
- With the SALT cap of $10,000 and suspension of all miscellaneous itemized deductions subject to the 2% floor, many more taxpayers will use the standard deduction.

# ESTIMATED INCOME TAXES

# Q4 2019 estimated tax payments

- Many traders skip making quarterly estimated tax payments during the year, figuring they might incur trading losses later in the year.

- Catch up with the Q4 estimates due by January 15.

- Consider the safe harbor exception to cover prior year tax liabilities.

# AVOID WASH SALE LOSS ADJUSTMENTS

 

# Wash sale loss adjustments

- Taxpayers must report wash sale (WS) loss adjustments on securities based on substantially identical positions across all accounts, including IRAs.
- Conversely, broker 1099Bs assess WS only on identical positions per the one account.
- Active securities traders should use a trade accounting program or service to identify potential WS loss adjustments, especially going into year-end.

# Avoid WS losses

- In taxable accounts, a trader can 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 his taxable or IRA accounts.

- Avoid WS between taxable and IRA accounts throughout the year, as that is otherwise a permanent WS loss.

- Starting a new entity effective January 1, 2020, can break the chain on individual account WS at year-end 2019 provided you don't purposely avoid WS with the related party entity.

# WS losses vs. capital loss carryovers

- WS losses might be preferable to capital loss carryovers.
- A Section 475 election in 2020 converts year-end 2019 WS losses on TTS positions into ordinary losses in 2020.
- That's better than a capital loss carryover into 2020.
- See How To Avoid Taxes On Wash Sale Losses.

# TRADER TAX STATUS AND SECTION 475

 

# Trader tax status

- If you qualify for TTS in 2019, accelerate trading expenses into that qualification period as a sole proprietor or entity.
- If you don't qualify until 2020, try to defer trading expenses until then.
- You may also capitalize and amortize startup costs and organization costs in the new TTS business, going back six months before commencement.
- See How Traders Get Enormous Tax Deductions, And Investors Do Not.

 

# Section 475 MTM

- TTS traders choose Section 475 on securities for exemption from wash-sale loss rules and the $3,000 capital loss limitation — and to be eligible for the 20% QBI deduction.

- To make a 2019 Section 475 election, existing individual taxpayers had to file an election statement with the IRS by April 15, 2019 (March 15 for existing S-Corps and partnerships).

# Section 481(a) adjustment

- If you make a 2020 Section 475 election by April 15, 2020, it takes effect on January 1, 2020.
- In converting from the realization (cash) method to the mark-to-market (MTM) method, you need to make a Section 481(a) adjustment on January 1, 2020.
- It’s unrealized capital gains, and losses on open TTS securities positions held on December 31, 2019.

 

# New taxpayer 475 election

- A “new taxpayer” entity can elect Section 475 within 75 days of inception.

- That would come in handy if you missed the individual sole proprietor deadline (April 15, 2019) for choosing Section 475.

- Forming a new entity on November 1, 2019, or later, is too late for establishing TTS for the 2019 short calendar year.

- Consider waiting until January 1, 2020, for starting a new entity with TTS and electing Section 475.

# 20% DEDUCTION ON QUALIFIED BUSINESS INCOME

# QBI deduction for TTS traders

- Traders eligible for TTS are a “specified service activity,” which means if their taxable income is above an income cap, they won’t receive a QBI deduction.
- The 2019 taxable income (TI) cap is $421,400/$210,700 (married/other taxpayers).
- The phase-out range below the cap is $100,000/$50,000 (married/other taxpayers), in which the QBI deduction phases out for specified service activities.
- The W-2 wage and property basis limitations also apply within the phase-out range.

# QBI includes Section 475 income

- QBI includes Section 475 ordinary income and loss, and trading business expenses.
- QBI excluded capital gains and losses, Section 988 forex and swap ordinary income or loss, dividends, and interest income.
- See A Rationale For Using QBI Tax Treatment For Traders.

# QBI wage limitation

- TCJA favors non-service businesses, which are not subject to an income cap. The W-2 wage and property basis limitations apply above the 2019 TI threshold of $321,400/$160,700 (married/other taxpayers).

- If taxable income falls within the phase-out range for a specified service activity, or even above for a non-service business, you might need higher wages, including officer compensation, to avoid a W-2 wage limitation on the QBI deduction.

- Your last chance to increase wages is by December 31.

# EXCESS BUSINESS LOSSES & NOLS

# Excess business losses

- The "excess business loss" (EBL) limitation for 2019 is $510,000/$255,000 (married/other taxpayers).
- Aggregate EBL from all pass-through businesses: A profitable company can offset another business with losses to remain under the EBL limitation.
- Include wage income in aggregate EBL. Other types of income and non-business losses do not affect the EBL calculation (i.e., capital gains and losses).
- EBL over the limit is an NOL carryforward.

# Example of EBL limitation

- TTS/475 trader filing single has an ordinary loss of $500,000 for 2019. It’s considered a business loss.
- He has income from wages of $100,000, so his net EBL is $400,000.
- The 2019 EBL limitation is $255,000.
- The 2019 NOL carryover to 2020 is $145,000 ($400,000 minus $255,000).

 

# Net operating losses

- Section 475 ordinary losses and TTS business expenses contribute to net operating loss (NOL) carryforwards.
- NOL carryforwards are limited to 80% of taxable income in the subsequent year(s).
- TCJA repealed NOL carrybacks after 2017 with one exception; farmers may carry back an NOL two tax years.
- TCJA made NOL carryforwards unlimited, changing the carryforward period from 20 years.

 

# S-CORP

# S-Corp officer compensation

- A TTS S-Corp pays officer compensation to deduct the owner’s health insurance and/or a retirement plan contribution.
- These “employee deductions” require earned income or self-employment income, and trading gains are not that.
- S-Corp salary is considered earned income.
- TTS sole proprietorships and partnerships cannot pay wages to the owners.

 

# Health insurance deduction

- The TTS S-Corp reimburses health insurance premiums through officer compensation, and there are no offsetting payroll taxes.

- You may only deduct health insurance for the months the S-Corp was operational and qualified for TTS.

- Employer-provided health insurance, including Cobra, is not deductible.

 

# Solo 401(k) elective deferral

- You must establish (open) a Solo 401(k) retirement plan for a TTS S-Corp with a financial intermediary before the year-end 2019.

- Plan to pay the 2019 100%-deductible elective deferral amount up to a maximum of $19,000 (or $25,000 if age 50 or older) with December payroll.

- That elective deferral is due by the end of January 2020.

# Solo 401(k) profit sharing plan

- You can fund the 25% profit-sharing plan (PSP) portion of the S-Corp Solo 401(k) up to a maximum of $37,000 by the due date of the 2019 S-Corp tax return, including extensions, which means September 15, 2020.

- The maximum PSP contribution requires wages of $148,000 ($37,000 divided by 25% defined contribution rate).

- Traders should only fund a retirement plan from trading income, not losses.

# Setting up a TTS S-Corp for 2020

- If you wait to start your entity formation process on January 1, 2020, you won’t be ready to trade in an entity account on January 1, 2020.

- Form a single-member LLC by December 2019, obtain the employee identification number (EIN), and open the LLC brokerage account before year-end.

- The single-member LLC is a “disregarded entity” for 2019, which avoids an entity tax return filing for the 2019 partial year.

# Setting up a TTS S-Corp for 2020

- If desired, add your spouse as a member of the LLC on January 1, 2020, which means the LLC will file a partnership return.

- If you want health insurance and retirement plan deductions, then your single-member or spousal-member LLC should submit a 2020 S-Corp election by March 15, 2020.

- The partnership or S-Corp should also consider making a Section 475 MTM election on securities only for 2020 by March 15.

# TAX-LOSS SELLING OF FINANCIAL INSTRUMENTS

# Tax-loss selling

- If you own securities or cryptocurrencies, you have the opportunity to reduce capital gains taxes via “tax-loss selling.”

- If you realized significant short-term capital gains year-to-date in 2019 and have open positions with substantial unrealized capital losses, you should consider selling (realizing) some of those losses to reduce 2019 capital gains taxes.

- Don’t repurchase the losing securities positions 30 days before or after, as that would negate the tax loss with wash-sale loss rules.

 

# Anti-abuse rules

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

# MISCELLANEOUS CONSIDERATIONS FOR INDIVIDUALS

 

# Miscellaneous strategies

- Sell off passive-loss activities to utilize suspended passive-activity losses.

- Maximize contributions to retirement plans. That lowers AGI and other income thresholds, which can unlock more of a QBI deduction, reduce net investment tax, and unlock credits and other tax benefits.

- Consider non-deductible IRA contributions.

# Charitable itemized deductions

- Consider a charitable remainder trust to bunch philanthropic contributions for itemizing deductions.

- Donate appreciated securities to charity: You get a charitable deduction at the FMV and avoid capital gains taxes. (This is a favorite strategy by billionaires, and you can use it, too.)

# Qualified charitable distributions

- Retirees must take required minimum distributions (RMD) from traditional retirement plans by age 70½ unless it's a Roth IRA.
- Per TCJA, consider directing your traditional retirement plan to make "qualified charitable distributions" (QCD).
- That satisfies the RMD rule with the equivalent of an offsetting charitable deduction, allowing you to take the standard deduction rather than itemize charitable contributions.

# Family considerations

- Section 529 qualified tuition plans now can be used to pay for tuition at an elementary or secondary public, private or religious school, up to $10,000 per year (check with your state).

- The 2019 annual gift exclusion is $15,000, and its $155,000 to noncitizen spouses; the 2019 unified credit for federal estate tax is $11.40 million per person, and "step-up in basis" rules still avoid capital gains taxes on inherited appreciated property.

- TTS traders should also consider hiring adult children as employees. (See How To Save Taxes With Children.)

# Qualified Opportunity Zones

- TCJA created Qualified Opportunity Zones (QOZ) "to spur economic development and job creation in distressed communities throughout the country and U.S. possessions by providing tax benefits to investors who invest eligible capital into these communities. Taxpayers may defer tax on eligible capital gains by making an appropriate investment in a Qualified Opportunity Fund and meeting other requirements," per Opportunity Zones Frequently Asked Questions.)

 

# QUESTIONS AND ANSWERS

# Closing Remarks

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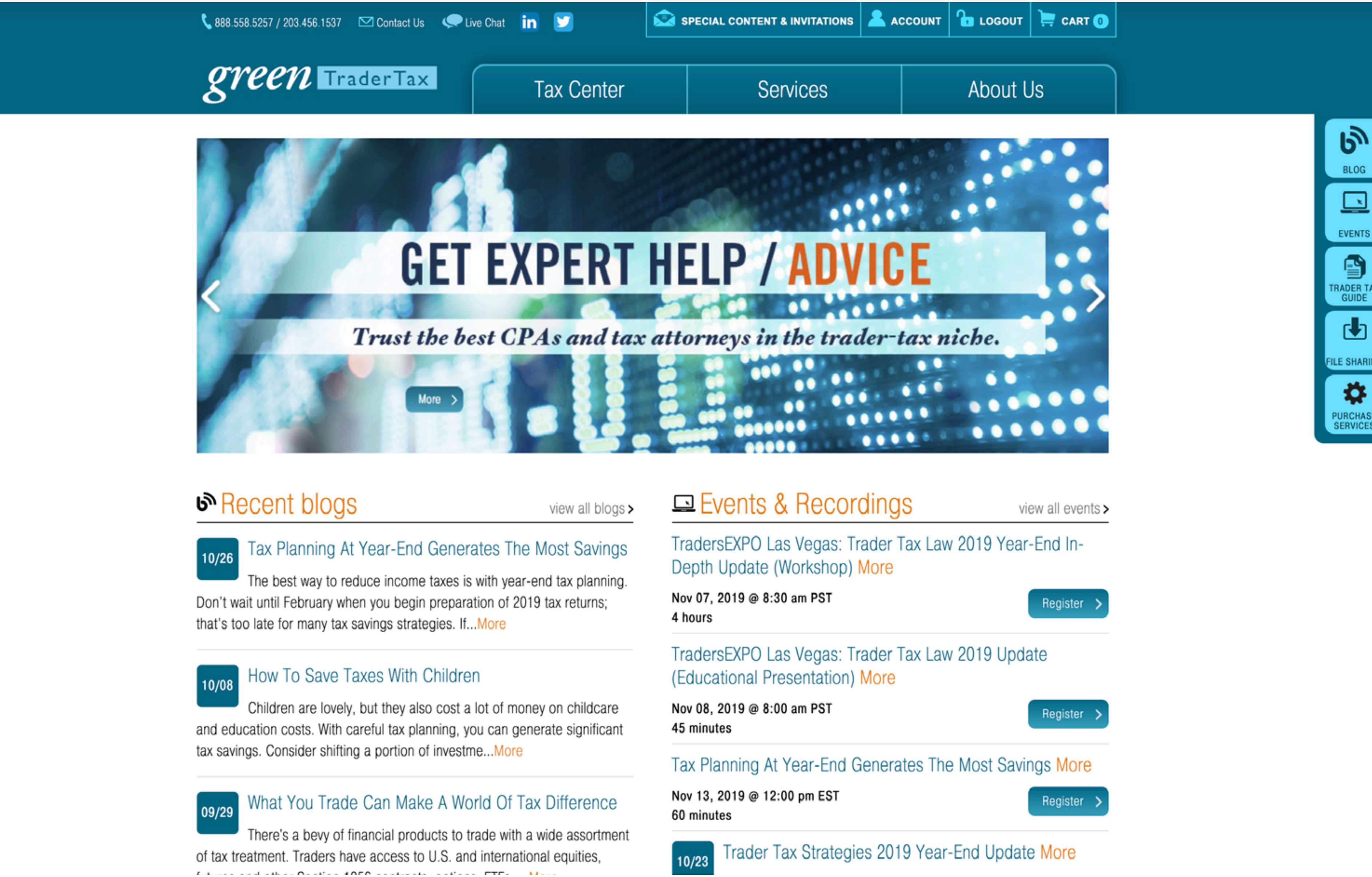

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