LAST-MINUTE TAX TIPS & EXTENSIONS FOR TRADERS

greenTraderTax

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Webinar description (1)

- Many traders are filing 2019 individual income tax returns or automatic extensions, and 2020 Section 475 elections, close to July 15, 2020, the postponed tax deadline.
- Last-minute tax tips.
- How to benefit from filing an extension for three additional months until October 15, 2020, for filing your tax return, but not for paying taxes due.
- Options if you cannot pay the IRS what you owe.

Webinar description (2)

- The IRS also postponed Q1 and Q2 2020 estimated tax payments until July 15, 2020.

- Should you file a 475 election for 2020 by July 15, 2020?

- The CARES Act positively impacts traders for 2018, 2019, and 2020. CARES suspended the excess business loss limitation and allowed five-year NOL carrybacks and or 100% NOL carryforwards.

Webinar description (3)

- CARES tax relief and economic aid that applies to traders.

- Learn current developments on pending further Covid-19 tax legislation.

IRS MOVED APRIL 15 TAX DEADLINE TO JULY 15

IRS moved April 15 tax deadline to July 15

- Congress postponed the tax filing and payment deadline from April 15 to July 15, 2020, for 2019 individual tax returns, extensions, and 2020 elections (i.e., Section 475). That’s good news for sole proprietor traders.

- The July 15 deadline also applies to calendar-year 2019 C-Corps, U.S. residents abroad, estates, trusts, gift tax returns, information returns, IRA, and HSA contributions originally due April 1, or later.

IRS confirmed July 15 deadline

- June 29: “IRS today announced the tax filing and payment deadline of July 15 will not be postponed.

- Individual taxpayers unable to meet the July 15 due date can request an automatic extension of time to file until Oct. 15 – it is not an extension to pay any taxes due.

- For people facing hardships, including those affected by COVID-19, who cannot pay in full, the IRS has several options available to help.”

- Taxpayers should file by July 15 tax deadline; automatic extension to Oct. 15 available.

Partnerships and S-Corps

- Calendar-year 2019 partnership and S-Corp tax returns and 2020 Section 475 elections for partnerships and S-Corps were due March 16, 2020.
- These pass-through tax returns and entity 475 elections are not eligible for the July 15 postponement deadline because the March 16 deadline was before April 1.
- IRS virus relief guidance mentions pass-through entities, but that's for a fiscal-year partnership or S-Corp tax return due on or after April 1, 2020.

Partnerships and S-Corps

- Traders have calendar-year partnerships and S-Corps, so their entities are not eligible for the July 15 postponement relief.

- Some asked our firm if their existing partnership or S-Corp could take advantage of the postponed deadline for making a 2020 Section 475 MTM election. The answer is no.

Extensions for individual taxpayers

- If you need more time to file your 2019 individual income tax return, file an automatic extension (Form 4868) for three additional months until October 15, 2020.

- If you cannot pay the taxes you owe for 2019, then it's essential to file the one-page extension to avoid IRS late-filing penalties of 5% per month for up to five months.

- The IRS charges this penalty based on the tax balance due.

Extensions for individual taxpayers

- On Form 4868, enter your estimate of total tax liability for 2019, total 2019 payments, including overpayment credits, balance due, and the amount you’re paying.
- “If your return is more than 60 days late, the minimum penalty is $330 (adjusted for inflation) or the balance of the tax due on your return, whichever is smaller.”
- Even if you cannot pay any amount due, filing the extension on time avoids the late-filing penalty.

IRS late-payment penalties

- The IRS also charges late-payment penalties if the taxpayer does not pay at least 90% of their 2019 tax liability by the postponed deadline of July 15, 2020.
- The late-payment penalty is 0.5% per month, for up to five months, for a maximum of 2.5%. It’s ten times less than the late-filing penalty.
- For example, if the taxpayer owes $50,000 by July 15 but doesn’t pay it until October 15, 2020, the total penalty is $750 (three months of 0.5% equals 1.5% times $50,000).

Reasonable cause to avoid penalties

- The IRS allows the taxpayer to request abatement of late-payment and late-filing penalties based on a “reasonable cause.”

- Contracting coronavirus in your family or being negatively impacted by the virus might constitute a reasonable cause.

Reasonable cause to avoid penalties

- “Attach a statement to your return, fully explaining the reason. Don’t attach the statement to Form 4868.”
- The IRS calculates penalties and interest based on the tax payment paid after July 15.
- The IRS does not forgive interest charges.

IRS payment extensions & arrangements

- Short-Term Payment Extension. If you are temporarily unable to pay your tax liability, you may be eligible for a short-term extension of time to pay of up to 120 days.
- Six-Month Payment Extension. If you can establish that timely payment would result in “undue hardship,” you may be able to obtain a longer term extension of time to pay of up to six months.
- **Installment Agreements.** If you cannot fully pay within 120 days, you may be able to pay in monthly installments. You will be charged interest and may be charged a late payment penalty on any tax not paid by its due date.
- There are several types of installment agreements.

Tax refunds with interest

- According to Bloomberg Tax, “For some people who took advantage of the extension to July 15, their postponement may deliver them a bonus. The IRS said that if they are owed a refund, they may also get a second check this year.

- Individuals eligible for a refund who didn’t receive one by April 15 will get interest—5% through June 30 and 3% after that.”

Section 475 election

- TTS traders as sole proprietor individuals have until July 15, 2020, to elect Section 475 on securities and or commodities (Section 1256 contracts) for 2020.

- Attach a 2020 Section 475 election statement to your 2019 income tax return or extension. Follow our special procedure if you already filed.

- See the next section for more information on 475.

2020 estimated taxes

- Treasury also postponed Q1 and Q2 quarterly estimated tax payments for 2020 until July 15, 2020. The original due dates were April 15 for Q1 and June 15 for Q2.
- Third and fourth quarters keep their original due dates of September 15, 2020, and January 15, 2021, respectively.
- Mark your payment memo "2020 Form 1040-ES," so the IRS does not confuse it with 2019 tax payments. You can combine Q1 and Q2 into one payment and voucher.
- Consider overpaying the 2019 extension, planning for an overpayment credit to apply to 2020 estimated taxes.

States also postponed the deadline

- All states with a personal income tax have extended their April 15 due dates.
- See AICPA state filing conformity chart that they update.
- Check if your state is decoupling from CARES, such as for NOL carrybacks. That's happened in prior stimulus legislation.

IRA, HSA, and Solo 401(k) contributions

- IRA and HSA contributions for 2019 are due July 15, 2020, the postponement deadline.

- SEP IRAs and Solo 401(k) contributions for 2019 are due by July 15, 2020, unless you file a 2019 tax extension, in which case the funding is due by October 15, 2020.

- How Recent Tax Relief & Aid Legislation Impacts Traders

CONSIDER A SECTION 475 ELECTION FOR TAX SAVINGS

Consider a section 475 election by July 15

- If you have 2020 YTD trading losses and are eligible for trader tax status (TTS) as a sole proprietor, consider a 475 election on securities and or commodities due by July 15, 2020, the postponed tax deadline.

- Many traders have massive trading losses in 2020, and they desperately need a 475 election for ordinary loss treatment to unlock NOL carryback refunds.

- Section 475 ordinary losses offset all types of income, which navigates around the $3,000 capital loss limitation.

Consider a section 475 election by July 15

- Section 475 securities trades are also exempt from wash-sale loss adjustments, which can create phantom income and capital gains taxes. I call Section 475, “tax loss insurance.”

- I generally recommend 475 for securities only to retain lower 60/40 capital gains rates on commodities (Section 1256 contracts).

- Section 475 does not apply to segregated investment positions so that you can enjoy deferral and long-term capital gains treatment, too. Be careful with segregation.

Elect 475 after using up capital loss carryovers

- If you have a significant capital loss carryover (CLCO) going into 2020 and have 2020 YTD capital gains as of July 15, 2020, consider skipping the 475 election to use up the CLCO.

- A CLCO does not offset 475 ordinary income, except for the $3,000 capital loss limitation.

- Take into consideration unrealized capital gains and losses on open investment and trading positions as of July 15. Perhaps, unrealized capital gains when sold can absorb a CLCO.

Entity provides "do-over" opportunities

- A new entity formation provides "do-over" opportunities on capital gains vs. 475 treatment.

- The "new taxpayer" can make an internal 475 election within 75 days of its inception.

- Discuss some examples of 475 decision making going into the July 15, 2020 deadline.

Segregate investment positions

- Be careful if you have an overlap on what you trade vs. your investment positions.

- For example, maybe you are long Apple equity as an investment with massive unrealized capital gains, and trade Apple options around that position to manage risk and collect the option premium.

- The IRS can play havoc by moving unrealized gains on the Apple investment position into 475 ordinary income or kicking 475 ordinary losses on trading Apple options into capital loss limitations.

Consider a TTS entity for segregation

- If you have an overlap between investments and trading; it's safer to ring-fence TTS/475 trading into an entity.
- However, there’s a potential problem: If you use portfolio margining and buying power on your investment positions to avoid “naked” options trading, then you need to retain investment positions in the same account you trade on.
- In that case, you will need to choose between Section 475 or portfolio margining.

QBI deduction on 475 income

- TCJA added a 20% deduction on “qualified business income” (QBI), including Section 475 income, net of TTS expenses. QBI excludes capital gains and portfolio income.
- Trading is a “specified service activity,” so you must be under the taxable income threshold of $326,600/$163,300 (married/other taxpayers) for 2020 to be eligible for the QBI tax deduction on TTS/475 income.
- A TTS S-Corp with wages also gets a QBI deduction in the phase-out range of $100,000/$50,000 (married/other taxpayers).

475 election procedure

- Be careful to follow the election rules properly.
- Attach a 2020 Section 475 election statement to your 2019 individual income tax return or extension filed by July 15, 2020.
- E-filing an extension is convenient, but taxpayers cannot attach an election statement to an e-filed extension.
- Print the extension, attach the election, and mail or fax them together to the IRS.
- If you already filed for 2019, consider our special procedure.

475 election statement

- Type the below statement on a sheet of paper with your name and social security number (or entity EIN) up top.

- "Under IRC 475(f), the Taxpayer at this moment elects to adopt the mark-to-market method of accounting for the tax year ended December 31, 2020, and subsequent tax years. The election applies to the following trade or business: Trader in Securities as a sole proprietor (for securities only and not Section 1256 contracts)."

- If you want the 475 election to apply to 1256 contracts, then revise the above wording.

Form 3115: Step two of the 475 process

- For Section 475 MTM elections filed with the IRS, this is just the first part of the election process - and the most crucial part.

- You also have to file a timely 2020 Form 3115 with your 2020 tax return in 2021 (with a duplicate copy to the IRS National Office).

- Form 3115 includes the Section 481(a) adjustment.

475 election mechanics

- If you are ready to file your tax return by July 15, there might be a problem: Most tax preparation software programs for consumers don’t include 475 elections.
- Either mail the 2019 tax return with 2020 Section 475 election statement attached, or e-file the tax return and send the election to the IRS separately by July 15.
- See more information on TTS and 475 in *Green’s 2020 Trader Tax Guide*, chapters 1 and 2.

CARES ALLOWS FIVE-YEAR NOL CARRYBACKS AND OR 100% CARRYFORWARDS

TCJA restricted business losses

- Starting with the 2018 tax year, TCJA repealed two-year NOL carrybacks and only allowed NOL carryforwards limited to 80% of the subsequent year’s taxable income.
- TCJA introduced the “excess business loss” (EBL) limitation, where aggregate business losses over an EBL threshold ($500,000 for married and $250,000 for other taxpayers for 2018) were considered an NOL carryforward. TCJA deferred losses into the future.

CARES suspended TCJA loss restrictions

- CARES suspended TCJA's EBL limitation for 2018, 2019, and 2020.
- CARES also allows five-year NOL carrybacks for 2018, 2019, and 2020 and/or 100% NOL carryforwards.
- Business owners should consider amending 2018 and 2019 tax returns to remove EBL limitations and consider five-year NOL carryback refund claims.
- It's too late to elect 475 for 2018 and 2019. A 475 election for 2020 is due by July 15, 2020.

2018 NOL carryback refund claims

- Businesses have until July 15, 2020, to file a 2018 Form 1045 (quickie refund) for a 2018 NOL five-year carryback.
- After July 15, 2020, you can use Form 1040-X to file a 2018 NOL carryback claim. The IRS has more time to process a 1040-X refund claim vs. a Form 1045 claim.
- A 2018 Form 1040X is not eligible for the new IRS 1040-X e-filing system.
- NOL carrybacks are complex, and it’s wise to engage a CPA with trader tax compliance experience.

NOLs for TTS/475 traders

- TTS traders with Section 475 ordinary losses and those without 475 but who have significant NOLs from expenses (i.e., borrow fees on short-selling) should consider NOL carrybacks for 2018, 2019 and 2020.

- If Congress changes the rules again (see below), your refund claim should be respected by the IRS as you filed based on current law in effect.

NOL carryback or carryforward?

- If TTS is a close call for the year of the NOL, consider an NOL carryforward instead of the NOL carryback.
- Or, absorb the NOL with a Roth IRA conversion during the same tax year.
- The IRS scrutinizes NOL carrybacks.

The House passed new tax legislation

- The House recently passed new virus legislation, backtracking on CARES business loss relief.

- The House law restricts taxpayers to carry back NOLs from 2019 and 2020 only to tax years beginning on or after January 1, 2018. It retains EBL limitations for 2018, 2019, and 2020 and lifts the SALT limitation for 2020 and 2021.

- Leaders of the House, Senate, and administration each said they expect to enact additional Covid-19 tax and aid legislation this year.

CARES TAX RELIEF AND ECONOMIC AID

CARES tax relief and economic aid

- CARES offered tax relief and economic aid to employees, independent contractors, sole proprietors, and other types of small businesses.
- However, traders don't fit into usual categories, so there are issues in applying for some CARES tax relief and aid.
- Traders generate "unearned income," and the CARES Act focuses on "earned income" (jobs).

CARES tax relief and economic aid

- Traders eligible for trader tax status (TTS) operating in an S-Corp might be able to receive state and federal unemployment benefits if they close their trading business due to the negative impact of the pandemic.

- TTS traders don’t qualify for a loan under the SBA Paycheck Protection Program (PPP), or any other SBA loan because trading is considered a “speculative business,” which the SBA bars from its lending programs.

- TTS traders might be eligible for NOL carrybacks, relaxed retirement plan distributions, and recovery rebates.

Retirement plan distributions

- Taxpayers negatively impacted by Covid-19 can take a withdrawal from an IRA or qualified retirement plan of up to a maximum of $100,000 in 2020 and be exempt from the 10% excise tax on "early withdrawals."

- The taxpayer has the option of returning (rolling over) the funds within three years or paying income taxes on the 2020 distribution over three years. See IRS updates.

- CARES also suspended required minimum distributions for 2020, and you can return them if already taken in 2020. See the IRS announcement.

EXAMPLE

Here's an example

- My client, Josh, was recently laid off due to Covid-19.
- He is collecting state unemployment insurance plus federal pandemic relief of $600 per week.
- Josh is eligible for the $100,000 early withdrawal from his employer 401(k), and he can pay taxes or roll it over during the following three years, depending on how things work out.
- Josh plans to use a Rollover IRA early withdrawal of $50,000 to finance a new TTS sole proprietorship.

Here’s an example

- Josh’s TTS Schedule C does not conflict with his unemployment insurance benefits because he is buying and selling capital assets and not collecting a salary.
- Josh plans to submit a Section 475 election on securities only for 2020, due by July 15, 2020.
- He wants tax loss insurance or to be eligible for a 20% QBI deduction because he expects to be under the QBI taxable income threshold.

Here’s an example

- Next year, after Josh’s unemployment insurance ends, he might form a TTS S-Corp to have a salary in December to unlock health-insurance and retirement-plan deductions.

- S-Corp salary would conflict with unemployment insurance. (It’s always best to check with your state.)

CURRENT DEVELOPMENTS ON PENDING FURTHER COVID-19 TAX LEGISLATION

Current developments on pending further Covid-19 tax legislation

- Panelist Darren Neuschwander, CPA, is tapped into current developments for pending tax relief for Covid-19.

- The AICPA appointed Darren Neuschwander to their Individual & Self-Employed Tax Technical Resource Panel for 2016-2021, and to serve as Vice-Chair for 2020-2021.

- The AICPA works closely with Congress and the administration for considering Covid-19 tax relief.

Closing Remarks

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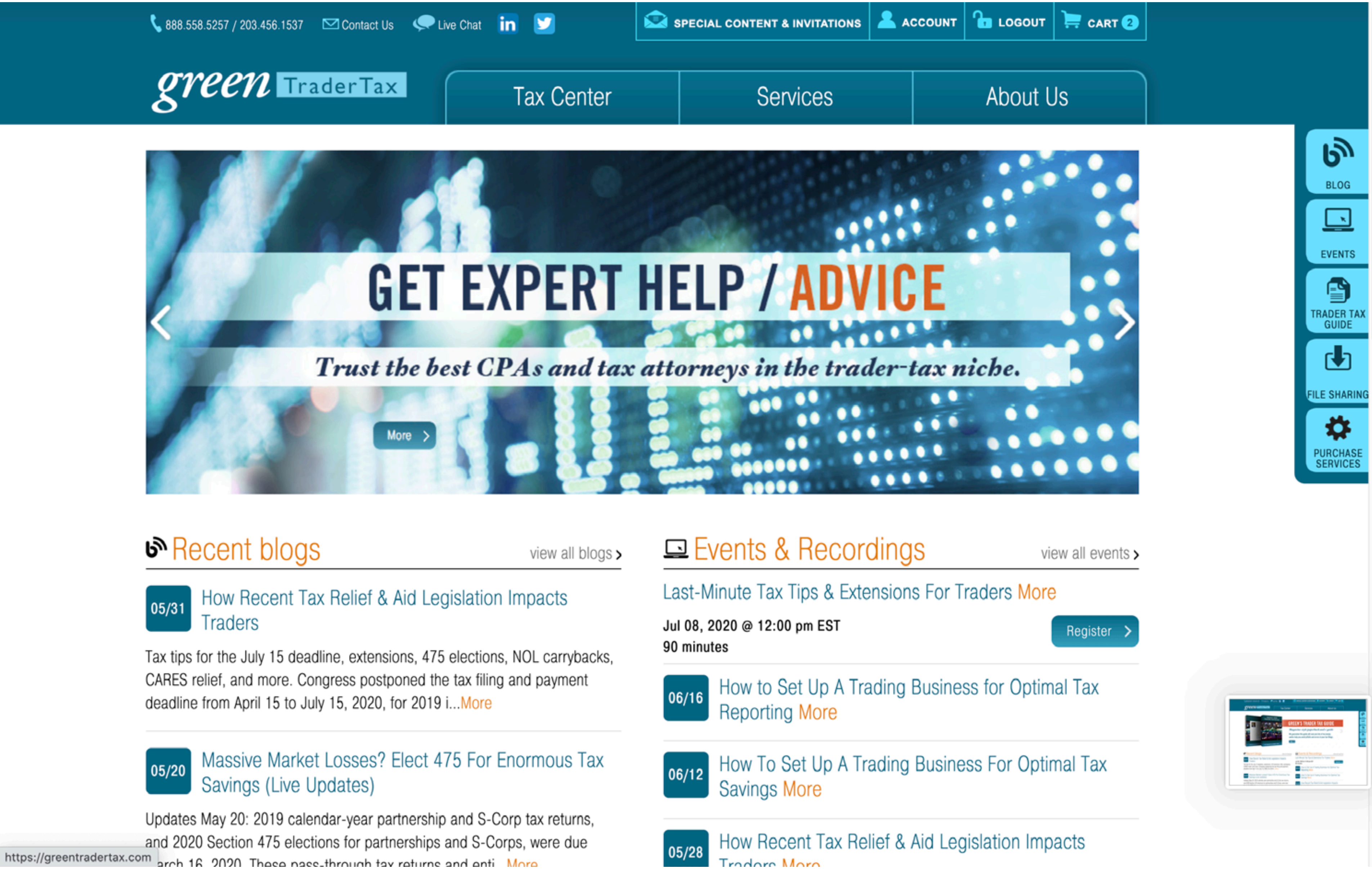
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05/20
Massive Market Losses? Elect 475 For Enormous Tax Savings (Live Updates)
Updates May 20: 2019 calendar-year partnership and S-Corp tax returns, and 2020 Section 475 elections for partnerships and S-Corps, were due
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