**Lifetime Paradigm, Inc.**

The Smart Tax Planning Newsletter

December 2019

# Does No 1099 Mean No Deduction for You?

Imagine this: you didn’t issue Form 1099s to your contractors. Now, the IRS is auditing your tax return, and the auditor claims you lose your deductions because you didn’t issue the Form 1099s. Is this correct?

No. IRS auditors often make this claim, but they are incorrect.

There is no provision in the federal tax law that denies you a deduction for labor expenses simply because you didn’t file the required Form 1099s. But the tax court has stated that the non-filing of required Form 1099s can cast doubt on the legitimacy of the deduction claimed.

As with any deduction claimed on the tax return, you have to keep sufficient records to substantiate the deduction amount. If you had filed Form 1099s, then this would have been solid documentation to help prove the expenses to the auditor.

But since you didn’t file Form 1099s, you need to provide ironclad documentation to prove the expenses, including some or all of the following:

- Bank statement transactions
- Canceled checks
- Credit card statement transactions
- Invoices from the contractor
- Signed agreements with the contractor
- A signed statement from the contractor verifying the amounts received

Ultimately, to prove your deduction in a court of law, should you have to go that far, you’ll need to show by a preponderance of the evidence that you made the payments. This means that your evidence has to make it more than 50 percent likely that you did make the payments to the contractors.

Besides the extra trouble of proving the deductions, keep in mind that the cost of not filing Form 1099s surfaces a financial penalty. For the 2019 Form 1099s, the potential penalties are

- $270 per Form 1099, or
- $550 per Form 1099 if the IRS determines you intentionally disregarded the requirement.

As you can see, filing the 1099s avoids trouble.

# IRS Issues New Bitcoin Tax Guidance

The IRS recently issued new cryptocurrency guidance and is hot on your trail if you bought and sold cryptocurrency and didn't report it on your tax return.

Here are the tax basics. You'll treat cryptocurrency as property for tax purposes.

- If you receive bitcoin in exchange for your services, then your income is the fair market value of the bitcoin received. Your basis in the bitcoin received is its fair market value at the time of receipt plus any transaction fees incurred.
- If you receive bitcoin in exchange for your property, then your gain or loss is the fair market value of the bitcoin received less the adjusted basis of your property given up. Your basis in the bitcoin is its fair market value at the time of receipt plus any transaction fees incurred.
- If you give bitcoin in exchange for services, then the value of the expense is the fair market value of the bitcoin given. Also, the value of the services received less the adjusted basis of the bitcoin is a gain or loss to you.
- If you give bitcoin in exchange for someone's property, then your gain or loss is the fair market value of the property you received less the adjusted basis of your bitcoin.

Cryptocurrency is a capital asset (provided you aren't a trader). Therefore,

- you pay tax on any gain at reduced rates, and
- losses are subject to capital loss limitation rules.

## Forks

In the cryptocurrency world, a fork occurs when the digital register that logs transactions of a particular cryptocurrency diverges into a new digital register. There are two types of forks:

- one in which you don't get cryptocurrency, and
- one in which you get new cryptocurrency.

The IRS ruled that

- a fork in which you don't get cryptocurrency is not a taxable event, and
- a fork in which you get new cryptocurrency is a taxable event and you'll recognize ordinary income equal to the fair market value of the new cryptocurrency received.

**Example.** You own J, a cryptocurrency. A fork occurs and you receive three units of K, a new Cryptocurrency. At the time of the fork, K has a value of $20 per unit. You'll recognize $60 of ordinary income due to the fork.

## Specific Identification

When selling property, you generally sell it on a first-in, first-out (FIFO) basis, unless you are eligible to use the specific identification method. You want to use the specific identification method if you can because you can select the amount of gain or loss your sale will create. With FIFO, you have no choice.

To use the specific identification method, you'll have to either

- document the specific unit's unique digital identifier, such as a private key, public key, and address, or
- keep records showing the transaction information for all units of a specific virtual currency, such as bitcoin, held in a single account, wallet, or address.

This information must show

- the date and time you acquired each unit;
- your basis and the fair market value of each unit at the time you acquired it;
- the date and time you sold, exchanged, or otherwise disposed of each unit;
- the fair market value of each unit when you sold, exchanged, or disposed of it; and
- the amount of money or the value of property received for each unit.

# Divorce-Related Tax Issues for Small-Business Owners

As with all financial transactions, divorce comes with tax consequences. And those consequences have changed for tax years 2018 and later thanks to the Tax Cuts and Jobs Act (TCJA).

## General Rule

The general tax rule in a divorce is that you can divide up most assets, including cash, between you and your soon-to-be ex-spouse without any federal income or gift tax consequences.

When an asset falls under the tax-free transfer rule, the ex-spouse who receives the asset takes over its existing tax basis (for tax gain/loss purposes) and its existing holding period (for short- or long-term holding period purposes).

**Example.** Your divorce settlement calls for your soon-to-be-ex to get 40 percent of your highly appreciated small-business corporation stock. Thanks to the tax-free transfer rule, there's no tax impact when you transfer the shares.

Your ex keeps on rolling under the same tax rules that would have applied had you continued to own the shares (carryover basis and carryover holding period). When your ex ultimately sells the shares, he or she (not you) will owe any resulting capital gains taxes.

## QDRO Required

Does your business have a qualified retirement plan, such as a profit-sharing plan, 401(k) plan, or defined benefit pension plan? If so, you probably will be required to give your soon-to-be-ex a percentage of your account balance or benefits as part of the divorce property settlement.

The trick is to do this without putting yourself on the hook for income taxes on amounts that go to your ex. Here's the drill: include a qualified domestic relations order (QDRO) in the divorce papers. The QDRO makes your ex responsible for the income taxes on retirement account money that he or she receives in the form of account withdrawals, a pension, or an annuity.

In other words, the QDRO causes the tax bill to follow the money, which is only fair.

## QDRO Not Required

You don't need a QDRO to obtain an equitable tax outcome when you are required to turn over some of your IRA money to your ex as part of a divorce property settlement. QDROs are only relevant in the context of qualified retirement plans.

Therefore, you don't need a QDRO for your Simplified Employee Pension accounts, Savings Incentive Match Plan for Employees (SIMPLE) IRAs, traditional IRAs, and Roth IRAs. Even so, you have to be careful and use the magic words to avoid getting taxed on money that goes to your ex.

### Magic Words

Avoid the tax problem: include magic words in the divorce papers.

You can make a tax-free transfer of all or a portion of an IRA balance to your ex ***only if*** the transfer is *ordered* by a divorce or separation instrument. For this purpose, the tax code narrowly defines a divorce or separation instrument as a "decree of divorce or separate maintenance or a written instrument incident to such a decree."

### TCJA Eliminates Alimony Tax Deduction

How do you counteract loss of alimony deductions?

The federal income tax deduction for alimony payments required by divorce agreements executed after 2018 was permanently eliminated by the TCJA.

If you are a higher-income individual, this TCJA post-2018 development is an expensive game-changer for you. In the pre-TCJA days, you as a higher-income individual could reap big tax savings from deducting alimony payments, but those tax savings are history.

What can you do now that those deductions have been eliminated? One thing is to transfer assets with tax liabilities to your soon-to-be-ex (such as qualified plan and IRA balances, appreciated stock and mutual fund shares, and ownership of your highly appreciated vacation home).

Disassociating yourself from tax liabilities is effectively the same as getting a deduction. In a divorce, make it your mission to try to keep ownership of assets that have no tax liabilities, such as your Roth IRA.

### Stock Redemption

If your business is incorporated and your soon-to-be-ex is a part owner, another idea is to arrange for a stock redemption deal to buy out your ex's shares in lieu of making nondeductible alimony payments. With proper planning, you can arrange for your ex to bear the tax consequences of the redemption.

As you can see, there's much to consider in a divorce.

## Tax Tips for the Self-Employed Age 50 and Older

If you are self-employed, you have much to think about as you enter your senior years, and that includes retirement savings and Medicare. Here a few thoughts that will help.

### Keep Making Retirement Account Contributions, and Make Extra "Catch-up" Contributions Too

Self-employed individuals who are age 50 and older as of the applicable year-end can make additional elective deferral *catch-up contributions* to certain types of tax-advantaged retirement accounts.

For the 2019 tax year, you can take advantage of this opportunity if you will be 50 or older as of December 31, 2019.

- You can make elective deferral catch-up contributions to your self-employed 401(k) plan or to a SIMPLE IRA.

- You can also make catch-up contributions to a traditional or Roth IRA.

The maximum catch-up contributions for 2019 are as follows:

| 401(k) Plan | SIMPLE IRA | Traditional or Roth IRA |
|---|---|---|
| $6,000 | $3,000 | $1,000 |

Catch-up contributions are above and beyond

1. the "regular" 2019 elective deferral contribution limit of $19,000 that otherwise applies to a 401(k) plan.

2. the "regular" 2019 elective deferral contribution limit of $13,000 that otherwise applies to a SIMPLE IRA.

3. the "regular" 2019 contribution limit of $6,000 that otherwise applies to a traditional or Roth IRA.

## How Much Can Those Catch-up Contributions Be Worth?

Good question. You might dismiss catch-up contributions as relatively inconsequential unless we can prove otherwise. Fair enough. Here's your proof:

**401(k) catch-up contributions.** Say you turned 50 during 2019 and contributed on January 1, 2019, an extra $6,000 for this year to your self-employed 401(k) account and then did the same for the following 15 years, up to age 65. Here's how much extra you could accumulate in your 401(k) account by the end of the year you reach age 65, assuming the indicated annual rates of return below:

| 4% Return | 6% Return | 8% Return |
|---|---|---|
| $136,185 | $163,277 | $196,501 |

## Is There an Upper Age Limit for Regular and Catch-up Contributions?

Another good question.

While you must begin taking annual required minimum distributions (RMDs) from a 401(k), SIMPLE IRA, or traditional IRA account after reaching age 70 1/2, you can continue to contribute to your 401(k), SIMPLE IRA, or Roth IRA account after reaching that age, as long as you have self-employment income (subject to the income limit for annual Roth contribution eligibility).

But you may not contribute to a traditional IRA after reaching age 70 1/2.

## Claim a Self-Employed Health Insurance Deduction for Medicare and Long-Term Care Insurance Premiums

If you are self-employed as a sole proprietor, an LLC member treated as a sole proprietor for tax purposes, a partner, an LLC member treated as a partner for tax purposes, or an S corporation shareholder-employee, you can generally claim an above-the-line deduction for health insurance premiums, including Medicare health insurance premiums, paid for you or your spouse.

**Key point.** You don't need to itemize deductions to get the tax-saving benefit from this above-the-line self-employed health insurance deduction.

## Medicare Part A Premiums

Medicare Part A coverage is commonly called *Medicare hospital insurance*. It covers inpatient hospital care, skilled nursing facility care, and some home health care services.

You don't have to pay premiums for Part A coverage if you paid Medicare taxes for 40 or more quarters during your working years. That's because you're considered to have paid your Part A premiums via Medicare taxes on wages and/or self-employment income.

But some individuals did not pay Medicare taxes for enough months while working and must pay premiums for Part A coverage.

- If you paid Medicare taxes for *30-39 quarters*, the 2019 Part A premium is $240 per month ($2,880 if premiums are paid for the full year).
- If you paid Medicare taxes for *less than 30 quarters*, the 2019 Part A premium is $437 ($5,244 for the full year).
- Your spouse is charged the same Part A premiums if he or she paid Medicare taxes for less than 40 quarters while working.

## Medicare Part B Premiums

Medicare Part B coverage is commonly called *Medicare medical insurance or Original Medicare.* Part B mainly covers doctors and outpatient services, and Medicare-eligible individuals must pay monthly premiums for this benefit.

Your monthly premium for the current year depends on your modified adjusted gross income (MAGI) as reported on Form 1040 for two years earlier. For example, your 2019 premiums depend on your 2017 MAGI.

MAGI is defined as "regular" AGI from your Form 1040 plus any tax-exempt interest income.

**Base premiums.** For 2019, most folks pay the base premium of $135.60 per month ($1,627 for the full year).

**Surcharges for Higher-Income Individuals.** Higher-income individuals must pay surcharges in addition to the base premium for Part B coverage.

For 2019, the Part B surcharges depend on the MAGI amount from your 2017 Form 1040. Surcharges apply to unmarried individuals with 2017 MAGI in excess of $85,000 and married individuals who filed joint 2017 returns with MAGI in excess of $170,000.

Including the surcharges (which go up as 2017 MAGI goes up), the 2019 Part B monthly premiums for each covered person can be $189.60 ($2,275 for the full year), $270.90 ($3,251 for the full year), $352.20 ($4,226 for the full year), $433.40 ($5,201 for the full year), or $460.50 ($5,526 for the full year).

The maximum $460.50 monthly premium applies to unmarried individuals with 2017 MAGI in excess of $500,000 and married individuals who filed 2017 joint returns with MAGI in excess of $750,000.

## Medicare Part D Premiums

Medicare Part D is private prescription drug coverage. Premiums vary depending on the plan you select. Higher-income individuals must pay a surcharge in addition to the base premium.

**Surcharges for higher-income individuals.** For 2019, the Part D surcharges depend on your 2017 MAGI, and they go up using the same scale as the Part B surcharges.

The 2019 monthly surcharge amounts for each covered person can be $12.40, $31.90, $51.40, $70.90, or $77.40. The maximum $77.40 surcharge applies to unmarried individuals with 2017 MAGI in excess of $500,000 and married individuals who filed 2017 joint returns with MAGI in excess of $750,000.

## Medigap Supplemental Coverage Premiums

Medicare Parts A and B do not pay for all health care services and supplies. Coverage gaps include copayments, coinsurance, and deductibles.

You can buy a so-called *Medigap* policy, which is private supplemental insurance that's intended to cover some or all of the gaps. Premiums vary depending on the plan you select.

## Medicare Advantage Premiums

You can get your Medicare benefits from the government through Part A and Part B coverage or through a so-called *Medicare Advantage plan* offered by a private insurance company. Medicare Advantage plans are sometimes called Medicare Part C.

Medicare pays the Medicare Advantage insurance company to cover Medicare Part A and Part B benefits. The insurance company then pays your claims. Your Medicare Advantage plan may also include prescription drug coverage (like Medicare Part D), and it may cover dental and vision care expenses that are not covered by Medicare Part B.

When you enroll in a Medicare Advantage plan, you continue to pay Medicare Part A and B premiums to the government. You may pay a separate additional monthly premium to the insurance company for the Medicare Advantage plan, but some Medicare Advantage plans do not charge any additional premium. The additional premium, if any, depends on the plan that you select.

**Key point.** Medigap policies do not work with Medicare Advantage plans. So if you join a Medicare Advantage plan, you should drop any Medigap coverage.

## Premiums for Qualified Long-Term Care Insurance

These premiums also count as medical expenses for purposes of the above-the-line self-employed health insurance premium deduction, subject to the age-based limits shown below. For each covered person, count the lesser of premiums paid in 2019 or the applicable age-based limit.

Your age as of December 31, 2019, determines your maximum self-employed health insurance tax deduction for your long-term care insurance as follows:

- $790—ages 41-50
- $1,580—ages 51-60
- $4,220—ages 61-70
- $5,270—over age 70