

SUBSTANTIATING DOCUMENTATION REQUIRED

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For your protection and mine – and to mitigate the unpleasant fallout from an audit – I am a stickler for documentation. Your protests to the contrary will fall on deaf ears. It's always easier to calmly gather the necessary paperwork nearest to the time that a transaction has occurred rather than in a panic when a tax examiner makes his demands as many as three and four years later. Do it now! (It's easier than you think.) Here's a helpful list of items that we may need in addition to the obvious W-2s and 1099s that should begin to dribble in during these next few weeks:



Form 1099-B: Taxpayers should review cost basis information provided by brokerage firms to ensure proper reporting of gains and losses attributable to sales of stock acquired through the exercise of stock options. **NOTE:** Brokerage firms do not adjust basis for income reported on a W-2, leaving taxpayers to manually adjust basis when filing the return.

Form 1099-C: If you receive this form from a lender after negotiating a debt cancellation, you'll have to report the amount of forgiven debt as taxable income unless the debt was discharged in a Title 11 bankruptcy proceeding or you were insolvent at the time the debt was cancelled. Excludible Qualified Principal Residence Indebtedness (QPRI) allows taxpayers to exclude up to \$750K of forgiven mortgage debt through 2025. **NOTE:** California (CA) does not conform.

Form 1099-NEC: Under new rules, most CA workers will be classified as “employees” rather than “independent contractors” and will, under state law, receive W-2s reporting wage income. Some workers, however, may continue to be treated as independent contractors for federal tax purposes and will, therefore, receive 1099s reporting *federal* non-employee compensation which must then be reconciled with *state* wage income. **TO DO:** Payers must issue Form 1099-NEC to independent contractors who earn more than \$600 during the calendar year. Form 1099-MISC may no longer be used to report non-employee compensation. Form 1099-NEC must be provided to payees and filed with the IRS on or before January 31st.

Form 1099-K: As it turns out, many gig companies issue Forms 1099-K rather than 1099-NEC because these companies claim to provide mere “transactional” services to their workers. 1099-Ks are used to report payments processed through a credit, debit or gift card and are required to be filed only if the worker earns more than \$20K in a series of more than 200 transactions. As a result, certain workers – such as Uber and Lyft drivers – may receive neither a 1099-K or 1099-NEC. Regardless, all gross earnings are reportable whether or not the taxpayer receives a reporting document! [Federal](#) and [state](#) tax authorities offer filing tips and tax strategies for workers and businesses affected by the sharing (or gig) economy. **UPDATE:** IRS has postponed implementation of the \$600 reporting threshold for third-party payment platforms (e.g., PayPal, Square, Stripe, Venmo, etc.) and plans to institute a \$5,000 phase-in threshold for tax year 2024.

Name, Image, Likeness (NIL) Income: Income from such sources as endorsements, social media advertising, public appearances and licensing arrangements paid to student athletes and others is taxable. NIL, unlikely to be reported on a W-2, may be reported on Forms 1099-NEC or 1099-K (or not at all). Regardless, each taxpayer is required to include such income when filing a return.



Forms 1099-SA and 5498-SA: California does not conform to the federal tax treatment of the Health Savings Account (HSA); as a result, state residents must include the annual investment income (loss) in their CA Adjusted Gross Income (AGI), increase the medical expense deduction for any qualified expenses paid by the HSA and reduce CA income by the amount of any taxable distributions received. **TO DO:** If the information is not provided on the information returns, clients will be asked to obtain the missing items from their employers.

Form 1098-T: Rule changes mandate that taxpayers wishing to claim education credits must provide a Tuition Statement. **TO DO:** Although some schools may send hard copies by mail, taxpayers may log onto the student's school account to pull down an online version.

Settlement Statements: Previously known as the HUD-1 Buyer's (Seller's) Closing Escrow Statement, this form has been replaced by the Loan Estimate and the Closing Disclosure. Presuming that you have purchased or sold real estate at any time in the prior year, you must provide complete copies of both forms to me so that I may properly account for your transaction.

Form 1098: The federal deduction for home mortgage interest is now limited to interest accrued on a maximum of \$750K acquisition debt. Older mortgages – unless refinanced after December 15, 2017 – have been grandfathered and remain eligible for the previous limitation of \$1 million. Interest on home equity debt and lines of credit (HELOC) is no longer deductible, unless the loan proceeds are used to improve the personal residence which secures the debt. **TO DO:** To ensure that you obtain the maximum tax benefit, please provide an accurate accounting of how the loan proceeds were used.

Schedule K-1: Taxpayers who receive a year-end tax reporting document from a partnership or S-corporation, should also receive Schedules K-2 and K-3, which are used to report the foreign activities of the entity or any of its partners and shareholders. These forms are required to be filed even if the entity did not engage in foreign activities and/or did not have any foreign partners or shareholders. **UPDATE:** The IRS has temporarily postponed the K-2/K-3 filing requirement for certain domestic partnerships for TY'22 if the entity sends specific notification to its partners by January 15th and no partners specifically request Schedule K-3 from the entity before February 15th.



Charitable Contributions: If you wish to claim a tax deduction, you must provide me with written letters of acknowledgement from each donee organization which include (1) the name and tax ID number of the receiving organization, (2) your name and address, (3) the date and amount of cash contributed or a description of any non-cash item(s) contributed, and (4) a statement that no goods or services were provided by the organization in return for your contribution or a description and good faith estimate of the value of goods or services that you received. As per IRS rules, *this letter must be in hand before submitting your return*. If you contributed non-cash items such as clothing or housewares, you must provide me with a copy of a written receipt, along with a *description of items donated and an estimate of fair market value*. Both Goodwill and Salvation Army offer valuation worksheets, accessible from links on my website in a section dedicated to "[Charitable Giving](#)." **NOTE:** Substantiation rules apply even to those taxpayers who do not itemize on Schedule A but still wish to claim the above-the-line deduction of up to \$300 (if single) or \$600 (if married).

Mileage Log: You may claim deductions for medical, charitable, and business miles *if* you can offer satisfactory substantiation. IRS rules require that you maintain a contemporaneous log detailing the date, the business purpose, and the beginning and ending odometer readings for each trip. Remember that your daily commute from your home to your permanent work location does not qualify for a business mileage deduction. You may use a [hand-written log](#), a computerized spreadsheet or even a smartphone app.

Repairs: If you are a landlord or business owner and wish to deduct your outlays for repairs, improvements, materials, or supplies, you must provide me with a detailed list including date, cost and description of each item purchased or project undertaken so that I may determine if your outlay can be currently expensed or must be capitalized.



Energy Efficient Home Improvement Credit: Available to homeowners who install certain energy efficient items such as insulation, roofing, windows, and doors has been reinstated retroactively and is available for property installed in 2022 – 2032. **NOTE:** Beginning in 2025, taxpayers may only claim a credit for eligible property produced by a qualified manufacturer and must include the qualified product identification number on the tax return.

Foreign Pension Plans: As the world shrinks, more US taxpayers work abroad and often invest in foreign pension plans. In general, such retirement accounts are not deemed to be "qualified" and are therefore ineligible for the tax benefits granted to US-based accounts, such as IRAs and 401(k) plans. Additionally, they are subject to onerous reporting requirements applicable to [passive foreign investment companies](#) (PFICs), including foreign mutual funds, money market accounts, pension funds, partnerships, and other pooled investment vehicles such as REITs. The PFIC regime was designed to close a loophole that encouraged US taxpayers to shelter investments from taxation by heading offshore. Since failure to attach a completed Form 8621 to your tax return for *each* PFIC owned can lead to substantial penalties, you must let me know about your foreign investments. **REMINDER:** Foreign bank accounts may separately be subject to FBAR reporting and specified foreign assets may be reportable on Form 8938 under the FATCA regime.

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Unrelated Business Income (UBI): Taxpayers who have used retirement account funds to purchase a limited partnership may be subject to additional reporting. While investment income earned inside an IRA account is generally not reportable until assets are distributed at retirement, UBI in excess of \$1,000/year is reportable and taxable. Failure to File Form 990-T may result in the disqualification of an otherwise qualified retirement plan, resulting in a deemed distribution of a lump-sum that is fully taxable. **TO DO:** Be sure to provide me with your K-1s for review.

Cryptocurrency: In its effort to encourage taxpayers to report previously undisclosed income, the IRS now includes a compliance question on Form 1040 that *all* taxpayers must answer. “Yes” is required if taxpayers have received, sold, exchanged, or otherwise disposed of a digital asset during the tax year. However, taxpayers may answer “no” if they have merely purchased virtual currency in exchange for fiat currency (e.g., US dollars). **NOTE:** Failure to report cryptocurrency transactions can lead to civil and criminal penalties. I, therefore, urge you to maintain accurate records that include the date the currency was purchased, mined, or received; the description, amount and value of units received, sold, or exchanged; along with the cost and purpose of the transaction. **UPDATE:** As per the Infrastructure Investment and Jobs Act, brokerage firms will be required to furnish Forms 1099-B to their account holders for TY 2024 beginning January 1, 2025.

Virtual currencies will be treated as property, which may result in income recognition if received in lieu of wages, or when coins are mined, sold, or exchanged. Barring revised guidance, these currencies are *not* treated as securities subject to the wash sale rule. **TIP:** The IRS has provided answers to [FAQs](#) on virtual currency transactions.

Nonfungible Tokens (NFTs): NFTs are digital property that can include a work of art, video or audio file, virtual real estate, amongst many other items. Like cryptocurrency transactions, NFTs rely on blockchain technology to identify and store the digital asset, as well as track its origin and history. However, NFTs are not themselves mediums of exchange and typically will not be paid in lieu of compensation or used to purchase retail goods. Nevertheless, NFTs are almost always sold in exchange for cryptocurrency. **NOTE:** If a taxpayer is in the trade or business of buying and selling NFTs, then the NFTs they purchase are classified as inventory, and the sales are classified as ordinary income reportable on Schedule C and subject to self-employment tax.



Nanny Tax: If you employ a domestic worker (e.g., nanny or senior caregiver), you are subject to quarterly and annual tax reporting requirements in addition to complex employment rules (e.g., [minimum wage](#), overtime, vacation pay, sick leave, benefits, etc.). All employers – including household employers – are required to electronically submit employment tax returns, wage reports, and payroll tax deposits to CA’s Employment Development Department (EDD).

Estimated Tax Payments: CA taxpayers may easily obtain a record of payments made to the FTB [online](#). Obtaining comparable information from the IRS is a bit more difficult but not impossible: Either request a [Tax Account Transcript](#) which will arrive by mail in about 10 days, log on to your [IRS Account](#) to check the history of all previously-submitted online payments, or call the IRS at (800) 829-1040.

ID Theft: To prevent the filing of fraudulent tax returns, taxpayers may now [register](#) for an IP PIN with the IRS. **TO DO:** Because the IRS will reject your return if it is e-filed with an incorrect or missing IP PIN, you must provide me with a copy of the IP PIN letter (CP-01A) that you received. If you misplaced the letter, you may go online or call the IRS at (800) 908-4490 to re-validate your identity.

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