

IRS Exams: How To Defend Trader Tax Breaks and Win

Wednesday, June 25, 2014 1:00 PM - 2:00 PM EDT

Join Green NFH CPAs Robert A. Green, Darren Neuschwander, Amanda Smitson, and tax attorney Mark Feldman.

IRS tax notices often question trader tax status (TTS) and the right to deduct trading business expenses on a Schedule C for individuals or pass-through entity tax returns. The IRS figures it can force limited investment expense treatment on Schedule A and a capital loss limitation instead of unlimited Section 475 MTM ordinary business losses which are conditional on qualifying for TTS. The IRS has recently been victorious against traders Assaderaghi, Nelson and Endicott in tax court, so we prepared some tips for other traders facing an exam. In this Webinar, we will cover:

- How to file a trader tax return without red flags.

Don't use trader tax status (TTS) unless you qualify. Document your qualification for TTS in tax return footnotes. Don't botch the reporting like entering trading gains and losses directly on Schedule C as that triggers an exam or notice. Don't be overly aggressive on Schedule C business expenses and maintain good support for your expenses. Follow rules on Form 8949 cost-basis reporting with wash sales and use compliant attachments, and don't report "details available on request."

- How to reply to tax notices.

Answer the questions directly. Don't lie or obstruct the truth. Be very matter of fact. Don't incriminate yourself. Consult with an expert about the questions and answers if you are unsure. If the agent questions Schedule C trading business expenses, provide a detailed and substantiated analysis of your trader tax status and explain the law and why you qualify for TTS. Consult a trader tax expert about the notice and your reply.

- How to keep an IRS exam limited in scope and under control for winning.

Agents may ask for the tax return for the preceding or subsequent tax year. If they ask about Sch C and A expenses only, try to limit the scope from expanding to Sch E or other issues. Giving fishy answers, and being nervous can lead to agents expanding the scope.

- Big issues like trader tax status, a Section 475 election, cost-basis accounting and IRS matching tax returns with 1099Bs from brokers.

Focus on the big picture which is TTS and Section 475, not a few thousand dollars of business expenses. Win TTS first and document your timely Section 475 MTM election for ordinary loss treatment. Did you file your Form 3115 (Change of Accounting Method) on time, too? If not, it may be a problem, but one you can recover from. Use good accounting software for securities gains and losses and make sure you handled wash sales right.

- How to stay in bounds on tax filings so you don't invite scrutiny.

Don't trump 1099Bs and K-1s unless you have good reason and file the correct tax form with it. Make sure 1099Bs reconcile and explain differences in footnotes. Don't be an outlier on deductions and profile. Avoid all things offshore if you can and if offshore do all tax compliance right like filing FBAR by June 30.

- When to "agree to disagree" with your IRS agent and move on to appeals, where you may have a much better chance of success.

In many states, the IRS is not familiar with trading businesses and they may be adversarial. Don't waste too much time trying to educate the IRS agent on TTS. They may cite TTS cases and law in the wrong manner and intimidate you with it. For example, like insisting that traders need customers like a dealer, which is not the law. Agree to

disagree and move on to the next step in appeals.

- How to write a winning appeals letter.

Work with our CPAs and tax attorneys. There is a certain style of presentation that counts. Cite trader tax court cases, explain and document your qualification for trader tax status, rebut arguments made by the agent and show you are prepared to go to tax court to win. The IRS views appeals as a settlement exercise and they don't want to lose a case in tax court.

- The pros and cons of tax court.

If you have a winning case on trader tax status and the IRS is charging you tens of thousands of dollars due to denial of TTS which also negates Section 475 ordinary loss treatment, then it's worth your while to file a petition for tax court. Although you can represent yourself, that is a mistake as you already have probably not done a good job getting this far without success. It's best to engage trader tax CPAs and tax attorneys to represent you and write a winning tax court petition and arguments to be heard.

- Learn how to file a petition for a tax court "small case", and attempt to negotiate a settlement back in appeals.

In many cases, we suggest a tax court "small case." There is no publication of the ruling in the public domain and you may like that – so a Google search doesn't air your dirty laundry in public. There is no appeal of a small case decision, but why litigate further if you can't succeed in this round? The tax court sends your case back to appeals to be settled, so view a small case like a second round of appeals, but this time using good tax attorneys and CPAs. Maybe you botched your own first round of appeals and let an appeals officer get off easy citing cases in inappropriate ways. 95% of cases are settled back in appeals and the other 5% go on to be litigated in tax court.

- Who should represent you in tax court.

Consider Green NFH's tax attorney Mark Feldman, and our CPA team handling tax controversy. We probably have the best knowledge of trader tax status in the country and we know how to write winning appeals letters and tax court protest letters.

- The consequences of not filing tax returns, filing late, installment payment agreements and not dealing with IRS collections.

If you don't file a tax return, perhaps because you figure you have large trading losses, the IRS will eventually send you tax notices based on 1099B filings. They will have jeopardy assessments for huge balance dues. You will be dealing with IRS Collections, who are unforgiving and very aggressive. File your tax returns and request installment payment plans. Consult with us about it.

Handling tax compliance right significantly reduces your chances of having problems with the IRS.

Invest the time and effort into filing a proper and accurate tax return. If you don't qualify for TTS, don't use it. Make sure you document all your expenses, time and TTS and consider using our new program GreenTraderTax Tracker powered by Deductr, which would should have available soon.

Questions and Answers.