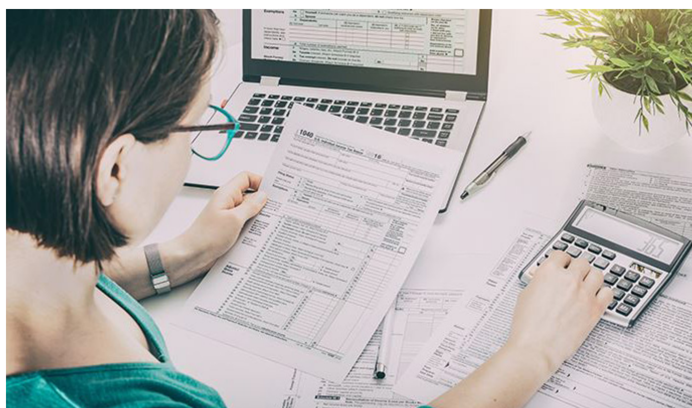
COMMON
Tax Errors

When you meet with your wealth advisor, he or she can coordinate with your CPA or attorney to help ensure you have a tax efficient strategy. You can help by giving your advisor and tax team all of the details they will need, such as whether you opened or closed an investment account. Here are three answers to common questions that will help keep your tax team in the loop.



Question 1: What are Qualified Charitable Distributions (QCD) and what tax items do I need to save?

Answer: One of the lesser known benefits of an Individual Retirement Account (IRA) is that Congress has granted a unique provision incentivizing IRA owners who are over 70-1/2 and have entered Required Minimum Distribution (RMD) status to donate to charity. Think about it—if you donate $10,000 to charity every year, would it be better to make that donation with dollars you have already paid taxes on like money in your taxable investment account, or IRA dollars that haven't been taxed yet since you don't pay taxes on money contributed to an IRA? The answer is undoubtedly IRA dollars, and for those individuals in RMD status who make donations directly from their IRA to charity, the funds distributed aren't considered taxable income. A little-known fact surrounding this transaction, however, is that it's not always readily apparent on a 1099 generated by an IRA that this unique contribution has been made.

For that reason, it's recommended that individuals making a qualified charitable donation receive and retain a receipt or letter from the charity to which they are donating. The receipt should note the date and amount of the individual's gift from the IRA. In turn, the individual must also make sure the tax preparer receives the charity's receipt. Otherwise, the amount may be mistakenly included as taxable income on his or her return.

Question 2: What considerations do I need to make when converting an IRA to a Roth IRA?

Answer: Individuals nearing retirement with a large portion of their net worth held in an IRA should consider converting a portion of that account to a Roth IRA. Because IRA distributions count as taxable income, some individuals find that they end up having a higher taxable income in retirement because they are drawing solely from their IRA for living expenses.

To potentially mitigate some of that tax, a portion of a traditional IRA can be converted into a Roth IRA, which allows for distributions to occur tax free. At the time of conversion from a traditional IRA to a Roth IRA, the amount of the conversion is considered taxable income, which is why it's advantageous to do this conversion in a year when an individual's income is lower and he or she may be in a lower tax bracket (typically in the year following retirement). As this transaction creates a relatively large amount of taxable income, it's vital for individuals to make sure their tax preparer

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receives the 1099 from the IRA custodian to make sure that income is included on their tax return. Without that 1099, the tax preparer won't be aware the conversion took place and may accidentally omit the income. This is not viewed favorably by the IRS.

Question 3: What are some unique tax documents I may need to be on the lookout for?

Answer: Investments in partnerships, trusts and even some exchange-traded funds generate tax forms called a Schedule K-1, which is different from a typical Form 1099.

These investments can be held in accounts easy to forget about, such as an IRA. Normally income in an IRA is not taxable until it is withdrawn, but alternative investments such as partnership interests or real estate holdings in an IRA account can create a tax return filing requirement if those investments generate unrelated business income.

If you have a taxable investment account that holds some of those types of K-1 generating investments, note that you may receive both a 1099 for the account as well as an individual K-1 for each partnership or trust interest you own.

Large custodial firms will typically generate Form 1099s early in the year to help investors have them available to file their taxes prior to the April deadline, but investments that generate a Schedule K-1 may be delayed in sending copies to their investors due to a variety of factors and actually aren't required to be provided until March 15 each year. For that reason, it's not uncommon for investors in these types of trusts or partnerships to file for extensions on their tax returns. If you hold one of these types of investments, be sure to inform your tax preparer as he or she will need to wait to file your return to help ensure any income generated by the K-1 investment is included.

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