Issues Addressed

Issue 1: Taxation of Life Insurance and Annuities .................. 346
Issue 2: Types of Retirement Plans ........ 357
Issue 3: Equity-Based Compensation Plans ....................... 367
Issue 4: Virtual Currency ......................... 372
Group-term life insurance premium provided by employer is:

- Excluded from income if the employer paid premium is for $50,000 or less coverage
- Taxable if employer pays premium above the $50,000 of coverage
Exclusion for Group-Term Insurance p. 346

Must meet four conditions

- The death benefit is excludable
- INS provided to a group of employees
- INS provided under employer policy directly or indirectly
- $$ of INS provided is computed by formula
Group-Term INS is not:  p. 346

- INS that does not provide general death benefits
- INS on life of employee, spouse, or dependent
- INS provides a permanent benefit (e.g. economic value)
To qualify, employer must provide group-term INS to at least 10 FT employees.

There are two exceptions to the 10-employee rule.
For the two exceptions there are three types of employees who don’t count:

- If 65 or older
- PT employee <20 hrs/week, < 5 mo/yr
- Employed for less than specified period
Policy is considered to be carried by the employer if:

- The employer pays any cost of INS
- The employer arranges for premium payments and the premiums paid by at least 1 employee subsidize payments by at least one other employee
### FIGURE 9.1 Table 2-2. Cost Per $1,000 of Protection for 1 Month

<table>
<thead>
<tr>
<th>Age</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under 25</td>
<td>$0.05</td>
</tr>
<tr>
<td>25–29</td>
<td>$0.06</td>
</tr>
<tr>
<td>30–34</td>
<td>$0.08</td>
</tr>
<tr>
<td>35–39</td>
<td>$0.09</td>
</tr>
<tr>
<td>40–44</td>
<td>$0.10</td>
</tr>
<tr>
<td>45–49</td>
<td>$0.15</td>
</tr>
<tr>
<td>50–54</td>
<td>$0.23</td>
</tr>
<tr>
<td>55–59</td>
<td>$0.43</td>
</tr>
<tr>
<td>60–64</td>
<td>$0.66</td>
</tr>
<tr>
<td>65–69</td>
<td>$1.27</td>
</tr>
<tr>
<td>70 and older</td>
<td>$2.06</td>
</tr>
</tbody>
</table>
Examples to Illustrate  pp. 348-349

- Ex. 9.1 Carried by Employer
- Ex. 9.2 Not Carried by Employer
- Ex. 9.3 More than 1 Insurer
- Ex. 9.4 Insurance for Former Employee
Example 9.2  pg. 348

- Same facts as before (ex. 9.1)
- All employees charged same rate (set by insurance co.)
- Employer pays none of the costs
- No taxable benefit to employee
Example 9.3  pg. 348

- 47 year old employee - $40,000 coverage
- $100,000 optional (pd. by employee)
- ($50,000 – 40,000) $10,000
- Value of $90,000 would be taxable if carried by the employer
- If premium on the $90,000 was paid by the employee – still taxable
S-corp. Shareholders

- The full cost of the group-term INS coverage is included in the >2% SH wages
Key Employees

1. Officers with annual $$ of $$180,000 (2019); or

2. Individual
   - Who owns 5% of business or
   - 1% owner with annual pay $$150,000

See 4 types of employees not counted
The monthly cost of INS above the $50K paid by employer is included in employee wages.

Ex. 9.5 Calculating the Cost of Coverage
Example 9.5

- Theo’s (age 45) - employer provides him with $200,000 life insurance
- Theo pays $100 per year
- $150,000 excess ($200,000 - $50,000)
- Yearly benefit of $150,000 = $270
  ($0.15 \times 150 \times 12 \text{ months})
- $270 - $100 = $170 taxable benefit
Surrenders or sales generally trigger recognition of gross income.

Outstanding loans can be an issue.
Example 9.6

- J.J owned a $100,000 life insurance policy
- Paid $64,000 in premiums
- Surrendered the policy for $78,000
- J.J. has a $14,000 taxable event
- $78,000 - $64,000 cost basis
A viatical settlement is an arrangement in which someone with a terminal illness sells his or her life insurance policy at a discount from its face value for ready cash. The buyer cashes in the full amount of the policy when the original owner dies. A viatical settlement is also referred to as a life settlement.
Viatical settlements are generally treated as paid upon death of TP.

- Payouts are made because TP is terminally or chronically ill.
Definitions

- Viatical settlement provider – an investor who buys life insurance contracts
- Terminally ill individual – a person reasonably expected to die within 24 months as certified by a physician
Chronically ill individual – person meeting one of three criteria as certified by med. pro.

1. Unable to perform at least 2 activities of daily living
2. Has a disability
3. Requires supervision to protect from threats
Sale or Assignment of INS  p. 351

- **Sale by Transferee**
  - Generally capital gain

- **Taxation on Death of Insured**
  - Calculate basis ($ paid + premiums)

- **Transferor’s Taxation**
  - Rev. Rul. 2009-13
  - Ex. 9.7 Sale of Policy with $ Value
TP purchased a 15 yr. term life ins. policy for $20,000 + pd. $9,000 in premiums.

Sold the contract for $30,000.

Gain is $1,000 ($30,000 - $29,000).

Held for over 1 yr. LTCG.
Third Party Sale

- Taxation on Death of Insured
  - Calculate basis ($ paid + premiums)
- Transferor’s Taxation
  - Rev. Rul. 2009-13
  - Ex. 9.7 Sale of Policy with $ Value
TCJA Exception  pg. 351

- For transfers after 12/31/2017
- Two exception rule will not apply if:
  - Reportable policy sale
  - “No family, business or financial relationship with the insured”
  - Taxable income
An annuity is a contract that requires regular payments for more than 1 full year to the person entitled to receive the payment (annuitant).
- Generally these are subject to qualified retirement plan distribution rules
- Could be fixed or variable amounts
Annuities Continued

- IRC 403 - Qualified Nonperiodic Payments

1. Qualified Employee Annuity
2. Tax Shelter Annuity
Example 9.9

- Coco received a $50,000 distribution from a qualified annuity before her annuity starting date
- Invested $10,000 in the plan
- Account balance was $100,000
- How much can she exclude from TI
  
  \[ \text{\{\$50,000} \times (\$10,000 / 100,000)\} = \$5,000 \]
Distributions to the TP before age 59.5 are subject to a 10% additional tax penalty.

- Three general exceptions apply:
  - Substantially equal payments
  - Due to disability
  - Due to death of TP

- 3 additional specific exceptions
Commercial annuities purchased directly by TP

Cross-reference NIIT

Nonqualified annuity distributions are subject to NIIT.
For these payments, TP calculates the tax-free amount of each annuity payment
- 6 step process
- Ex. 9.10 Calculating the Tax-Free $$
Payment is allocated first part to earnings (taxable) and then to cost (basis)

Example 9.11 Calculating the taxable portion

Note the special rules

Early Distribution Penalty...10%
Example 9.11

- Millie – Age 66 - received first single life annuity payment March 2019
- Adjusted basis $75,000
- Expected return is $138,240 ($600 per. Month X 12 mos. X 19.2) Table V
- Assume 10 pymts. @ $600 in 2019
- Exclusion (.543 X $600) $325.80 X 10 = $3,258
Issue 2: Types of Retirement Plans

- Three types of popular plans:
  - SEP IRA
  - SIMPLE IRA
  - Profit-sharing
SEP IRAs are relatively easy to establish,

- Must be established by the extended due date of the employer’s tax return filing date:
  - Self-employed – October 15, 20xx
Participation

- All employees 21 yrs old,
- And who provided services 3 of last 5 years (employer can reduce requirement)
- All eligible employees must participate
- See list of excludible employees
Contributions

- Only Employer makes $$ into each employee’s separate SEP IRA
- Vested immediately
- Max is lesser of 25% of comp or $56,000
- Watch for other plans combining to hit max of $56,000.
Example 9.12 SEP contributions
Investments
Reporting
Self-Employed TPs
  • Circular calculation
  • Fig 9.3 provides IRS Rate Table
Example 9.13 Self-employed  

- Jax’s profit $100,000
- SEP plan says 10% of compensation
- See Worksheet (Fig. 9.4) for calculation of $8,449 allowable SEP IRA contribution.
## FIGURE 9.5 Key Provisions of SEP Plan

<table>
<thead>
<tr>
<th>Sponsor/eligible employer</th>
<th>Any employer</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Key advantage</strong></td>
<td>Easy to set up and maintain</td>
</tr>
</tbody>
</table>
| **Employer’s role**       | To set up plan, employer may use Form 5305-SEP  
|                           | Transmit contributions for employees to SEP IRA  
|                           | Generally, no annual reporting—bank or financial institution does reporting |
| **Contributors to the plan** | Employer can decide whether to make contributions each year  
|                           | Only employer can contribute  
|                           | Maximum annual contribution per participant is up to 25% of compensation but no more than $56,000 for 2019  
|                           | No catch-up contributions |
| **Minimum employee coverage requirement** | Must be offered to all employees who are at least 21 years of age, were employed by the employer for 3 of the last 5 years, and have compensation of at least $600 |
| **Withdrawals, loans, and distributions** | Withdrawals permitted any time subject to federal income taxes  
|                           | Subject to 10% additional tax penalty if before age 59½  
|                           | Must start receiving distributions by April 1 of the year following attainment of age 70½  
|                           | Loans are not permitted |
| **Rollovers/transfers**   | Rollovers permitted from one IRA to another and to an eligible retirement plan |
| **Self-employed taxpayers** | Can establish, contribute, and deduct contributions |
| **Vesting**               | Contributions are immediately 100% vested |
SIMPLE IRAs are plans for small businesses that have 100 or fewer employees who received $5,000 or more in compensation.

- Note an employer can’t offer a SIMPLE IRA if other qualified plans are offered to employees.
SIMPLE IRAs

- **Establishment**
  - Easy: Form 5305-SIMPLE

- **Participation**
  - Any employee who received $5,000 in any 2 prior years and is expected to earn at least $5,000
    - Employer can set lower $$
    - Employer can set prior service
Employee Contributions

- Lesser of $13,000 or 100% of comp
- If employee is over 50, $3,000 catch up
- Contributions indexed for inflation
- 100% vested
Employer Contributions

- Mandated to make $$
- Employer must decide which of two methods
  - nonelective 2%
  - matching of employee’s $, limit 3% of compensation
- 100% employee vested
Investment and Distributions

- Employee is responsible for decisions
- Employer does not have access or info relative to employee accounts
- Distributions allowed anytime
  - Early distributions 10% penalty
  - 25% if taken out within 2 yrs of start
Reporting

- SIMPLE IRA plan must annually provide employees a summary plan notice providing details
- No annual reports with government
- Distributions: 1099-R
SE ed Taxpayers

- Net earnings from SE up to $13,000
- If \( \geq 50 \) $3,000 catch up allowed

Again, SEP IRA and SIMPLE IRA not allowed together
## FIGURE 9.6 Key Provisions of SIMPLE Plan

<table>
<thead>
<tr>
<th>Sponsor/eligible employer</th>
<th>Employer with 100 or fewer employees that does not currently maintain another plan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Key advantage</td>
<td>Salary reduction plan with little administrative paperwork</td>
</tr>
<tr>
<td>Employer’s role</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To set up plan, employer may use Form 5304-SIMPLE or 5305-SIMPLE</td>
</tr>
<tr>
<td></td>
<td>Transmit contributions for employees to SIMPLE IRA</td>
</tr>
<tr>
<td></td>
<td>Generally, no annual filing requirement—bank or financial institution does reporting</td>
</tr>
<tr>
<td>Contributors to the plan</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Employee salary deferrals (maximum $13,000 for 2019)</td>
</tr>
<tr>
<td></td>
<td>$3,000 catch-up contributions</td>
</tr>
<tr>
<td></td>
<td>Mandatory employer match (100% of first 3%, but can be as low as 1% in any 2 of 5 years) or nonelective contributions equal to 2% of compensation (limited to $280,000 for 2019)</td>
</tr>
<tr>
<td>Minimum employee coverage requirement</td>
<td>Must be offered to all employees who have compensation of at least $5,000 in any prior 2 years and are reasonably expected to earn at least $5,000 in the current year</td>
</tr>
<tr>
<td>Withdrawals, loans, and distributions</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Withdrawals permitted any time subject to federal income taxes</td>
</tr>
<tr>
<td></td>
<td>Subject to 10% additional tax penalty if before age 59½ (25% if less than 2 years of participation)</td>
</tr>
<tr>
<td></td>
<td>Must start receiving distributions by April 1 of the year following attainment of age 70½</td>
</tr>
<tr>
<td></td>
<td>Loans are not permitted</td>
</tr>
<tr>
<td>Rollovers/transfers</td>
<td>Rollovers permitted from one SIMPLE IRA to another and rollover to a non-SIMPLE IRA or to an eligible retirement plan can be made tax-free only after a 2-year participation</td>
</tr>
<tr>
<td>Self-employed taxpayers</td>
<td>Can establish, contribute, and deduct contributions</td>
</tr>
<tr>
<td>Vesting</td>
<td>Contributions are immediately 100% vested</td>
</tr>
</tbody>
</table>
Profit-Sharing Plans

- Has a predetermined formula for allocating contributions
- May have options for a 401(k)
- Self-employed TPs can establish a solo 401(k)
Establishing a Plan

- Adopt a written plan document
- Arrange a trust/account for plan’s assets
- Develop recordkeeping system
- Provide info to eligible employees to participate
Profit-Sharing Plans p. 363

- Participation – All Employees
- Exclude some employees
  - Not 21
  - Not completed length of service
  - Covered by collective bargaining agreement
  - Certain nonresident aliens
Employer Contributions

- Simplest is % allocation of compensation
- Contributions can be made up to the extended due date of return (PLANNING)
- Limit is lesser of 100% of comp or $56K
- No catch up $$
- Vesting up to 6 years, BUT, if plan requires 2 years of service, then 100%
Employee Contributions

- Participants can make nondeductible contributions
  - $19,000 limit (2019)
  - $6,000 catch up for 50 yr olds or older (not treated as catch up until over $19,000 amount)
  - Ex. 9.15 Annual Contribution Amount
ABC has a profit sharing plan/401K
- Allows up to 10% of earnings contribution
- ABC matches first 5%
- J.J age 48 earned $180,000 in 2019
- J.J. elects the 10% option + 5% matching
- \((180,000 \times (10\% + 5\%)) = 27,000\)
Investment and Distributions

- Investments can be held in a separate trust or account in the name of the plan
- Trustees can hold assets in separate accounts for each employee or hold in a consolidated account
- Participants can choose investment choices made available
Investment and Distributions

- Distributions can be
  - Lump sum of the employee’s account
  - Roll over to an IRA or other retirement plan
  - Take periodic payments
  - Annuity or lifetime to not outlive $
Profit-Sharing Plans

- Reporting – the plan must keep employees informed of operations, any changes, provide opportunity to make decisions, and allow timely action.
Profit-Sharing Plans

- Individual Benefit Statement
- Summary Annual Report
- Nondiscrimination
  - Cross-reference to discuss discrimination testing
Profit-Sharing Plans

Self-Employed
  - Solo 401(k)
    - Covers a business owner with no employees
    - Can cover owner’s spouse
    - Net earnings must come from personal services
## FIGURE 9.7 Key Provisions of a Profit-Sharing Plan with a 401(k) Component

<table>
<thead>
<tr>
<th>Sponsor/eligible employer</th>
<th>Any employer with one or more employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Key advantage</td>
<td>Permits high level of salary deferrals by employees</td>
</tr>
<tr>
<td>Employer’s role</td>
<td>- No model form to establish the plan</td>
</tr>
<tr>
<td></td>
<td>- Arrange for employees to make elective deferral contributions</td>
</tr>
<tr>
<td></td>
<td>- Transmit contributions</td>
</tr>
<tr>
<td></td>
<td>- May be annual filing requirements</td>
</tr>
<tr>
<td>Contributors to the plan</td>
<td>- Employee elective deferral contributions ($19,000 maximum for 2019)</td>
</tr>
<tr>
<td></td>
<td>- $6,000 (for 2019) catch-up contributions</td>
</tr>
<tr>
<td></td>
<td>- Employer/employee combined: up to the lesser of 100% of compensation or $56,000 (for 2019)</td>
</tr>
<tr>
<td></td>
<td>- Employer can deduct amounts that do not exceed 25% of aggregate compensation (maximum $280,000 for each employee for 2019) for all participants and all salary reduction contributions</td>
</tr>
<tr>
<td></td>
<td>- May require annual nondiscrimination testing</td>
</tr>
<tr>
<td>Minimum employee coverage requirement</td>
<td>Generally, must be offered to all employees at least 21 years old who worked at least 1,000 hours in a previous year</td>
</tr>
<tr>
<td>Withdrawals, loans, and distributions</td>
<td>- Withdrawals permitted after a specified event occurs (retirement, plan termination, etc.), subject to federal income taxes</td>
</tr>
<tr>
<td></td>
<td>- Must start receiving distributions by April 1 of the year following the later of retirement or attainment of age 70½</td>
</tr>
<tr>
<td></td>
<td>- Possible 10% additional tax penalty if under age 59½</td>
</tr>
<tr>
<td></td>
<td>- Loans and hardship withdrawals may be allowed</td>
</tr>
<tr>
<td>Rollovers/transfer</td>
<td>Rollovers permitted to an eligible retirement plan or IRA</td>
</tr>
<tr>
<td>Self-employed taxpayers</td>
<td>Can establish, contribute, and deduct contributions</td>
</tr>
<tr>
<td>Vesting</td>
<td>Employee salary contributions are immediately 100% vested</td>
</tr>
<tr>
<td></td>
<td>Employer contributions may vest over time according to plan terms</td>
</tr>
</tbody>
</table>
Virtual currency is created, transmitted, and verified by blockchain.

Blockchain is an internet-based decentralized network that stores encrypted data.
The IRS defines virtual currency (also called cryptocurrency) as a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value.
Benefits of Crypto Currency

- Transfers can be immediate
- Fees may be less than credit card fees
- The payer does not have to give credit card or other payment information to a merchant, resulting in less chance of identity theft
- There are no exchange rates, which facilitates worldwide transactions
Miners use high-powered computers to solve complex mathematical equations that are part of the encryption process.

The first miner who solves the transaction and validates it receives a reward. This reward is a digital token of the currency he or she is mining.
Obtaining virtual currency

- Through centralized exchanges
- Peer-to-peer exchange
- Miners of blockchain transactions can “earn” VC for solving the transaction
- Practitioner Note: Coins and Tokens
Virtual Currency

Additional ways to get VC

- Bitcoin ATM
- Initial Coin Offering
- Airdrop and Giveaway
- Purchasing Goods or Services
Using Virtual Currency  pg. 373

- Some auto dealers
- Amazon
- Overstock.com
- eBay
- Some States (taxes)
- Tax School???????
Taxable Events

- Exchanges for goods and services
- Gross income to vendor
- Capital gain (loss) to purchaser
- Payments for services (employee)
- Wages for worker (salary)
- Employer – issue W-2 (same withholding requirements)
IRS Response to Cryptocurrency

IRS Notice 2014-21

- This notice explains how existing general tax principles apply to transactions using virtual currency
- This notice describes how existing general tax principles apply to transactions using virtual currency
2016 TIGTA Audit Report - 2014-21
Does not provide taxpayers with guidance on what records to keep and how to maintain records

The report concludes that further guidance is needed to help taxpayers voluntarily comply with their tax obligations
2016 TIGTA Audit Report

- Broadly raised awareness and asked for guidance
  - Small transactions: coffee
  - A bitcoin can be divided into 100,000,000 pieces !!!!!

- BASIS…BASIS…BASIS
After five years of silence, the IRS has released eagerly awaited cryptocurrency guidance addressing hard forks and airdrops, but the guidance leaves unanswered questions on cryptocurrency foreign reporting requirements, non-hard-fork airdrops and fair market value.
Major IRS/Practitioner Issues

- What is acceptable valuation and documentation?
- How do you value your currency (FIFO ?)
- Blockchain provides lots of security but little records
- IRS has issued 10,000 hard letters to known holders of Bitcoins – did you get one
AICPA requested guidance in 2018

- Expenses of obtaining VC
- Acceptable Valuation and Documentation
- Computation of Gains and Losses
- De Minimis Election
- Charitable Contribution Valuation
- Other issues
Congress on April 11, 2019 sent a bipartisan letter requesting IRS provide guidance on VC.
Virtual currency has many benefits:

- Transfers can be immediate
- Fees are less than CCs
- Payers are more secure when conducting business
- There are no exchange rates
Issue 4: Virtual Currency  p. 372

- IRS has issued limited guidance to date.
- In 2018, IRS began a virtual currency campaign
  - TPs not reporting income tax consequences of transactions
Current Tax Guidance

- IRS Notice 2014-21 states VC is property, therefore, the general principles of property transactions apply.
### Payment for Goods and Services – Seller

- A TP receiving VC as payment for good or services includes in income the FMV (in US $) of VC at the time of receipt.
- Basis is the issue to address.
Payment for Goods and Services – Buyer

- A TP using VC to pay for goods or services will have a capital gain or loss on the transaction.
Exchange or Sale

- Capital gain or loss
- Basis is needed to calculate

Compensation Income

- FMV when received is income
- Subject to FICA, FUTA, FIT, and SIT
- If a self-employed miner…SE tax
Virtual Currency

- Reporting Issues
  - W-2 for wages
  - Form 1099-MISC for $600 or more
  - Form 1099-K
  - Practitioner Note: Foreign Accounts

BOTTOM LINE: Records, Records, Records !!!
Virtual Currency

- Backup Withholding
- Penalties
- Practitioner Note: Tax Prep Software
2016 TIGTA Audit Report

- Big issue - is a change coming to move from property to currency?
  Much left to be discovered
Questions??