Why You Should Not Hate Your Brokerage 1099 Form

Here are some things that almost nobody likes: spiders, snakes, warm squishy fruit, splinters, paper cuts…and IRS Form 1099 sent by your brokerage firm. That 1099 always seems to be late. It is so easy to misplace. And it reports every last bit of income, causing your accountant to give you bad news. While we realize that most of you just hand it to your accountant and give it little to no thought, I would like to share with you some things you might want to know about it.

A frequent question we get is, "When will I get my 1099?" The common misconception is that the brokerage firm, Raymond James (RJ) in our case, is required to mail 1099s by January 31st. The confusion most likely stems from the fact that W2 forms and 1099-Rs, sent to retirees with IRA distributions, are supposed to be mailed each year by January 31st. When one thinks of a 1099 from their brokerage account, they are most often referring to 1099-Int for interest, 1099-Div for dividends, and 1099-B which reports gains and losses from securities transactions. Brokerage accounts typically contain all three types of transactions, so the brokerage company will issue a consolidated 1099 statement with all the different types of earnings included in one report. These 1099 forms don't actually have to be mailed until February 15th.

1099s are often delayed due to income reallocation. This process is conducted by the issuer of particular investments, and changes are subsequently reported to RJ. The types of securities impacted by income reallocation typically include Mutual Funds, Real Estate Investment Trusts, Exchange Traded Funds, Unit Investment Trusts, and select individual stocks. Brokerage firms would rather send out preliminary 1099s than have to send out Corrected 1099s, causing you to have amend your tax returns.

There are many types of form 1099, but they all have one thing in common—they report income that was paid to you. And the various forms of income shown on 1099s are taxed at different rates. Interest, ordinary dividends and short-term capital gains (positions held for less than one year) are taxed at ordinary income tax rates. Qualified dividends and long-term capital gains (positions held for longer than one year) are taxed at preferential capital gain rates. We are very aware of different tax treatments, and do our best to purchase and sell investments in a tax efficient manner. A number of examples follow, along with general information about various forms 1099.

Taxable Interest vs Tax-Exempt Interest — When building your portfolio, we look at your income tax bracket and state of residence to see whether taxable bonds and/or tax-exempt municipal bonds should be included in your portfolio.

Realized Gains/losses — Before year end, we review taxable accounts for capital gains realized during the year. "Tax loss harvesting" is a standard practice that we use when possible, selling securities with a loss in order to offset these taxable gains. We provide significant gain or information directly to client accountants, if applicable.

Foreign Taxes Withheld — Some non-US companies pay dividends but withhold a portion for taxes. This withholding is shown on 1099s as foreign taxes paid. If the investment is held in a taxable account rather than in a retirement account, the investor/taxpayer can get reimbursed for some or all of the withheld amount with their tax filing. When building a portfolio, we try to put international stocks in taxable accounts so you can get the benefit of reported foreign tax withholding.

Required Minimum Distributions (RMD) — Beginning at age 72, IRS regulations generally require a minimum withdrawal amount each year from tax-deferred retirement accounts, such as traditional IRAs and 401(k) plans. Steep penalties are assessed on required amounts not withdrawn. If an account owner fails to withdraw the RMD, fails to withdraw the full amount of the RMD or fails to withdraw the RMD by the applicable deadline, the amount not withdrawn is taxed at 50%. IRA distributions are included as income on 1099-R.

Beneficiary IRA Distributions — For those accounts inherited before 2020, annual minimum distributions are required. But those who inherit accounts after December 31, 2019 have 10 years to withdraw the entire balance, and are not subject to annual minimum distributions. We can review distribution plans with clients, to determine their impact on income taxes, Medicare premiums, and the taxability of Social Security.

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529 Plan Distributions — Form 1099-Q and Form 1098-T will list the amount of the 529 plan distribution and how much was used to pay for college tuition and fees, but it is up to the 529 plan account owner to calculate the taxable portion, if applicable. 529 plan distributions used to pay for non-qualified expenses are subject to income tax and a 10% penalty on the earnings portion of the withdrawal.

Tax Prep Software — Raymond James has partnered with tax preparation software companies H&R Block, Tax ACT and TurboTax, to provide tools that will enable you to easily import tax form data. Be sure to use this download tool to accurately and efficiently report your investment activities.

While we review investment portfolios throughout the year, the year end offers us and our clients an opportunity to impact the 1099 before it is issued to minimize income taxes and maximize the use of various benefits. Shown below are the more significant year-end planning issues. Please review to see what may apply to you, and let us know.

New Jersey Pension Exclusion — Since 2000, New Jersey has provided taxpayers a pension and retirement income exclusion. The retirement exclusion allows qualifying New Jersey retirees to avoid state income tax on a portion of their retirement income. Taxpayers with gross income of $150,000 or less may qualify to exclude some or all of the retirement income. However, a taxpayer with gross income of $150,001 or more will lose their entire exclusion.

Maximize 401(k) Contributions — Employees can contribute up to the lesser of $19,500 or participant's compensation, and an additional catch-up contribution of $6,500 if age 50 or older. If not maxing out, consider increasing the percentage of your 401(k) contribution in order to maximize the contribution in the future.

Estimated Income Tax Payments — The self-employed and retirees should discuss with their accountant whether they need to make estimated tax payments. Fourth quarter Federal estimated payments are due by January 15, 2022. State estimated payments also have a January 15th due date, unless a taxpayer is subject to the Alternative Minimum Tax in the future. Then an accountant might recommend pre-paying by December 31st. In the event that a client has an unusually large capital gain in a given year, we will communicate this information to the client and/or the accountant so that an appropriate estimated payment can be made.

Charitable Donations — If you itemize, consider making charitable donations before the end of the year. Donations are generally deductible to those that itemize. Consider gifting highly appreciated stock if held for more than a year. These deductions are set at the current market value, and no tax is due on the capital gain. If you wish to donate stock that has declined in value, sell the stock and donate the proceeds. Not only will you get the write off but you will also be able to take advantage of the capital loss generated from the sale.

Individual Retirement Accounts (IRAs) — The deadline for 2021 Roth or traditional IRA contributions is April 15, 2022. Even though the deadline is April 15th, consider making contributions earlier. The maximum contribution is $6,000 ($7,000 if you are 50 or older by the end of year) or 100% of earned income, whichever is less.

Roth IRA Conversion — Unlike Roth IRAs which have contribution and income limits, any taxpayer can now convert a traditional IRA to a Roth IRA regardless of income. When you convert to a Roth IRA, the converted amount of your traditional IRA will be taxed as ordinary income in the conversion year at the income tax rates in effect on the conversion date. A year with unusually low taxable income can be ideal for a conversion before year end. A Roth IRA offers tax-free growth of assets, tax-free distributions and no required minimum distributions (RMDS) during the original account holder's lifetime. Review with your accountant whether a Roth IRA conversion makes sense.

In between the year-end parties, work deadlines and many other asks, take the time to consider the issues we identify above. We'll do the same. Happy holidays to you and your family.

As always if you have any questions, please give us a call.

Sincerely,

John G. Kaiser

John G. Kaiser, CFP®

Raymond James and its advisors do not offer tax, accounting or legal advice.

Investments in municipal securities may not be appropriate for all investors, particularly those who do not stand to benefit from the tax status of the investment. Municipal bond interest is not subject to federal income tax but may be subject to AMT, state or local taxes. Unless certain criteria are met, Roth IRA owners must be 59½ or older and have held the IRA for five years before tax-free withdrawals are permitted. Additionally, each converted amount may be subject to its own five-year holding period. Converting a tradition-al IRA into a Roth IRA has tax implications. Investors should consult a tax advisor before deciding to do a conversion.

The foregoing information has been obtained from sources considered to be reliable, but we do not guarantee that it is accurate or complete, it is not a statement of all available data necessary for making an investment decision, and it does not constitute a recommendation. Any opinions are those of John G. Kaiser and not necessarily those of Raymond James. Prior to making an investment decision, please consult with your financial advisor about your individual situation.