



**Tax Benefits for Active Traders  
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## Speaker Bio:

### Robert A. Green (1/2)

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- **Robert A. Green is a CPA and founder and CEO of Green & Company Inc. (GreenTraderTax.com and GreenTraderFunds.com), a publishing company, and Green & Company CPAs, LLC, a virtual tax and accounting firm catering to traders and investment management businesses.**
- **He is a leading authority on trader tax. Mr. Green writes the “Business of Trading” section for *Active Trader* magazine. He is also the author of *The Tax Guide for Traders* (McGraw-Hill, 2004), *Green's 2010 Trader Tax Guide*, and the annual GreenTrader tax return example guides.**

# Speaker Bio:

## Robert A. Green (2/2)

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- **Mr. Green is frequently interviewed and has appeared in the *Wall Street Journal*, *Forbes*, *Fortune*, and *Barron's*. Mr. Green has also appeared on CNBC, Bloomberg Television, and Forbes.com Video Network.**
- **He is the main tax speaker at the MoneyShow University, Traders Expo, Forex Trading Expo, and other trade shows.**
- **Mr. Green is also founder and CEO of the GreenTraderTax Traders Association. You can find more information about Mr. Green, his company's services and products, and taxes for traders at [www.greencompany.com](http://www.greencompany.com).**

# Overview: Trader Tax Status

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- **Active traders in securities, futures/commodities, or forex can claim “trader tax status” (business treatment) on their tax returns.**
- **Qualifying business traders are treated as sole proprietors by default, and they don’t need to file forms or elections to claim this status with the IRS in advance. They simply include a Schedule C (Profit and Loss from Business) with their Form 1040 individual tax returns.**
- **It’s not too late to claim trader tax status on a Schedule C for 2009. Traders can also file amended tax returns to claim this status for any of the three prior open tax years.**

# Overview:

## Entities for Traders (1/2)

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- **Filing a separate trading entity tax return is a better option for business traders rather than filing a Schedule C.**
- ***Reduce red flags:* Entity tax returns significantly reduce IRS challenges on trader tax status. The IRS recently denied trader tax status in a key tax court case (*Holsinger vs. Commissioner*) and qualification is becoming a bigger concern for traders. With the budget deficit crisis, the IRS and states are getting more aggressive on tax exams.**
- ***AGI-deductions:* Entities also provide more opportunity for tax savings, such as AGI deductions for health-insurance premiums and retirement-plan contributions (traditional and Roth).**

# Overview:

## Entities for Traders (2/2)

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- **The best types of entities for traders are general partnerships, multi-member LLCs (filing partnership returns), or S-Corporations (best for single owners). C-Corporations have many pitfalls, but can be useful for some fringe benefit plans, such as a medical-reimbursement plan.**
- **A pass-through entity is simple, easy to form, and inexpensive in most states.**
- ***Late year MTM elections:* Newly formed entities are considered “new taxpayers” which may elect Section 475 MTM treatment later in the year.**

# Overview:

## Tax Treatment (1/2)

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**There are key tax treatment differences between:**

- **Trading securities (stocks, stock options, bonds, mutual funds, single stock futures, and more).**
- **Trading futures and commodities with Section 1256 lower 60/40 tax treatment.**
- **Stock options (securities) and narrow-based index options (securities) vs. broad-based index options (futures).**
- **ETFs based on securities vs. ETFs based on commodities (futures), and options on ETFs (unclear, but probably futures).**

# Overview:

## Tax Treatment (2/2)

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- **Domestic futures (with 60/40 treatment) versus foreign futures (often without 60/40 treatment, unless the foreign exchange received an approval letter from the CFTC and revenue ruling from the IRS).**
- **Forex spot, forward and OTC option contracts by default have Section 988 ordinary gain or loss treatment. Traders may file an internal “capital gains election”.**
- **Precious metals have the higher “collectibles” long-term capital gains tax rate (28%) and there are nuances versus base-metals (commodities).**

# Overview: Elections

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## Key tax elections for traders to make on a timely basis:

- **Qualifying business traders only may file a timely Section 475(f) MTM election for ordinary loss treatment (exempt from capital loss and wash sale limitations).**
- **All futures traders may elect to carry back futures losses three tax years, but they can be applied only against futures gains (on Form 6781).**
- **Forex traders may elect to opt out of Section 988 (ordinary gain or loss treatment) into Schedule D (capital gains and loss treatment). This opt-out election is not allowed for holding actual foreign currency; Section 988 must be used. Lower 60/40 treatment is possible in Section 1256g (foreign currency contracts) on forex spot and forwards in major currencies for which the trader doesn't take or make delivery of the underlying currency.**

# Trader Tax Status & Benefits

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- **Highly-active traders may qualify for “trader tax status” (business treatment vs. the default investment treatment).**
- **Business treatment gives full ordinary loss deductions (including home office, education, start-up Section 195, organization expenses, margin interest, and much more), whereas investment expenses are very limited, only allowed in excess of 2 percent of adjusted gross income (AGI), and not deductible against the alternative minimum tax (AMT).**
- **There are special rules for (pre-business) start-up expenses (Section 195), organization expenses, education, travel to seminars, and home-office expenses. You need trader tax status to deduct these items.**

# Golden Rules: Qualifying for Trader Tax Status (1/4)

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**Business traders need to meet these golden rules to qualify for trader tax status:**

- ***Job:*** Trades full time or part time; part-time traders often hold a full-time job in addition to their trading career. West coast traders often trade early in the day before going to work. East coast traders may trade forex at night. There are several examples in Green's 2010 Trader Tax Guide.
- ***Frequency:*** Executes trades on more than 75 percent of available trading days in a consistent, frequent, and continuous manner with no sporadic lapses. *Holsinger* lost his tax court case with only 45 percent of available trading days. Read about that case on our blog.

# Golden Rules: Qualifying for Trader Tax Status (2/4)

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- ***Hours:*** Trades more than four hours per day, every day.
- ***Volume:*** Makes close to 500 or more round-turn trades per year on an annualized basis. The IRS can easily verify this factor and overweigh it in its analysis.
- ***Taxable activity:*** Only trading in taxable accounts counts toward trader tax status. Trading in retirement-plan accounts doesn't qualify, although it can be a good idea.
- ***Holding periods:*** Mostly day trades or swing trades, and few positions are held for more than a few weeks (which is more understandable for option strategies). Investment positions are properly segregated.

# Golden Rules: Qualifying for Trader Tax Status (3/4)

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- ***Intention:*** Has the intention to run a business activity, to make a living from trading, and acts accordingly with formal record keeping and planning.
- ***Resources:*** Has significant business tools (i.e., multiple computers and monitors), business expenses (trading services), training, and a home office.
- ***Account size:*** Has a material account size for staging a serious business effort; for example, \$25,000 to be a “pattern day trader” in securities. A mini forex account of \$5,000 is too low to impress the IRS on trader tax status.

# Golden Rules: Qualifying for Trader Tax Status (4/4)

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- **Traders falling short of these golden rules should consult with a trader tax expert; special facts and circumstances may apply.**
- **Robert A. Green, CPA handles these consultations for GreenTraderTax clients. Simply contact us to schedule a phone appointment right away.**
- **Green's 2010 Trader Tax Guide expands on these bullet points and includes lots of examples of close-call business traders. It's available at [www.greencompany.com/Traders/Guides.shtml](http://www.greencompany.com/Traders/Guides.shtml).**
- **An entity is better for claiming trader tax status, since the IRS raises the bar on the golden rules for part-time individual traders. Sole proprietor Schedule Cs attract undue IRS attention.**

## Business traders may elect Section 475(f) Mark-to-Market (MTM) (1/4)

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- **Qualifying business traders should generally elect Section 475 MTM accounting treatment on securities only in a timely fashion. The election is due by April 15<sup>th</sup> of the current tax year for individuals and partnerships.**
- ***Report unrealized gains and losses:* Section 475 MTM imputes sales on open positions at year-end on business positions in securities only; not on segregated investment positions in securities too. This is usually not a factor for day traders with no business positions open at year end.**
- ***Tax-loss insurance:* The more important element of Section 475 MTM is ordinary gain or loss treatment. The biggest pitfall for traders is getting stuck with capital loss carryovers (capital losses are limited to \$3,000 per year), wasted losses, and wash sales; this is solved with MTM.**

## Business traders may elect Section 475(f) Mark-to-Market (MTM) (2/4)

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- **Section 475 MTM accounting is also much easier than cash accounting, since there are no open positions or wash-sale loss deferrals. Note that both Schedule D (cash accounting) and Form 4797 (MTM accounting) require line-by-line reporting for securities.**
- **Short-term capital gains – which securities business traders have anyway – are taxed at ordinary tax rates; so there is no difference on gain treatment with MTM.**
- ***Recommended for securities only:* Unless a trader has a material capital loss carryover, realized and/or unrealized capital losses, they should generally elect Section 475 MTM on securities only (not on futures). Consult a trader tax expert as there are many nuances to consider.**

## Business traders may elect Section 475(f) Mark-to-Market (MTM) (3/4)

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- **Section 475 MTM is free tax-loss insurance for securities traders, but expensive for futures traders, who want to retain lower 60/40 tax rates (in Section 1256).**
- **Futures traders can benefit from Section 475 MTM ordinary loss treatment too, but they must give up lower 60/40 tax treatment on subsequent year gains. If you have a large Q1 2010 trading loss in futures, elect Section 475 by April 15, 2010 (the due date) and then set up a new entity for a “do over” on the Section 475 election for the rest of 2010.**
- **Section 1256 includes an election to carry back futures losses three tax years, but only against futures gains.**

## Business traders may elect Section 475(f) Mark-to-Market (MTM) (4/4)

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- ***Warning and problem:*** Capital-loss carryovers may only be applied against subsequent year capital gains and not Section 475 MTM trading gains. For this reason, far too many traders skip MTM elections, thinking they will generate capital gains to use up capital losses. However, they often generate even more unutilized capital losses.
- ***Solution:*** Use an internal MTM election in a new entity to reduce the gamble in filing a MTM election. It's one of the few times traders can use hindsight on an election, since there is a 75-day period allowed for the internal Section 475 MTM election. Elect MTM to lock in new ordinary losses and form another entity for a "do over election." For example, this strategy can be used with the cash method to use up prior capital loss carryovers.
- Without entities, traders are stuck with MTM until they exit their individual trading activity (MTM is suspended only) or they file a second Form 3115 to seek the consent of the IRS to change back to the cash method. Partnerships are the least expensive and they are best for the "do over" MTM election strategy.

# Immediate Tax Refunds Using Net Operating Loss Carrybacks (1/2)

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- **Net operating losses (NOLs) are comprised of business losses, which include Section 475 MTM (securities and/or futures) and Section 988 (forex) ordinary trading losses and trading business expenses.**
- **Business losses offset current year income of any kind (portfolio, capital, business, or passive).**
- **NOLs arise in a negative taxable income situation. In that case, some deductions are wasted unless they are carried over to subsequent years, such as home-office, investment interest, and charitable contribution expenses.**

# Immediate Tax Refunds Using Net Operating Loss Carrybacks (2/2)

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- **NOLs are carried back two tax years, unless the taxpayer elects to forgo the carryback, instead carrying it forward (it must be used up within 20 years). The 2009 Stimulus Bill allowed a five-year carryback choice for 2008. A 2009 bill extended a similar five-year carryback to 2009 NOLs. Even large traders qualify for this small-business tax break, because the cut off applies to net trading gains, not proceeds.**
- **After carrying back a NOL two or five tax years – oldest year first is a must – any remaining NOL amount is carried forward.**
- ***Warning:* If a trader is a “close call” on trader tax status, it’s wise to forgo the NOL carryback and use it in subsequent tax years. Or, absorb a NOL with a Roth IRA conversion.**
- **NOL carryback refund claims attract IRS attention and can lead to an IRS exam, where the IRS seeks to deny trader tax status and all these related benefits. NOL carryforwards are much safer.**

## Don't Get Trapped with Capital Loss Carryovers

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- **The biggest tax pitfall for traders is getting trapped with unused capital-loss carryovers and wasted trading losses.**
- **Most problems occur when traders are uneducated on available elections and strategies in starting their trading activity.**
- ***Section 475(f) MTM elections:* If a business trader has a large current year-to-date trading loss (futures included) as of April 15, it's wise to elect Section 475 to lock in ordinary loss treatment.**
- **Next, form a new entity for a “do over” internal Section 475 election (decision) for the balance of the year.**

## Don't Get Trapped With Wasted Forex Losses

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- **Forex traders start off in Section 988 with ordinary gain or loss treatment, whether they have trader tax status or not.**
- ***Potential problem for non-business forex traders:* Ordinary losses offset income of any kind. But, if forex losses are significant and other taxable income is low, there will be a large amount of wasted negative taxable income. Conversely, with trader tax status, forex ordinary losses are business losses for NOL treatment.**
- ***Solution:* Non-business forex traders should consider an internal capital gains election in order to use capital-loss carryover treatment (with capital loss carryovers).**

# Claiming Trader Tax Status and Preparing Business Trader Tax Returns

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- **Assess trader tax status before or after year-end. Since it's based on facts and circumstances, after year-end may be safer. Assess it now for 2009 tax returns.**
- **Traders who qualify for trader tax status and have not formed a separate legal entity are classified as a “sole proprietor” or “unincorporated business.”**
- **Report trading business expenses on Form 1040 Schedule C (Profit or Loss from Business).**
- **Home-office deductions are reported on Form 8829. Depreciation and amortization are reported on Form 4562. Both of these tax forms transfer their deductions to Schedule C. Business trading gains are required for home-office deductions; otherwise they carry over to the next year(s).**

# Trading Gains/Losses are Reported on Different Forms

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- **Futures trading gains and losses are reported on Form 6781 where the 60/40 treatment is applied before moving over to Schedule D.**
- **Securities trading gains and losses are reported on Schedule D (cash method). If you elect Section 475 MTM, you report your trading gains and losses on Form 4797 Part II (ordinary gain or loss treatment).**
- **Section 988 forex is reported on line 21 “Other Income” of Form 1040, or Form 4797 for business forex traders. The internal capital gains election uses Schedule D (and/or Form 6781 first).**

## Problem and Solution: Transfer of Income Strategy (1/3)

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- ***Problem:*** Only trading business expenses are reportable on Schedule C, whereas all trading gains and losses are reported on other tax forms. So there is no revenue on Schedule C and it looks like a losing business, even if the trader is profitable.
- ***Red flag:*** The IRS will think a trader has a losing business activity with no business revenue reported on Schedule C. The IRS may then seek to challenge trader tax status and business treatment, thereby jeopardizing business expenses, as well as Section 475 MTM ordinary loss treatment on Form 4797. Reporting trading gains and losses directly on Schedule C will also invite an IRS exam.

## Problem and Solution: Transfer of Income Strategy (2/3)

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- ***Solution:*** Tie the trading business tax forms together by transferring business net trading gains only (not investment capital gains) to Schedule C in an attempt to “zero out” Schedule C.
  - If a trader doesn't have enough business trading gains to zero out Schedule C, transfer all business trading gains to at least reduce the Schedule C loss amount and perhaps free up some home-office deduction.
  - If a trader has plenty business trading gains, transfer only enough gains to zero out Schedule C and no more.

## Problem and Solution: Transfer of Income Strategy (3/3)

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- **No SE tax:** Do not show a net income on Schedule C, as that could invite IRS questions about SE tax. Only futures traders who are members of futures or options exchanges owe SE tax.
- **Unlock more deductions:** Zeroing out Schedule C unlocks the home-office and 179 depreciation deductions, both of which require income. Section 179 can look to wages too.
- **Warning — it's not in the tax forms:** This transfer of income strategy is not included in any tax forms or instructions. It's our customary practice. Entities are better solutions for business traders and they avoid this Schedule C problem.
- **Footnotes:** It's important to attach thorough footnotes explaining your trader tax status, tax treatment, and this transfer strategy. Find the footnotes in our trader tax examples guides.

## Trade Accounting: A Snap for Futures & Most Forex Traders (1/3)

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- **Futures traders receive a simple one-page Form 1099-B showing summarized “Aggregate Profit or Loss” which includes realized and unrealized gains and losses.**
- **Forex traders usually receive an online report from their broker showing net forex trading gains or losses. Forex brokers are not supposed to issue a Form 1099 for forex trading gains and losses, but a few do (and it can cause problems).**
- **Futures and forex traders use summary reporting; they don’t need to use trade accounting software. Whereas, securities traders need third-party software for line-by-line reporting. TradeLog® for GreenTraderTax software is the best around!**

## Trade Accounting is a Responsibility for Securities Traders (2/3)

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- **Securities traders receive a more complex Form 1099-B, yet it doesn't provide net trading gain or loss information.**
- **Securities traders need to use line-by-line reporting on their tax returns, whereas futures and forex traders can use summary reporting. The IRS often sends tax notices if you don't comply.**
- ***Problem:* Under current tax law, a securities 1099-B reports only proceeds on the sales of securities. It doesn't report cost basis, holding periods, options, wash sales, or net trading gains and loss information.**
- ***Improved 1099-Bs on the way:* Effective in 2011, securities brokers must add average cost basis and short-term vs. long-term holding period information to 1099-B reporting of covered securities. Lots of info will still be missing.**

# Trade Accounting for Securities is Easier with TradeLog® (3/3)

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- **Securities traders should simplify their accounting needs by using specialized trade accounting programs. The best program is TradeLog®, as explained on [www.greencompany.com/Traders/Software.shtml](http://www.greencompany.com/Traders/Software.shtml).**
- **Consumer tax preparation and money programs have basic trade accounting capability, but they aren't adequate or robust enough for business traders. See the Barron's tax preparation software review, which highly recommended GreenTraderTax and TradeLog® on Jan. 11, 2010. [www.greencompany.com/EducationCenter/InTheMediaBarrons.shtml](http://www.greencompany.com/EducationCenter/InTheMediaBarrons.shtml)**
- **Download and match your trades from most brokerage firms directly into TradeLog® (or into Excel or csv first and then into TradeLog®).**
- **Simply attach the reconciled TradeLog® Schedule D-1 or Form 4797 IRS-compliant reports to tax return filings.**

# Entities For Traders (1/3)

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- **Entities are recommended for traders and are required for investment-management businesses. Traders don't need liability protection, but money managers do.**
- **One size doesn't fit all when it comes to entities. Don't go with canned solutions; work with a trader-tax expert to pick the best entity for your special needs. It varies by state and there are other factors to consider, too.**
- **Learn the differences between in-state and out-of-state entities. Tax-free states market entities for "asset protection" and tax-avoidance reasons, but both usually fail in practice. If you live and work in your home state, you probably need to register a foreign entity in that state. It's different for funds, which are usually formed in Delaware.**

## Entities For Traders (2/3)

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- **Most traders don't have earned income from trading, so in order to contribute to a retirement plan, they need to form a trading entity and use it to financially "engineer" an administration fee (earned income) or payroll.**
- **Learn about different types of entities and retirement plans, and how to choose the best ones for your situation.**
- **Multi-member LLCs, general partnerships, and S-Corps are good for traders.**
- **C-Corps are bad for traders (double taxation, losses are trapped in the entity, and there is no 60/40 treatment on futures). A C-Corp (in a dual-entity structure) can not fix lack of trader tax status.**

## Entities For Traders (3/3)

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- **General partnerships between spouses are a good choice in many states because they are the most inexpensive to form and maintain. Partnerships are portable.**
- **LLCs and S-Corps have state filing fees and most states have annual report charges, minimum taxes, and/or franchise taxes. These costs vary by state and are fairly low in most states.**
- **Single-member LLCs are “disregarded entities,” a tax nothing in the eyes of the IRS. Consider electing S-Corp status on a SMLLC. S-Corps should use payroll rather than administration fees for the earned-income element.**

## Retirement Plans For Traders (1/2)

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- **Mini 401(k) retirement plans can generate the most tax savings for traders. They can have a traditional or Roth feature.**
- **Profit-sharing plans, such as a SEP IRA, limit “defined contributions” to 20 percent (net) of earned income.**
- ***A Mini 401(k) plan is better.* It adds an “elective deferral” [401(k) element] to a profit-sharing plan (\$16,500 for 2009 and 2010) and that portion is almost 100 percent tax deductible, versus only 20 percent in a profit-sharing plan.**
- **For the maximum Mini 401(k) allowed contribution of \$49,000 (for 2009 and 2010), you can reduce earned income and save SE tax (the 2.9 percent Medicare portion) by approximately \$2,000. Most of this net tax savings comes from the first elective deferral portion.**

## Retirement Plans For Traders (2/2)

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- **Mini 401(k) plans also have a catch-up provision for taxpayers 50 or older (\$5,500 for 2009 and 2010), and some custodians allow plan loans (up to the lower of \$50,000, or 50 percent of plan assets). Loans must be paid back within five years with market interest.**
- **Mini 401(k) plans must be established before year-end, whereas a SEP IRA can be established up until the due date of the tax return including extension.**
- **The GreenTraderTax entity/retirement plan strategies are designed to maximize income tax savings vs. SE tax costs.**

# GreenTrader Retirement Plans

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- **Self-directed retirement plans through intermediaries contain value-added features such as plan loans (on qualified plans only, not IRAs) and the ability to trade futures and forex and make other types of alternative investments (such as hedge funds and real estate).**
- **Most brokerage firms provide “cookie-cutter” retirement plans that don’t offer most of these features.**
- **Avoid self-dealing and prohibited transactions. You can’t invest in your own trading company LLC.**
- **Roth IRA conversions are a great idea for traders.**

# Self-Employment (SE) & Payroll Taxes (1/2)

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- **Many online traders are exempt from SE and payroll taxes (FICA and Medicare).**
- **SE and payroll taxes are 15.3 percent of the base amount (\$106,800 for 2009 and 2010) and 2.9 percent (Medicare only) thereafter.**
- **Traders are exempt from SE or payroll tax because trading gains are not considered “earned income” whether or not you have trader tax status or use MTM. SE or payroll tax is assessed on earned income only.**

# SE Tax: Exceptions for Traders (2/2)

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- **There are two exceptions to SE tax exemption rules for traders:**
  - **Futures traders who are dealer/members of an options or futures exchange are deemed to have earned income on all their exchange-generated Section 1256 trading gains (Section 1402i).**
  - **Proprietary traders who receive a Form 1099-Misc. for non-employee compensation are considered to have earned income. Some prop traders try to argue it's really disguised retail trading gains not subject to SE tax.**

# Contact Information

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