



**Forex Taxation: IRC 988 vs. 1256 60/40 Treatment,
Trader Tax Status, Forex Funds, and More
The Forex Trading Expo in Las Vegas
Sat. Sep 15, 2007 03:15 P.M. - 04:15 P.M. PT**

If you can't attend, watch the Webcast and/or download the Podcast.

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Classroom Training: Forex Taxation: IRC 988 vs. 1256 60/40 Treatment, Trader Tax Status, Forex Funds, and more

- The tax code is uncertain and confusing regarding forex trading taxation. In this workshop, Robert Green will simplify the rules and show you how to lower your tax rates on forex gains by up to 12 percent by electing out of IRC 988. He will also show you how to maximize your tax refunds from forex losses. You will learn how to use important tax savings strategies in connection with trader tax status (business treatment) and how to qualify to claim that status. Business traders will learn how to deduct all business expenses safely, without having to form an entity. Since a trading entity is sometimes a good idea because it allows the deduction of health-insurance premiums, retirement-plan contributions, and other fringe-benefit plans, this session also will cover the formation of trader entities. Learn how to get huge tax refunds from net operating losses (NOLs). We will show you how to avoid IRS exams and, if examined, how to win before the auditor even gets started.

Speaker Bio:

Robert A. Green

- **Robert A. Green, CPA, is CEO and founder of Green & Company CPAs, LLC (GreenTraderTax.com and GreenTraderFunds.com), a virtual tax and accounting firm catering to traders and investment management businesses; Green & Company Inc., a publishing company; and GTT Alliance for Traders, an advocacy alliance for traders.**

He is a leading authority on trader tax and hedge funds. Mr. Green writes the monthly "Business of Trading" section for *Active Trader* magazine, and the main trader tax content for *SFO* magazine. He is also the author of *The Tax Guide for Traders* (McGraw-Hill 2004) and the annual GreenTrader tax return examples guides. Mr. Green is frequently interviewed and has appeared in the *Wall Street Journal*, *Forbes*, *Fortune*, *Barron's*, brokerage firm newsletters, and many other media. Mr. Green has also appeared on CNBC, Bloomberg Television, Forbes.com Video Network, CBOT Webinars, and several radio shows. He is the main tax speaker at the International TradersExpo, The Forex Trading Expo, MoneyShow.com University and other events.

Items for discussion:

- **Active forex, futures and securities traders can save plenty of tax money by claiming “trader tax status” (business treatment) on their tax returns; it’s still not too late for 2006. Learn all about these trader tax breaks, how to qualify for trader tax status, and filing strategies to use that shouldn’t draw IRS attention.**
- **Its OK for many business traders to file as sole proprietors using Schedule C, included with their Form 1040 individual tax returns.**
- **However, a separately filed trading entity is sometimes a good idea, as it allows you to deduct health-insurance premiums, and retirement-plan contributions (Adjusted Gross Income deductions). It also helps deflect IRS questions about part-time trader tax status. This session will cover the best types of entities and retirement plans for forex traders.**

Items for discussion (cont.)

- **Learn the key tax differences between trading futures, securities and forex. IRC 1256, IRC 475 and IRC 988 are different but dueling regulations.**
- **Foreign futures may not qualify for lower 60/40 tax breaks (1256 contracts). Learn how to make a winning case to utilize lower 60/40 tax rates on foreign futures, too.**
- **Forex and futures tax laws often intertwine and there are important elections to make on a timely basis, such as electing out of IRC 988 (ordinary gain or loss treatment on forex) for IRC 1256 60/40 tax treatment.**
 - **The forex part of this presentation will be covered in-depth at The Las Vegas Trading Expo.**

Items for discussion (cont.)

- **If you hold a full membership on an options or futures exchange, your trading gains are subject to self-employment (SE) taxes (IRC 1402i); otherwise, trading gains are exempt from SE taxes. A case can be made that electronic corporate memberships on futures exchanges do not trigger SE tax, so forex traders are exempt from SE tax.**
- **Learn how to get huge tax refunds from net-operating losses (NOLs) and/or futures IRC 1256 capital-loss carrybacks.**
- **We'll show you how to avoid IRS exams and, if examined, how to win before the auditor even gets started.**
- **We will briefly discuss forex funds.**
- **Questions and answers.**

Trader tax status unlocks trader tax benefits

- **The first step to tax savings is qualifying for “trader tax status” (business treatment vs. the default investment treatment).**
- **Business treatment gives full ordinary loss deductions (including home-office, education, start-up 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 at all against the nasty Alternative Minimum Tax (AMT).**
- **There are special rules for (pre-business) start-up expenses (IRC 195) and education expenses.**
- **The average trader saves more than \$10,000 with trader tax status, and forex and futures funds save a fortune for all their investors.**

Qualifying for Trader Tax Status

- **A business trader meets most of the following qualifications:**
 - **Trades full-time or part-time, all day every day.**
 - **Spends more than four hours per day, every day, with few sporadic lapses.**
 - **Makes more than 300 to 500 round-turn trades per year, but there is no magic number in case law. Forex and futures trades are not listed line-by-line on your tax return (as securities trades must be), so the IRS can not see your number of forex or futures trades.**
 - **Mostly day trades or swing trades, and few positions are held for more than a few weeks. Investment positions are segregated.**
 - **Has the full intention to run a business and act accordingly with formal record keeping, business plans and other documentation.**
 - **Has significant business tools, business expenses and a home-office.**

Qualifying for Trader Tax Status (cont.)

- **If your trading activity is anything less than the current golden rules stated above, the IRS may scrutinize and challenge your qualification for trader tax status. In this case, it's wise to consider a consultation with a trader tax expert to review your particular facts and circumstances. Robert Green is available for 30-minute consultations.**
- **You can claim trader tax status after year-end; it doesn't need to be elected in advance (like IRC 475 MTM and the forex election out of IRC 988).**

Qualifying for Trader Tax Status

Statutory vs. Case Law

- **Currently, the IRS does not provide “statutory law” with objective tests for how to qualify for trader tax status. Subjective “case law” applies, and it’s weak on guidance; case law has not caught up with the online business trading revolution. Our golden rules are based on years of experience.**
- **Subjective “case law” has a two-part test to qualify for trader tax status:**
 - **“Taxpayers’ trading activity must be substantial, regular, frequent and continuous.”**
 - **“The taxpayer seeks to catch the swings in the daily market movements and profit from these short-term changes rather than profiting from long-term holding of investments.”**

Case Law (cont.)

- **The above is too broad and subject to varying interpretation**
- **The IRS likes to challenge “sporadic lapses” in trading activity**
- **Do you need to trade every day, or is just managing your trading business on a daily basis enough to satisfy the IRS?**
- **How does the IRS treat automated trading or trading forex at night?**

IRC 475 Mark-to-market is good for securities traders

- **GreenTrader recommends IRC 475 MTM for securities traders only, and not for forex or futures traders (so they retain lower 60/40 tax rates).**
- **Learn about IRC 475 mark-to-market (MTM) accounting (ordinary gain or loss treatment) and how to elect it on time. Protect your capital with “tax-loss insurance,” as MTM allows unlimited ordinary trading losses rather than restricted capital losses.**
- **Forex traders have ordinary (tax) loss insurance by default. They also can have the best of both worlds: they can “internally” elect out of forex IRC 988 for the lower tax rates of futures IRC 1256 (60/40 tax treatment) on their gains.**

Net-operating losses (NOL) give huge immediate tax refunds

- **Futures trading capital losses (on Form 6781) may be carried back three tax years and only applied towards Form 6781 trading gains in those years; and/or they may be carried forward.**
- **Forex traders may elect into futures IRC 1256 treatment, so they may also carry back Form 6781 losses against Form 6781 gains. If a forex trader stays in IRC 988, they have ordinary losses, which could be wasted. *Caution:* Forex trading ordinary losses may be entirely wasted with negative taxable income and no trader tax status.**
- **Securities capital losses may only be carried over to following tax years to offset capital gains.**
- **Trader tax status and MTM work together to deliver huge NOL tax benefits. NOLs are comprised of your MTM ordinary trading losses and trading business expenses. NOLs may be carried back two tax years and/or forward 20 tax years. NOLs may offset any type of income in prior and future years, whether you were/are a business trader then or not.**

Don't get trapped with capital loss carryovers or wasted forex losses

- **The biggest problem for traders is getting trapped with unused capital-loss carryovers or entirely wasted forex trading losses. There are ways to prevent and limit this damage.**
- **The net capital-loss deduction allowed for individuals each tax year is \$3,000. Don't confuse this with the fact that you may apply your entire capital loss in the following tax year, providing you have sufficient capital gains to utilize them.**
- **Forex traders who lack trader tax status may waste their trading losses if they have negative taxable income. Unlike futures capital losses, which may be carried back or forward without regard to trader tax status, ordinary forex trading losses may only be carried back or forward as part of an NOL; NOL treatment requires trader tax status.**
- **By electing out of IRC 988, forex traders can convert forex losses into futures capital losses; which can prevent wasted losses if you lack trader tax status.**

How do I claim trader tax status and prepare my tax returns?

- **Trader tax status is *not* elected with the IRS; rather, you claim it on your own.**
- **Assess your trader tax status before or after year-end. Since it's based on facts and circumstances, after year-end may be safer.**
- **If you qualify for trader tax status, and have not formed a separate legal entity, then you are classified as a “sole proprietor” or “unincorporated business.”**
- **Report your 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; income is required for home-office deductions and IRC 179 (100 percent) depreciation.**

Trading gains and losses are reported on different tax forms

- **Futures trading gains and losses are reported on Form 6781, where the 60/40 treatment is applied.**
- **By default, forex is reported on line 21 of Form 1040 (Other Income or Loss), but if you elected out of IRC 988, you report forex the same way as futures on Form 6781.**
- **Securities trading gains and losses are reported on Schedule D (cash method). If you elect IRC 475 MTM, you report your trading gains and losses on Form 4797 Part II.**

Transfer strategy and footnotes

- **Transfer business trading gains (from futures Form 6781, or forex line 21 or securities Schedule D) to Schedule C to unlock home-office deductions and IRC 179 depreciation. Both of these deductions require income. But do not show a profit on Schedule C (it could invite IRS questions about SE tax).**
- **It's important to attach a good tax return footnote explaining your trader tax status and tax treatment on your return.**
- **You can even amend prior year tax returns to claim trader tax status.**

Trade accounting is a snap for futures traders

- **Futures traders receive a Form 1099-B showing “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 gain or loss. Brokers are not supposed to issue a Form 1099 for forex trading gains and losses.**
- **Securities traders receive a more complex Form 1099-B, which only reports proceeds; it does not report net trading gains and losses.**

Accounting is more difficult for securities traders

- **Securities traders should simplify their trade accounting with GTT TradeLog software. Barron's rates it best for hyperactive traders.**
- **Download your trades into the program. It works with most brokerages.**
- **Securities traders can attach the GTT TradeLog report to be in compliance with the new IRS rule forcing line-by-line reporting for securities only.**
- **Learn how to use the GreenTrader Worksheets and Formulas for annual trade accounting; it may be your last resort for forex and other accounting. It's a simple way to count the forest rather than each tree in the forest.**

Futures and forex have lower "60/40" tax rates

- **Learn how to pay up to 12-percent lower tax rates with futures (IRC 1256 contracts). That's why forex traders elect into IRC 1256.**
- **Securities and forex IRC 988 are taxed at ordinary tax rates up to 35 percent, whereas futures are subject to lower 60/40 tax rates (60 percent of capital gains are taxed at lower long-term rates, even for short-term trades, while the other 40 percent are ordinary rates).**
- **Learn the varying tax treatment for:**
 - **Securities (stocks, equity options, mutual funds, bonds, ETFs, single-stock futures and narrow-based indices);**
 - **Commodities and futures (regulated futures contracts, broad-based indices, options on indices, and non-equity options);**
 - **Forex, foreign futures, and precious vs. base metals.**

Forex has special tax rules

- **Learn the special rules for forex, including how to elect out of IRC 988 (ordinary gain and loss treatment) for the more tax-beneficial 60/40 treatment of futures IRC 1256.**
- **Taxation of forex is confusing and uncertain in the tax code, and that makes tax filings difficult for forex traders.**
- **The tax problem is that some types of forex are treated as IRC 1256 contracts with lower 60/40 tax treatment and other types of forex are treated as IRC 988 foreign currency transactions with ordinary gain or loss treatment.**
- **Plus, IRC 1256 and IRC 988 are dueling and conflicting tax code sections. There are also some new IRS rules about Over-the-Counter Foreign Currency Options.**
- **See the forex tax rules at www.greentradertax.com. We will review these in-depth during The Forex Trading Expo in Las Vegas.**

Entities, retirement plans and health-insurance premiums

- **Entities are helpful for traders and are required for forex and commodity funds. 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 need to register a foreign entity in that state. It's different for funds.**
- **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.**

Entities, retirement plans and health-insurance premiums (cont.)

- **Learn the self-employment (SE) tax rules for traders (see below).**
- **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).**
- **Mini 401(k) retirement plans can generate the most tax savings for traders. Defined-benefit plans and Roth IRAs are also good.**
- **If you missed the April 15 deadline for electing IRC 475 MTM, consider setting up a new entity. A “new taxpayer” (i.e., a new entity) elects MTM internally within 75 days of its inception.**

Self-employment tax

- **By default, almost all online traders are exempt from SE taxes, which are equivalent to payroll taxes in a job situation (FICA and Medicare). This can be a huge savings!**
- **SE taxes are 15.3 percent of the first \$97,500 (2007 base) and 2.9 percent (Medicare only) thereafter.**
- **Traders are exempt from SE tax because trading gains are not considered “earned income,” whether or not you have trader tax status or use MTM. SE tax is assessed on earned income only.**
- **There are two exceptions to the SE tax rules for traders.**

SE tax exceptions for members and special tax strategies

- **There are two exceptions to the SE tax rules for traders:**
 - **Traders who are members of an options or futures exchange are deemed to have earned income on all their exchange-generated trading gains (IRC 1402i). Many futures traders on the floor of Chicago exchanges may meet this exception and owe SE tax on their trading gains.**
 - **Proprietary traders who receive a Form 1099-Misc. for non-employee compensation are considered to have earned income.**
- **The GreenTraderTax entity/retirement plan strategies are designed to maximize income tax savings (with AGI deductions for retirement plans and health-insurance premiums) vs. SE tax costs. You almost always wind up with net tax dollars in your pocket, plus you replace bad (income) taxes with good (SE) taxes (which provide retirement benefits).**

Trade other people's money in a commodity or forex fund, and/or managed accounts

- **Successful traders are often asked to give investment advice or trade for others.**
- **Be cautious – if you get compensated for investment advice or trading for others, you may trigger your home state and/or federal investment adviser rules. The CFTC and NFA govern futures traders. There are special exemptions for forex.**
- **Some states are taking a position that forex falls under their definition of securities, so consult with an attorney.**
- **Learn about the unique GreenTrader Incubator Fund strategy. It's a very low-cost way to get started in a fund business. Visit www.greentraderfund.com**
- **An incubator fund helps you generate a track record before you prepare your offering memoranda. It breaks the legal costs into two phases, saving you money. It can also serve as your trading business entity.**

Questions and Answers

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