



2004 GTT Guide: Trader Tax Law & Benefits

Includes Trader Tax Status, Mark-to-Market Accounting, Net Operating Losses, Case Law & IRS Exams, Securities vs. Commodities, Entities, Retirement & Fringe Benefit Plans, Proprietary Trading, Self Employment Taxes, Tax Planning and more.

Guide Highlights

Are you a “business trader”?

If you actively trade financial products (securities, commodities, futures and/or currencies) with the intention of making a living, you can qualify for business treatment with “trader tax status.”

It is well worth your time and effort to learn about trader tax laws and benefits. Learn how to deduct every business-related expense possible including home office, education and much more; generating average savings well over \$10,000 per year. Elect mark-to-market accounting on time so you can get immediate tax refunds on all your trading losses, without limitation (“tax loss insurance”); otherwise you are stuck with capital loss limitations and wash sale rule deferrals. Learn how to use entities for added tax savings on retirement and fringe benefit plans. Investors get the shank in the tax laws, but traders get the golden goose – only problem is that you must learn about these laws and make key elections and filings on time. Most traders miss the boat, but you just caught it by finding this guide. Now read it and prosper.

Business tax returns

Individuals who qualify as being in the business of trading, rise to the level of “trader tax status” from the default level of “investor tax status.” With business rather than investor tax treatment, these individuals file business tax returns as part of their individual tax returns; they file a Schedule C (Business Profit or Loss). Individuals may also operate their trading businesses in an entity and providing they reach trader tax status on the entity-level, they are allowed to use business treatment for all their expenses on the entity tax returns. Both individual and entity tax returns for trading businesses report business expenses rather than investment expenses, leading to significant tax savings.

Trading business expenses are treated as “ordinary” expenses and they can be offset against any type of taxable income (ordinary, portfolio, capital or passive). Negative income (excess expenses) contribute to Net Operating Losses which may be carried back two tax years, also against any type of income, for immediate tax refunds.

You may use business expenses on your current year and prior 3 year tax returns (if amended). No election is required and you and/or your accountant make this determination on your own. Trader tax status is the most important determination, so carefully read the laws and cases and be certain you qualify; otherwise you may have trouble with the IRS – and if you do, learn how to win your case.

Mark-to-market accounting

Qualifying traders may elect to use mark-to-market (MTM) accounting (IRC § 475) by the election deadline of April 15th of the current tax year. As an example, if you wanted to use MTM for tax year 2004, you needed to elect MTM by April 15, 2004. If you did not elect

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MTM, then you may not use MTM and you must use the "cash method," which is the default method. The cash method is the same as what investors use, meaning that all trading gains and losses are treated as capital gains and losses, and you are subject to the wash sale rules (a real headache). MTM converts capital gains and losses to ordinary gains and losses, so there is no limit on the amount of losses that can be deducted (there is a \$3,000 limit on capital losses). MTM traders are also exempt from wash sale rules. If you tried to elect MTM on time but did not do so because you got bad advice from your accountant, or you have some other reasonable excuse, there are limited opportunities to file extensions.

MTM is good for securities business traders and losing commodities traders but not profitable commodities traders; who want to retain the 60/40 benefits of IRC § 1256. If you have capital loss carryovers (tax baggage), there are many nuances and some gambles in electing MTM. Learn all the nuances and complexities, so you make the right decision about MTM and you save more tax money.

The capital loss limitation rules are a joke for active business traders who can make or lose much more than the puny allowed annual deduction of \$3,000 per year. Every trader that misses making the right decisions on MTM is putting themselves at a great disadvantage. The biggest cause of failed trading businesses is large capital losses that can't generate immediate tax refunds to help keep traders in the game with capital to trade.

Net Operating Losses (NOLs)

In addition to MTM, business taxpayers are allowed another huge tax benefit – Net Operating Losses (NOL) – that non-business taxpayers entirely miss out on. NOL tax laws provide the opportunity to carry back or forward business losses; business expenses and MTM trading losses in excess of your other income. In effect you can average your income and losses out over three tax years, which is perfectly suited to the special needs of business traders. Make a fortune in one year, pay your taxes, then lose a fortune in the following years and carry back your NOLs for immediate tax refunds to replenish your trading accounts and stay in the business.

NOL carry back tax returns are complex for traders and the IRS is watching closely, obstinate about not paying huge refunds – which traders are clearly entitled to. Learn how to properly file an NOL return, with the fewest red flags and how to deal with the IRS if they raise any questions. Do one little thing wrong and you may cause an exam and jeopardize your tax refunds. When it comes to NOLs it's wise to consult with a CPA or tax attorney expert in trader tax and NOL returns. Be on the look out for your home state freezing NOL carry backs; California recently did.

Qualification can be difficult

OK, I'm convinced, trader tax status and MTM are the only way to go and I can protect myself on the downside with "tax loss insurance" and get big refunds. It can't be this easy.

It's not. Many traders face a difficult task in determining if they qualify for trader tax status. Unless you trade every day all day as your primary means of making a living with success, the IRS may attack your status (and IRS exams for traders are on the rise). The IRS is particularly wary and in fact prejudiced against part-time traders, part-year traders, and money-losing traders. A large percentage of business traders may fall into one of these special statuses – but don't be scared off from using and benefiting from trader tax status. Learn about the special circumstances that apply to these statuses, how to reduce the red flags on your tax return, how to deal with the IRS if they attack your status and win.

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Watch out for some snake oil salesmen, including other trader tax firms that promise guaranteed trader tax status using multiple entities schemes. It will cost you thousands extra then you should spend and they won't deliver trader tax status – only your actual trading activity will help you qualify. Look before you leap when it comes to entities schemes. The best entities for traders are included in this guide (see below).

IRS Exams

The IRS is examining more traders and attacking their “trader tax status” which if successful causes the disallowance of tax deductions for trading business expenses and MTM trading losses. The ugly consequence is no refunds and instead possibly a tax bill plus interest and penalties.

Learn how the IRS works in their exams for traders, what they focus on and how you can expect to be treated. Learn how to beat them at their own game, how to cite trader tax court cases in your favor and to win an exam even before it's fully underway. Our firm has had great success for traders all around in the country, when hired to represent them before the IRS – whether we prepared their returns or others did. We share all our winning experience with you – and you just can't get this really important stuff anywhere else.

Better yet, after you understand how the IRS may react to your return, you can prepare your tax return with fewer red flags, better footnotes and strategies, which may prevent an exam in the first place. For example, if you are a very close call, don't file a NOL carry back return and instead carry it forward – the IRS exams NOL returns much more than other returns.

Case Law

Trader tax laws are complex but also too vague, which forces you and the IRS into relying on “case law”, which are a collection of tax court cases applying to investors and traders. Not only do you need to learn and apply trader tax laws, but you also need to master a huge body of case law, which is not readably available, analyzed or organized – until now, since we have done just that and you can't find this any where else.

We cite the favorite cases the IRS likes to cite in attacking traders and we show you how to use these same cases to support your rather than the IRS positions. We also cite cases that help you and the IRS chooses to not mention. Case law for traders is very new and the IRS seeks to apply cases that are more appropriate for investors and not modern business traders. Our observations, analysis and recommendations bridge the gap and provide the winning argument. Learn all the ropes in this exclusive in-depth “case law” section.

We also include all the trader tax laws as written, point out the vague areas and then add our observations, recommendations and strategies. Our final strategies and recommendations are based on a combination of trader tax law and case law – so we make it simple for you to act with confidence. For the many accountants and lawyers who buy our guides every year, we pack them with all the cites, actual law and details – they like reading this stuff – but you traders can skip those parts if you like.

Securities Trading

MTM is the preferred method for securities business traders for four reasons: You don't give up anything if you have trading business gains, you benefit greatly if you have losses (ordinary loss treatment rather than capital loss limitations), you are exempt from the wash sale (straddle and constructive receipt) rules, and you still benefit from lower long term capital gains rates on your “segregated investment positions.”

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Commodities & Futures Trading

Commodities and futures are taxed differently from securities. You need to learn about IRC § 1256 contracts, Form 6781 and special carry backs, and how they relate to IRC § 475, the new mark-to-market rules.

MTM (IRC 475) is not a preferred method for profitable commodities and futures business traders for one reason: With the default method, commodities and futures trading gains are 60 percent long-term and 40 percent short-term (and long-term rates are significantly lower); MTM (IRC 475) commodities and futures trading gains are all short-term. IRC § 1256 also has a loss carry back feature; you can carry back commodities and futures trading losses three tax years, but only against commodities and futures trading gains in those years (so you may be able to forgo the IRC § 475 ordinary loss carry back benefits).

Not confused enough yet - between the two types of MTM and tax differences between IRC § 475 and IRC § 1256 – you will be confused further between what is a security versus a commodity or future to begin with.

What's the (Tax) Difference?

There has been a bevy of new financial products launched by securities and commodities exchanges the past few years, including but not limited to ETFs (Exchange Traded Funds), E-minis (an index), single-stock futures, plenty of other new stock indexes, and options and futures on almost everything. Before you start trading an instrument, find out how it's taxed. Generally all new instruments are either taxed like securities or IRC § 1256 contracts (commodities and futures) and the later currently enjoy a significant lower tax rate savings.

Single-stock futures are taxed like their underlying securities (stock, options and narrow based indices) and not like commodities (commodities, futures, FOREX and wide based indices).

Stock indexes that are “narrow-based” are taxed like securities. Conversely, if the index is comprised of ten or more securities, it is considered a “broad-based” index that resembles a commodity.

Interbank (Forex) currency traders are entitled to "elect out" of IRC § 988 (the ordinary gain or loss rules for special currency transactions) to achieve IRC § 1256 treatment; providing for the lower "60/40" capital gains tax rates.

Find your way through the myriad of new financial products and how they are taxed in this guide. Learn strategies for electing the best tax treatment for different types of vehicles and how to combine all these strategies into one program with trader tax status benefits maintained. There are many nuances and you won't find this stuff anywhere else.

Entities for traders

A trader entity allows you to establish a retirement plan and/or other tax-deductible and tax-deferred fringe benefit plans. These are not available for sole proprietor traders (who otherwise receive all trader tax status and MTM accounting benefits). A trader entity can also deliver business tax breaks to your spouse or investors. If you miss the April 15th MTM election as an individual, you can form an entity to elect MTM for the balance of the tax year – since you make an internal election as a “new taxpayer.”

An excellent solution for many traders, with some hidden gems for late MTM elections, is husband/wife general partnerships. They are free to form, the paperwork is easy to assemble and there are rarely any state taxes to pay. Plus you can achieve all the best strategies, whether your spouse is active in the business or not.

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If you are not married, a single-member LLC is a great entity for many traders. A separate tax return is not required for this entity and you save accounting fees every year by reporting this activity on your individual tax return.

Part-time traders who are not married may benefit from an S-Corp, as a separate tax return may deflect some IRS questions about part-time trader tax status.

Whatever you do, stay clear of C-Corps to avoid double taxation and trapped losses that don't provide any tax benefits. C-Corp/LLC schemes sound good on the drawing board, but they are highly expensive and don't provide most of the benefits promised.

Every state has different tax rules and rates for various types of entities, so make sure to customize your entity for your home state. Traders face trouble when they use entities in tax-free states, outside their home state, because they live and work in their home state. When it comes to entities, watch out for snake oil salesmen and consult with a CPA or attorney you can trust and who are experts in trader taxation.

Retirement plans for traders – which ones are best for you?

Profitable traders should save for their retirement, just like all other businesses and individuals. Uncle Sam makes it worth you while with tremendous tax incentives, including generous deductions and tax credits. Consider these excellent initial returns on your money. Plus consider the power of compounded tax-free annual returns – wow can your money grow fast!

A Mini 401(k) plan is the plan of choice for traders. You get both an elective deferral from a traditional 401k plan plus a maximum defined contribution plan, all in one. Big earners can sock away even more with defined benefit plans including 412(i) plans. Roth IRAs are also very attractive for traders.

If you want to use your retirement plan accounts as part of your trading business, watch out, you could be in for some nasty surprises from the IRS and ERISA! Learn the rules and some limited ways to navigate around the rules.

Retirement plan assets can grow to become your most important and biggest nest egg, so use this guide to customize the best type of retirement plan for traders and learn how to stay out of trouble when trading those assets. It's just too great an asset to risk losing.

Fringe Benefit Plans

By employing your spouse and classifying yourself as a “spouse of a non-owner/employee,” you can unlock valuable fringe benefit plan tax savings. Fringe benefits are known as “perks,” including health, life and disability insurance; education, dependent care and adoption assistance; meals, lodging and parking; and many other types of plans.

Learn how to convert your fixed family expenses into tax deductions which can put another \$10,000 of so per year in your pocket. If you have some time and inclination, you can enjoy the same types of perks that corporate America enjoys.

Tax Planning

Wise taxpayers should do special tax planning through-out the year; before April 15 (MTM elections and trader tax status), during the year (to monitor trader tax status) and at year-end (to save taxes in the current and future year). Traders have more to think about than other types of taxpayers.

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Don't wake up to bad news just before April 15th, when it's usually too late to accomplish much in terms of saving more in taxes. If you are tardy at least make sure to focus on April 15th planning for the current rather than prior year and get your hands around your entire tax affairs in December.

Miscellaneous

Traders are exempt from self-employment taxation, except if they are commodities dealers or traders registered on an exchange, proprietary traders compensated with a Form 1099, or entity traders paying themselves a fee.

Short sales, payments in lieu of dividends and other special types of transactions cause further complications for traders.

Everything you need to know as a trader for tax purposes is included in this guide. You won't need one other resource. And our entire guide is all new and all researched, written and formulated by GreenTraderTax.com. We don't use outside experts or sources because there are none more qualified than our own. We have self-published our GTT Guides for Traders for five years and consulted, prepared tax returns and formed entities and retirement plans for thousands of traders all around the country. The more we research and service clients and deal with the IRS, the more nuances and complexities we find. This stuff is not getting any easier, it's getting harder, and we continue to leave our competition in the dust. Get your advice from the most trusted leading experts in the trader tax business and that's us.

After you read our guides if you have any questions, use our message boards, attend our PalTalk chats and purchase our consultations. You don't have to prepare your own tax returns if you find this too complex, you can hire our firm and get a credit for your purchase of our guides. Good luck and thanks for being our customer! We value your business and input.

Robert A. Green, CPA & CEO

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It is well worth your time and effort to learn about trader tax laws and benefits. Learn how to deduct every business-related expense possible including home office, education and much more; generating average savings well over \$10,000 per year. Learn how to elect mark-to-market accounting on time so you can get immediate tax refunds on all your trading losses, without limitation (“tax loss insurance”); otherwise you are stuck with capital loss limitations and wash sale rule deferrals. Learn how to use entities for added tax savings on retirement and fringe benefit plans. Investors get the shank in the tax laws, but traders get the golden goose – only problem is that you must learn about these laws and make key elections and filings on time. Most traders miss the boat, but you just caught it by finding this guide. Now read it and prosper.

Traders can save a fortune with legal means; this guide is not for tax avoidance schemes or tax cheats.

Taxpayers are keen on using every legal and ethical means to lower their tax bills. Some go too far over the gray line chasing “tax avoidance schemes”; others are plain “tax cheats.”

If you are looking for tax avoidance schemes, this guide is not right for you. This guide is for the legitimate and significant tax savings you can realize by unlocking all the tax benefits related to “trader tax status.” There is a minefield of benefits and most traders have still not tapped into them; so why chase fools gold, when you can tap into this trader tax gold.

You won’t find any tax avoidance schemes in this guide, including but not limited to: “offshore” (for hiding investment or trading income); complex straddle or offsetting position strategies to accelerate losing positions and defer winning positions with tax avoidance in mind only; tax protestors who claim they don’t owe taxes; complex estate planning mixed up with business tax planning; using entities in tax-free states (trouble for traders); C-Corp/LLC schemes which are financial engineering and nothing else; and more.

If you are a business trader or active investor, you need this guide; as you can’t find this

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information anywhere else and without it, you will most likely miss out on many trader tax benefits. Or, you will find some of this information elsewhere but skewed in the wrong direction and you may be pushed into complex entities and trader tax schemes you don't need. We do lower the boom on the trader tax scam providers and give you the necessary alerts. Trader tax success is as much about trusted judgment as it is about information; and both are clearly lacking in the marketplace today – except from our firm, education center and our guides.

We start with showing you every possible way to save taxes as a trader and we focus on helping you make the determination if you qualify for these benefits in the first place. If you fall short of qualification, we show you the next best things you can do as investors to save as much in taxes as possible.

Tax cheating and avoidance was always against the law and in the current environment of corporate, accounting and tax scandals it's just plain foolish to pursue. Yesterday's recipe for success using tax avoidance schemes – many promoted by premiere names in the law and accounting fields, Wall Street and big money center banks – are tomorrow's recipe for fines, penalties, interest and possibly even jail time.

Use your common sense and smell test when evaluating tax strategies; if they seems “too good to be true” and it makes little or no economic sense, and they cost plenty of money with the professionals advocating them, then you should figure they are trouble and walk the other way.

Taxes are like a long-term investment over many years; it often takes the IRS a few years to catch up and once they do, they are entitled to go back three tax years for most items and as far back as they like for fraud. Throw those wishes of “no tax” nirvana out the window, get real, and as a trader, this book will show you all the trader tax benefits.

Focus first on trader tax benefits, high-net worth family tax planning comes later
High net-worth taxpayers (with millions of dollars) should also be interested in estate, gift and family tax planning. No sense giving half your estate to Uncle Sam and depleting what you pass on to your heirs.

But the great majority of business traders are not high net worth taxpayers and they should not mix up trader tax laws, benefits and planning with estate, gift and family tax planning. One has little to do with the other. A popular tax book for traders does mix up the two together and it's a big mistake. Combining the two types of planning can lead to a loss of trader tax status, business tax benefits, mark-to-market accounting and more. Plus it's just not necessary. The two worlds are mutually exclusive. So if you are both a business trader and a high net-worth taxpayer, then do both types of planning, but keep them separate. If you are not a high net worth taxpayer, stay clear of any pitches from lawyers, accountants, insurance salesmen and brokers to pursue complex estate and family plans that you simply don't need. The estate exemption is increasing significantly rendering estate planning a wasted activity for the majority of taxpayers.

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Trader tax law benefits are fully legal but still widely unknown and under-utilized. Trader tax laws are very beneficial and our mission in this guide is to deliver the secrets to tax success for traders, while keeping them out of tax trouble. That's a winning long-term tax position.

Most trader tax benefits are still widely unutilized by traders and our mission is to get the word out.

Traders need all this scarce information plus our good advice.

Our guide is very unique. Not only do we give you all the information you need, which is scarce, but we give you our best ideas, strategies and judgment, which are all keys to trader tax success.

Walk into any national chain of tax offices and ask about “trader tax status”, “mark-to-market accounting”, “net operating losses” or any thing else in this guide and in almost every instance you will get a blank stare from a tax preparer who does not have a clue about these laws and benefits.

Ask your local CPA or tax attorney and they may know a little about it, but probably not much. Way too many business traders have missed out on mark-to-market accounting - their trading house burned down and they did not have tax loss insurance – because their long-time trusted CPA or tax attorney missed the boat on MTM. Or they said ok let's elect MTM, but they then missed the election deadline. Or they elected MTM on time but then botched the necessary filing deadline or form entries to Form 3115 (Change of Accounting Method) – required to complete the MTM election process.

Big law and accounting firms have not shown much interest in the small business trader. The larger firms prefer to cater their interests, research and practices to large corporations and public companies.

Trader tax laws are very complex, vague and there are many nuances, most of which require good judgment based on many years of dedicated experience. Unless a CPA or tax attorney handles dozens of traders, they probably will come up short in their advice to you.

Everything we know about the trader tax laws, delivering tax benefits to thousands of traders for over 20 years is included in this guide. We give you our very best advice. If you were to pay us our hourly rates for delivering this advice it would cost you tens of thousands of dollars. The price of this guide, if you read and use it, will be the best investment you make this year in your trading business; plus it's a business deduction if you have trader tax status, or an itemized deduction if you don't.

General tax help guides and software are good; but you still need our guide.

General all purpose tax guides are very helpful for most taxpayers, but they do not cover special trader tax laws, benefits and strategies.

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The IRS Web site www.irs.gov is excellent for tax information and it includes information for business traders, but don't rely on the IRS for the best tax strategies and everything you need to know – you will come up short. Do you really want the IRS to prepare your tax returns and do you want to rely on the IRS as your trusted source to deliver the most possible savings? Bad move, as you will see in this guide, some of their “unofficial” Web site information is not correct and damaging to traders (eg. Part-time traders).

“Consumer” tax preparation software programs and online services are excellent for many Americans, but they don't include trader tax content, questions or resources that are a must for business traders.

Our trader tax guides (see companion examples and accounting guides) are specially prepared to be used in conjunction with general tax guides, tax preparation software and other available resources. Without our “niche” guide, you will probably miss out on most of the trader tax benefits and not save thousands of extra dollars.

Most importantly, tax guides and software are geared for “after-the-fact” tax preparation, after year-end. You need our guide to make vital elections, determinations and tax plans early in the tax year – that's where the money is! These other products are not geared for tax planning; especially not trader tax planning.

A business trader tax return can cause IRS questions unless it includes special footnotes, and other strategies to reduce red flags. These general tax guides and preparation programs and services don't include what you need in this regard – and our guide does.

Our fifth year self-publishing our best selling trader tax guides.

We have been self publishing our best selling trader tax guides for the past five years. Barron's, Active Trader and many other media sources have rated them number one and important for traders. Next year, McGraw-Hill Professional Book Group, a leading business publisher is publishing “The Tax Guide for Traders” by Robert A. Green, CPA – it will be released in fall 2004. Don't wait for that book, our 2004 Guides have the same content.

Robert A. Green, CPA & our CEO was the first to educate traders about all these important new trader tax laws and tax saving strategies. Our professional services firm is a leader in the niche market for trader taxation and it's our core business. We monitor the trader tax laws very closely and we contribute to the formation of trader case law, by handling many important tax exams for traders. When it comes to trader tax, our firm sets the standard.

The more we know the more we learn about new potential nuances in the law, even before the IRS may focus on them. Our business model is to share our knowledge with all traders using our guides, articles and Web site.

Traders should also consider our trader accounting software and services.

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Many of our customers and clients also purchase our best selling trade accounting software (GTT TradeLog) and/or sign up for our tax preparation services, entity and retirement plan formations, IRS exam representation services, consultations and much more. What ever your needs are as a business trader, we are here to serve you – we built our firm’s practice around your needs.

Don’t start a trading business without first reading this guide.

If you are planning to start a trading business, or even if you already have one, you will find great value in this guide. Most mistakes tax-wise are made early on, so prevent mistakes and make all the right moves with the advice you gain from this guide when you start your trading business.

If you are still not convinced you need this guide, then take this test.

Do you have capital loss carryovers on your trading positions? If yes, you blew it and should have read this guide beforehand and probably elected mark-to-market accounting. You could have already received huge tax refunds and instead you are waiting for the prospect of future refunds, which may never happen.

Did you deduct your home office expenses last year? No, you need this guide.

If you are profitable, do you have a retirement plan? No, read on.

Did you pay self employment taxes on your trading gains? If yes, you and/or your accountant probably made a mistake and overpaid. This guide can help get your money back with an amended tax return filing.

Did you file a Schedule C (Business Profit of Loss) to deduct all your trading business expenses including margin interest expenses? If no, you overpaid your taxes by limiting your deductions on Schedule A (Itemized deductions). This guide can help you fix this even “after-the-fact” with an amended tax return.

Did you offset your trading losses and business expenses against your spouse’s income or other types of income of any kind, including prior year’s income? If no, the guide will teach you about mark-to-market accounting and the power of net operating losses (NOLs) – so you can get immediate tax refunds and stay in the trading business.

Did you buy the latest promotion to set up multiple entities schemes that seemed too complex for your needs? Well they probably were wasteful and they won’t work as sold to you. Learn all about how to protect yourself from tax avoidance schemes and how to recover from having bought some schemes.

Was your tax return examined (audited) by the IRS? This guide could have prevented the exam in the first place. Now it can show you how to deal with the IRS and win fast. Otherwise, the IRS may eat your lunch.

2004 GTT Guide: Trader Tax Law & Benefits

Have you been burdened with accounting for wash sales, straddle rules and constructive receipts? The guide will show you how to skip these tax accounting headaches with mark-to-market accounting. Not only will this save you lots of time, but also lots of money.

Did you trade a security for a higher tax rate, when you could have traded a commodity that was similar in risk and effect, for a lower tax rate? Learn the difference between all the new financial products and how they are taxed in this guide.

Thanks for purchasing, reading and using this guide. If you have any questions or comments, please email us at info@greencompany.com or call us at 212-658-9502.

Robert A. Green, CPA & CEO