

TRADERS HAVE UNIQUE BENEFITS FOR THIS TAX SEASON



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- We focus on tax compliance (preparation/planning services), accounting, consultations, entity formations, and IRS/state tax controversy.
- Robert A. Green founded the firm in 1983, and we have clients throughout the U.S. and abroad using our [virtual process](#).

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Webinar description

- Join Robert A. Green, CPA of GreenTraderTax to review highlights from [Green's 2019 Trader Tax Guide](#).
 - Business traders fare better.
 - Can traders deduct trading losses?
 - Tax treatment on financial products.
 - Entities for traders.
 - Retirement plans for traders.
 - Tax Cuts and Jobs Act impact on traders.
 - 20% deduction on qualified business income.
 - Investment management carried interest.

BUSINESS TRADERS FARE BETTER THAN INVESTORS

Trader tax status is way better than investor tax status.

Investors:

- Have restricted investment-interest itemized deductions, and suspended investment fees and expenses on Schedule A. Stock borrow fees are still deductible.
- Are subject to capital-loss limitations (\$3,000/year), and wash-sale loss adjustments on securities.
- May not elect Section 475 MTM ordinary treatment.
- Do not have self-employment income, which is required to deduct health insurance premiums, and make retirement plan contributions.

Trader tax status (TTS)

- Business traders eligible for TTS are entitled to many tax breaks.
- A sole proprietor (individual) TTS trader may deduct all types of business expenses and is entitled to elect Section 475 MTM ordinary gain or loss treatment.
- However, to deduct health insurance and make retirement plan contributions, a TTS trader needs an S-Corp to create earned income with officer compensation.

Section 475 MTM for TTS traders

- Don't confuse TTS with a Section 475 election: Traders must qualify for TTS to elect to use Section 475.
- Section 475 converts new capital gains and losses into business ordinary gains and losses, avoiding the \$3,000 capital loss limitation. Section 475 trades are also exempt from wash-sale loss adjustments. I call it “tax loss insurance.”
- TCJA has a new 20% deduction on qualified business income, which includes Section 475 ordinary income but excludes capital gains. There is an income cap on the QBI deduction for a service business including trading.

There is no election for TTS

- A business trader can assess and claim TTS after year-end and even going back three open tax years.
- However, business traders may only use Section 475 MTM if they filed an election on time, either by April 15 of the current year (i.e., April 17, 2018, for 2018) or within 75 days of inception of a new taxpayer (i.e., a new entity).
- TCJA suspended investment expenses making TTS more crucial than ever before. The average TTS trader may save over \$7,000 per year by deducting business, startup and home office expenses from gross income.

CAN TRADERS DEDUCT 2018 TRADING LOSSES?

Does anybody want to pay taxes because they cannot deduct their losses?

TTS does not convert capital losses into ordinary losses, 475 does

- Deducting trading losses depends on the instrument traded, TTS vs. investor tax status, and various elections.
- Many traders are hoping to find a way to deduct 100% of their 2018 trading losses. They may be disappointed.
- Maybe they qualify for TTS, but that only gives them the right to deduct trading business expenses.
- TTS traders also had to elect Section 475 on time for ordinary loss treatment on securities and or commodities.

Securities and Section 1256 contracts

- Securities, Section 1256 contracts, ETN prepaid forward contracts, and cryptocurrency trading receive capital gain/loss treatment with the capital loss limitation.
- If a TTS trader did not file a Section 475 election on securities and/or commodities on time (i.e., by April 17, 2018), or have Section 475 from a prior year, they are stuck with capital loss treatment on securities and Section 1256 contracts. With a timely 475 election, it's ordinary loss treatment.
- Section 475 does not apply to ETN prepaid forward contracts, which are not securities, or cryptocurrencies, which are intangible property.

Capital losses

- Capital losses offset capital gains without limitation, whether short-term or long-term, but a net capital loss on Schedule D is limited to \$3,000 per year against other income.
- Pass-through entities flow through capital gains and losses to the individual return.
- Excess capital losses on Schedule D are carried over to the subsequent tax year(s).

Capital loss carryovers

- Once taxpayers get in the capital loss carryover trap, a problem they often face is how to use up the carryover in the following year(s).
- If a taxpayer elects Section 475 by April 15, 2019, the 2019 business trading gains will be ordinary rather than capital. Remember, only capital gains can offset capital loss carryovers.
- Wait to the last minute to make a decision.

Dealing with capital loss carryovers

- Once a trader has a capital loss carryover hole, he or she needs a capital gains ladder to climb out of it and a Section 475 election to prevent digging an even bigger one.
- The IRS allows revocation of Section 475 elections if a Section 475 trader later decides he or she wants capital gain/loss treatment again.
- An entity is better for electing and revoking Section 475 as needed.

Section 1256 loss carryback election

- Traders with capital losses from trading Section 1256 contracts (such as futures) might be in luck if they had gains in Section 1256 contracts in the prior three tax years.
- On the top of Form 6781, traders can file a Section 1256 loss carryback election.
- This allows taxpayers to offset their current-year 1256 losses against prior-year 1256 gains to receive a refund of taxes paid in prior years.

Forex losses

- Taxpayers with losses trading forex contracts in the off-exchange Interbank market may be in luck.
- Section 988 for forex transactions receives ordinary gain or loss treatment, which means the capital loss limitation doesn't apply.
- However, without TTS, the forex loss isn't a business loss and therefore can't be included in a net operating loss (NOL) calculation — potentially making it a wasted loss since it also can't be added to the capital loss carryover.

Forex capital gains election

- If a taxpayer has another source of taxable income, the forex ordinary loss offsets it; the concern is when there is negative taxable income and no TTS.
- Forex traders can file a contemporaneous “capital gains and losses” election in their books and records to opt out of Section 988, which is wise when capital loss carryovers exist.
- In some cases, this election qualifies for Section 1256(g) lower 60/40 capital gains tax rates on major pairs, not minors.

Excess business loss limitation

- A TTS trader with Section 475 has ordinary losses from trading losses and business expenses.
- These ordinary losses offset income of any kind, and a net operating loss carries forward to subsequent tax year(s).
- TCJA's new "excess business loss" (EBL) limitation of \$500,000 married and \$250,000 other taxpayers apply to ordinary business losses.
- Add an EBL to an NOL carryforward.

TAX TREATMENT ON FINANCIAL PRODUCTS

There are complexities in sorting through different tax-treatment rules and tax rates. It's often hard to tell what falls into each category.

Securities vs. 1256 contracts

- Securities have realized capital gain and loss treatment and are subject to wash-sale loss adjustments and the \$3,000 per year capital loss limitation on individual tax returns.
- Section 1256 contracts — including regulated futures contracts on U.S. commodities exchanges — are marked to market by default, so there are no wash-sale adjustments, and they receive lower 60/40 capital gains tax rates. (60% is a long-term capital gain even on day trades and 40% is short-term capital gain at ordinary rates.)

Options

- An option is a derivative of an underlying financial instrument, and the tax treatment is generally the same.
- Equity options are taxed the same as equities, which are securities with capital gains, wash sale loss adjustments and 475, if elected by a TTS trader.
- Index options are derivatives of indexes, and broad-based indexes are Section 1256 contracts, so the options are too.

Precious metals, cryptocurrencies and foreign futures

- Physical precious metals are collectibles and, if these capital assets are held over one year, sales are subject to the taxpayer's ordinary rate capped at 28% (the collectibles rate). It's still capital gains and losses.
- Cryptocurrencies are intangible property taxed as capital gains and losses, but wash-sale losses and Section 475 rules do not apply because most cryptocurrencies are not securities or commodities.
- Foreign futures are taxed like securities unless the IRS issues a revenue ruling allowing Section 1256 tax treatment.

Volatility ETNs and ETFs

- Several brokerage firms classify CBOE-listed options on volatility exchange-traded notes (ETNs) and options on volatility exchange-traded funds (ETFs) structured as publicly traded partnerships as “equity options” taxed as securities.
- However, there is substantial authority to treat these CBOE-listed options as “non-equity options” eligible for Section 1256 contract tax treatment.
- ETNs structured as prepaid forward contracts are not securities, whereas, ETNs structured as debt instruments are. The latter is subject to wash sale loss adjustments or 475 treatment, and the former is not.

Don't solely rely on broker 1099-Bs

- There are opportunities to switch to lower 60/40 tax capital gains rates in Section 1256, use Section 475 ordinary loss treatment if elected on time, and report wash-sale losses differently.

ENTITIES FOR TRADERS

Entities for traders

- Entities can solidify TTS, unlock health insurance and retirement plan deductions, gain flexibility with a Section 475 election or revocation, and prevent wash-sale losses with individual and IRA accounts.
- An entity return consolidates trading activity on a pass-through tax return, making life easier for traders, accountants, and the IRS.
- An LLC with S-Corp election is generally the best choice for a TTS trader seeking a health insurance deduction, making a retirement plan contribution, and being eligible for a 20% QBI deduction in the phase-out range.

RETIREMENT PLANS FOR TRADERS

Solo 401(k) retirement plan

- Annual tax-deductible contributions up to \$62,000 for 2019 to a TTS S-Corp Solo 401(k) retirement plan generally saves traders significantly more in income taxes than it costs in payroll taxes (FICA and Medicare).
- Trading gains aren't earned income, so traders use an S-Corp to pay officer compensation at year-end.
- There's also an option for a Solo 401(k) Roth: If you are willing to forgo the tax deduction, you'll enjoy permanent tax-free status on contributions and growth within the plan.

20% DEDUCTION ON QUALIFIED BUSINESS INCOME

TCJA introduced a fantastic new deduction for pass-through businesses, and it doesn't require a cash outlay.

20% deduction on qualified business income

- Final IRS 199A regs confirmed TTS traders, hedge funds and investment managers are “specified service trades or businesses” (SSTB), which means there is a taxable income (TI) cap limiting a QBI deduction. Non-service businesses benefit from no income cap.
- The SSTB TI cap for 2018 is \$415,000/\$207,500 (married/other taxpayers). The cap is indexed for inflation.
- The phase-out range below the income cap is \$100,000/\$50,000 (married/other taxpayers), in which the QBI deduction phases out for SSTB.

20% deduction on qualified business income

- The W-2 wage and property basis limitations also apply within the phase-out range for SSTB. (In and above the phase-out range for a non-SSTB.)
- The preamble to the final 199A regs confirmed that QBI includes Section 475 ordinary income, whereas, TCJA expressly excluded capital gains and losses and forex ordinary income.
- A Schedule C trader can pay a spouse or others W-2 wages to unlock the deduction in the phase-out range. Alternatively, they might be able to aggregate QBI with another QBI activity.

INVESTMENT MANAGEMENT CARRIED INTEREST

It helps both the manager and investors, too.

Investment management carried interest

- TCJA modified the carried interest tax break for investment managers in investment partnerships, lengthening their holding period on profit allocation of long-term capital gains (LTCG) from one year to three years.
- The three-year rule only applies to the investment manager's profit allocation — carried interest.
- Investors still have LTCG based on a one year holding period. LTCGs have lower tax rates (0%, 15% and 20%).

Investors also benefit from carried interest

- TCJA suspended “certain miscellaneous itemized deductions subject to the 2% floor,” which includes investment fees and expenses.
- Separately managed account investors are out of luck, but hedge fund investors can limit the negative impact by using carried-interest tax breaks.
- Carried interest reduces a hedge fund investor’s capital gains instead of having a suspended investment fee deduction.

QUESTIONS & ANSWERS

Closing Remarks

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01/21 **IRS Confirms Traders Are Eligible For QBI Deduction**
 Great news for traders: Section 199A final regs confirm QBI includes Section 475 ordinary income and loss. On Jan. 18, 2019, the IRS issued final 199A regs for the 2017 Tax Cuts and Jobs Act (TCJA)...[More](#)

01/15 **Highlights From Green's 2019 Trader Tax Guide**
 Use Green's 2019 Trader Tax Guide to receive every trader tax break you're entitled to on your 2018 tax returns. Our 2019 guide covers the 2017 Tax Cuts and Jobs Act's impact on investors, tra...[More](#)

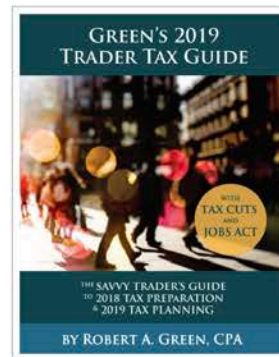
10/31 **To Save Taxes, Traders Need To Deal With Unique Issues Before Year-End**

While the 2017 Tax Cuts and Jobs Act did not change trader tax status,

Trader Tax Guide

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