

# HOW TO BECOME ELIGIBLE FOR TRADER TAX STATUS BENEFITS

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*green* **TraderTax**

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# Robert A. Green CPA

## **Job:**

- Managing Member of Green, Neuschwander & Manning, LLC, a tax and accounting firm catering to traders and investment managers. CEO of GreenTraderTax.com.

## **Focus on traders:**

- Trading is a real profession, and other tax professionals and solution providers underserve them. Traders deserve tax advice from CPAs and tax attorneys who are acutely aware of different tax laws and regulations that apply to them.

# Robert Green's content

- Mr. Green is a leading authority on trader tax. He is the author of Green's 2017 Trader Tax Guide, which GreenTraderTax published as an annual tax guide every year since 1997.
- Mr. Green has been a contributor to Forbes.com since 2010. Mr. Green wrote the "Business of Trading" column for Active Trader magazine for 14 years until the magazine closed in 2015. Leading brokerage firms and other financial media feature Mr. Green's blog posts and Webinar content.

# Robert Green's media

- Mr. Green is frequently interviewed and has appeared in Barron's, New York Times, Wall Street Journal, and several other media. Mr. Green has also appeared on CNBC, Bloomberg Television, and Forbes.com Video Network.
- Mr. Green is the chief tax speaker at Traders Expo and taught "Trader Tax 101" for CCH to tax professionals.

## Webinar disclaimers

- This information is educational. It is not intended to be a substitute for specific individualized tax, legal, or investment planning advice.
- Where specific advice is necessary or appropriate, you may wish to consult with a qualified tax advisor, CPA, attorney, financial planner, or investment manager.
- Robert A. Green and the Green companies are not affiliated with Interactive Brokers.
- This presentation is based on current tax law, and tax reform changes may occur in 2017 or 2018.

# Overview of trader tax status

- Trader tax status (TTS) drives many key business tax breaks like business expenses, business ordinary trading losses with the Section 475 election and through an S-Corp, employee benefit deductions for retirement plans and health-insurance premiums.
- These items are deducted from gross income without restriction, whereas investment expenses are subject to itemized deductions, AMT preferences, and Pease limitations, and there are limitations on capital losses and wash sale loss deferral adjustments.

# TRADER TAX STATUS

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Trader tax status (TTS) delivers many tax benefits.



# TTS benefits

- Business expense treatment.
- Option to make a timely election for Section 475 MTM ordinary gain or loss treatment.
- Form an S-Corp to unlock employee-benefit plans including health insurance and retirement plans.

# Assess eligibility for TTS each year

- Consider facts and circumstances which can change year to year.
- A trader may qualify for TTS one year but not the next.
- It's analogous to taking bread out of the oven each year to see if it rose or if it's flat bread (investor tax status).

# Section 475 MTM

- If you elected Section 475 and later don't qualify for TTS, you must suspend use of Section 475 treatment until you re-qualify since Section 475 is conditional on qualification for TTS.
- As long as you are eligible for TTS, you must use Section 475; it's not optional.
- You can revoke a Section 475 election on a timely basis, in a similar manner as making the first election.

# Partial year for TTS

- You might only qualify for TTS for part of a year and use it during that period of the year only.
- For example: Perhaps you qualified for TTS in 2016 and quit or suspended active trading on June 30, 2017. Or you began active trading on July 1, 2017, and continued through year-end.
- Include the period of qualification on Schedule C or the pass-through entity tax return and deduct business expenses during that part-year period.
- If elected, use Section 475 for the TTS time, too.

# TTS business expenses

- Qualifying for TTS means you can report business expenses as opposed to more limited investment expenses.
- Business expense treatment gives full ordinary deductions, including home-office, education, Section 195 start-up expenses, Section 248 organization expenses, margin interest, tangible property expensing, Section 179 (100%) depreciation, amortization on software, seminars, market data, stock borrow fees and much more.
- Watch [Top 11 Tax Deductions For Active Traders](#).

# Investment expenses

- Investment expenses don't allow home-office, education, start-up, and organization costs, and they are only allowed as a miscellaneous itemized deduction in excess of 2% of adjusted gross income (AGI), and not deductible against the alternative minimum tax (AMT).
- The IRS further restricts investment expenses with the “Pease” itemized deduction limitation for taxpayers with AGI's over \$313,800 (married) and \$261,500 (single), based on 2017 thresholds.
- Many states limit itemized deductions too.

# There is no election for TTS

- You can claim TTS after year-end; you don't need to make a timely election in advance like Section 475 MTM and the contemporaneous forex capital gains election.
- You can claim TTS for the tax year that just ended and even for the prior three tax years with amended returns
- Filing amended tax returns may increase your odds of IRS questions or exam so be sure of your status.

# CASE LAW & IRS PUB. 550

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There's no statutory law for TTS with objective tests.  
Case law applies.



# Case law has a two-part test:

1. Taxpayers' trading activity must be substantial, regular, frequent and continuous.
2. The taxpayer must seek to catch the swings in the daily market movements and profit from these short-term changes rather than profiting from the long-term holding of investments.

# IRS Pub. 550 looks at:

- Typical holding periods for securities bought and sold.
- The frequency and dollar amount of your trades during the year.
- The extent to which you pursue the activity to produce income for a livelihood.
- The amount of time you devote to the activity.

# GOLDEN RULES

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I base our golden rules on trader tax court cases and our firm's vast experience with IRS and state controversy for traders.

# The volume of trade executions

- The trader should make 720 total trades per year (Poppe court) on an annualized basis.
- If you start July 1, then you need 360 executions, half of the 720.
- The court mentioned Poppe having 60 trades per month as being sufficient volume. That's about 14 total trades per week.
- Count the buy and sell, or open and close, separately. One round trip is two total trades.

# The frequency of trade executions

- You should execute trades on close to four days per week, almost every week that you trade.
- It's wise to prevent an IRS challenge by trading close to four days per week or 75% of available trading days — even if you need to make smaller executions with reduced risk on otherwise non-trading days. Courts have denied TTS with 50% frequency.
- It's not a good idea to have the tax tail wag the dog, and any trading you do for TTS should have an actual economic risk.
- The Endicott court said unexecuted trades do not count.

# Calculating the volume of trades per day

- The markets are open approximately 250 days per year, and with personal days and holidays, you might be able to execute a trade on 240 days.
- With a 75% frequency, you would trade on 180 days per year ( $240 \times 75\%$ ).
- 720 total trades divided by 180 trading days equals four total trades per trading day.

# Holding period

- The IRS stated that holding period is the most important factor, and in the Endicott court, the IRS said average holding period must be 31 days or less.
- That's a bright-line test and the only one.
- Active traders usually make day trades or swing trades, with an average holding period of just a few days.
- Don't hold many trading positions over a month, unless you segregate them as an investment, which then doesn't count in the holding period calculations.

# Holding period issues for option traders

- Options traders may have an average holding period over 31 days if they trade monthly options and keep them open for one or more months.
- Many options traders qualify for TTS by also trading weekly options, thereby shortening their average holding periods to under 31 days.



# The impact of lower lot sizes

- Some traders scale into trades and executions are broken down into smaller lot sizes.
- If you initiate a trade and the broker breaks down the lot sizes without your involvement, the IRS may reject counting the extra volume of trades.
- Options traders have multi-legged positions on complex trades. We believe you may count each trade confirmation of a complex trade, providing you make the executions separately, although this has not come up in tax court cases.

# Intention

- A trader must intend to run a business, and make a living.
- Trading your money, not other people's money.
- It doesn't have to be your exclusive or primary means of making a living.
- The key word is "a" living, which means it can be supplemental income for your livelihood.
- Having trading losses does not indicate you lack the intention of making a living.

# Part-time trading is okay

- Part-time and money-losing traders face more IRS scrutiny and individuals face more scrutiny than entities.
- Full-time options traders actively trading significant portfolios may not qualify because they don't have enough volume and frequency and their average holding period is over 31 days.
- On the other hand, a part-time trader with a full-time job may qualify as a day and swing trader in securities meeting all the golden rules.

# Hours

- Work four hours or more per day, almost every available trading day in the trading business activity.
- All time counts, including execution of trade orders, research, administration, accounting, education, travel, meetings, and more.
- A trading business is exempt from the material participation requirement in Section 469 passive activity loss rules.

# Don't have many lapses in activity

- The IRS has successfully denied TTS in a few court cases by arguing the trader had too many breaks in trading, taking several months off during the year.
- Traders can take vacations, sick time, and personal time off just like everyone else.
- Some traders take a break from active trading to recover from recent losses and learn new methods and markets.
- Don't trade one month, visit grandchildren the next month, trade another month, and then vacation for a month.

# The total proceeds from trading

- Traders should have gross proceeds in the millions of dollars per year on trading equities.
- More traders are using options and futures, which have lower proceed values.
- Explain this in footnotes since proceeds for futures and forex are not reported on 1099s, and the IRS won't see the proceeds amount.
- Securities proceeds on a Form 1099-B provide the IRS with a quick indication about qualification for TTS.

# Operations

- Most business traders have multiple monitors, computers, mobile devices, trading services and subscriptions, education expenses, high-speed broadband, wireless and a home office.
- If you use the office exclusively for business rather than personal use, don't skip reporting a valid home-office deduction.
- Most businesses have an outside and or home office expenses.

# Account size

- Securities traders need to have \$25,000 on deposit with a U.S.-based broker to achieve “pattern day trader” (PDT) status, and without that status, they will have a hard time qualifying for TTS.
- Some futures or forex traders have mini-account sizes of \$5,000 or less, and that won’t impress the IRS for TTS.
- We like to see over \$15,000 of trading capital to qualify for TTS.



# Factors that don't qualify for TTS

- Automated trading without much involvement by the trader (but creating your program qualifies).
- Engaging a professional outside investment manager.
- Trading in retirement funds.

# TAX REFORM: EXPECTED IMPACT ON TTS

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# Status of tax law changes

- Congress and President Trump's team are working on tax reform in 2017, and considering delays; I expect tax changes may not be effective until 2018.
- Don't wait for new tax legislation, get started on 2017 tax planning based on current law, and hopefully, tax law changes will favor your planning.

# TTS should be stable with tax changes

- TTS works well for 2017, and tax reform should be the icing on the cake offering a lower tax rate on business income, hopefully, available to a TTS company.
- Tax reform may also repeal investment expense deductions, thereby making TTS even more attractive.
- Read my May 18, 2017, blog post [Consider Smart Tax Moves Now That Work With Possible Reform.](#)
- Watch my June 21, 2017, recording [Trader Tax Reform with Robert Green.](#)

# TTS should be stable with tax changes

- Read my Aug. 7, 2017 blog post:  
[Traders Need Fair Tax Reform](#)

# CLOSING REMARKS, QUESTIONS & ANSWERS

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# Closing Remarks

- Questions & Answers
- Thank you for attending this Webinar or watching the recording at IB.
- Visit [www.GreenTraderTax.com](http://www.GreenTraderTax.com) for additional information.
- Call us toll free at 888.558.5257 or 203.456.1537
- Chat with us.
- Email us at [info@greentradertax.com](mailto:info@greentradertax.com)

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