



**Trader Tax Benefits, Qualifying, Business Expenses,
Tax Treatment & Elections, Trader Tax Returns,
Entities & Retirement Plans**

*Short-Version for Free Educational Workshop
Long-Version for Paid Intensive Workshop*

For Traders Expo Las Vegas Nov. 17, 2011:

Instructor: Robert A. Green, CPA/CEO

info@greengreencompany.com; www.greentradertax.com;

www.greentraderfunds.com 888-558-5257 or 646-224-6923

Disclaimer from GreenTraderTax

The following Webinar is being provided for educational and informational purposes only, from third-party provider Green & Company, Inc. (including its Web site GreenTraderTax.com). Please consult your tax adviser to discuss your specific situation. Information delivered by or accessed through GreenTraderTax does not constitute specific tax advice from GreenTraderTax. You are solely responsible for your tax reporting decisions, and you should carefully evaluate all information delivered to you by GreenTraderTax. Not all information may be appropriate for all traders.

Disclaimer from Traders Expo.

- Please be advised that Green & Company Inc. (GreenTraderTax.com) is independent and not affiliated with Traders Expo. Traders Expo does not provide tax advice and no portion of the presentation should be so construed as such. Traders Expo has no obligation or liability relating to or derived from any tax, penalty or related interest charge assessed against a taxpayer or any return preparer.

Speaker Bio:

Robert A. Green (1/2)

- Robert A. Green is a CPA and founder and CEO of Green & Company Inc. (GreenTraderTax.com and GreenTraderFunds.com), a publishing company; Green & Company CPAs, LLC, a virtual tax and accounting firm catering to traders and investment management businesses; TradersAdvocacy.org, an advocacy group for online traders; and Green's Entrepreneurs Network (www.greensentrepreneurs.net).
- He is a leading authority on trader tax. He is the author of *The Tax Guide for Traders* (McGraw-Hill, 2004), *Green's 2011 Trader Tax Guide*, and the annual GreenTrader tax return example guides. Mr. Green writes the "Business of Trading" section for *Active Trader* magazine, and is a frequent contributor to Forbes blog "Great Speculations", Fidelity's Active Trader Newsletter, and several other publications.

Speaker Bio:

Robert A. Green (2/2)

- Mr. Green is frequently interviewed and has appeared in the *New York Times*, *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.com, Traders Expo, and other trade shows.
- You can find more information about Mr. Green, his company's services and products at www.greencompany.com.

Current Developments for Traders

- Tax changes are in the works, including expiration of Bush-era tax cuts and Super Committee-led tax reform.
- Will traders be able to retain lower tax rates on futures (including forex in some cases), business expense treatment using trader tax status and Section 475 ordinary loss treatment? Will traders be able to continue excluding trading gains from social security taxes?
- A flatter tax code may include one or fewer tax rates (no capital gains rate) and also limit itemized deductions and credits. That negatively impacts investors much more than business traders.
- There are other threats looming like a financial-transaction tax (FTT), reining in of HFT, rule-making for Dodd-Frank financial regulations, and other changes from the SEC, CFTC, NFA and exchanges. The IRS and states are turning up the heat on traders too. Join [Traders Advocacy.org](http://TradersAdvocacy.org).

Trader Tax Benefits & Qualifying for Trader Tax Status

- Trader tax benefits may apply to any type of trader: securities, futures, options, ETFs, and forex traders;
- Learn how to qualify for trader tax status (business treatment), and claim these tax breaks for 2011, and the prior three open tax years too.
- For qualification, see our Golden Rules and IRS Pub. 550 Chapter 4. It's harder for part-time traders to qualify. Using an entity looks better.

Business expenses are unlimited for sole proprietors and entities with trader tax status

- Business deductions (Section 162) are far better than restrictive investment expenses (Section 212). Business treatment gives full ordinary loss tax deductions including:
 - Home office – a huge deduction and value for home-based and even some proprietary traders;
 - Section 179 - 100% depreciation;
 - Educational expenses after business commencement;
 - Start-up expenses (Section 195) – up to 6 months back;
 - Organization expenses;
 - Margin interest expenses;
 - Trading equipment, software, services, and supplies;
 - Travel to trade shows and some meals & entertainment too.

Investment expenses are limited and apply when you fall short of trader tax status.

- **Investment expenses are very limited:**
 - They exclude home office, most pre-business education, and start-up costs (IRC 195).
 - Investment interest expense is restricted to investment income. The rest is carried over to subsequent years.
 - What's left of investment expenses is only allowed in excess of 2 percent of adjusted gross income (AGI);
 - Investment expenses are not deductible against the alternative minimum tax (AMT).
 - Many seminars, online classes and travel to seminars are not deductible under IRC 274(h)(7).
 - A flatter tax under future tax and deficit reform may do away with all investment expenses, whereas business expenses will remain.

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

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 2011 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)

- **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)

- ***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)

- 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 2011 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.
- 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.
- Read our Jan. 11, 2011 blog about winning an important trader tax status case.

Tax Treatment and Choices

- The are key tax treatment differences between securities, futures, options, ETFs, forex, precious metals and other instruments;
- Learn different tax treatment elections that apply to business traders versus investors, and how and when to file them on time. It can make a world of difference on your tax returns;
- It's tricky to handle pre-business education and other expenses. Stay clear of promoters' false promises for education deductions using poorly-designed multi-entity schemes. Consider Section 195 (start up costs) and Section 248 (organizational costs).

Tax Treatment – Securities, Including Stock Options

There are key tax treatment differences between what you trade:

- Securities are short-term and long-term (held 12-months) capital gains and losses.
- Short-term capital gains are taxed at ordinary income tax rates (currently up to 35%), whereas long-term capital gains tax rates are significantly lower (currently 0, 10 and up to 15%).
- Securities include equities (stocks), equity- options, bonds, mutual funds, narrow-based indexes, single-stock futures, ETF (see special rules) and more.

Tax Treatment – Futures, Including Index Options (1/2)

- There are tax advantages – lower tax rates on short-term trading – on trading futures and other types of Section 1256 contracts.
- Section 1256 contracts are marked-to-market at year-end (automatically) and since you can't benefit by deferring taxes into the next tax year – to get long-term capital gains rates - you get lower 60/40 tax rates, even on day trades. The current maximum 60/40 tax rate is 23%; 12% less than the current maximum ordinary tax rate of 35%.

Tax Treatment – Futures, Including Index Options (2/2)

- **Section 1256 contracts include regulated futures contracts (RFC)– most contracts on U.S. futures exchanges - non-equity options, broad-based indexes, options on indexes, foreign currency contracts (special rules apply) and more.**
- **Be careful with commodities. Futures on commodities are futures, but trading in physical commodities is subject to ordinary income or loss treatment.**
- **Broad-based indexes (10 or more underlying securities, like most eminis) are Section 1256 contracts. Narrow-based indexes are securities.**

Tax Treatment – ETFs (1/2)

- ***Securities ETFs:*** Securities ETFs are usually Registered Investment Companies (RICs). Like mutual fund RICs, securities ETFs pass through their underlying ordinary and qualifying dividends to investors. When you sell a securities ETF, it's deemed a sale of a security, calling for short-term and long-term capital gains tax treatment.
- ***Commodities/futures ETFs:*** Commodities/futures ETFs may not use the RIC structure, so they are usually publicly traded partnerships (PTPs). Commodities/futures ETFs issue annual Schedule K-1s passing through their underlying Section 1256 futures tax treatment on futures transactions to investors, as well as other taxable items too.
- When you sell a commodities/futures ETF, it's still deemed a sale of a security, calling for short-term and long-term capital gains tax treatment. That may be counter-intuitive, since it's a commodities/futures ETF, and the ETF itself is still considered a security for tax purposes. We elaborate on this point and ETFs in the article.

Tax Treatment – ETFs (2/2)

- ***Precious metals ETFs:*** Physically backed precious metals ETFs may not use the RIC structure either. Although they could use the PTP structure, they usually choose the publicly traded trust (PTT) structure (also known as a grantor trust). A PTT also issues an annual Schedule K-1 passing through tax treatment to the investor, which in this case is the "collectibles" long-term capital gains tax rate on sales of physically backed precious metals (such as gold bullion).
- The sale of a precious metal ETF is not a sale of a security, but rather it's deemed a direct sale of physically held precious metals applying the "collectibles" long-term capital gains tax rate. (The short term rate applies in those instances, too.)

Tax Treatment – ETF Options

- *Options on ETFs have unclear tax treatment.* The IRS hasn't clearly stated tax treatment on sales of options based on ETFs.
- Many tax attorneys make the case that sales of exchange-listed options on broad-based securities ETFs as well as on commodities or futures ETFs should be treated as Section 1256(g)(3) non-equity options, with lower 60/40 tax rates.
- If you wish to take such a position, you should consider getting a tax opinion in order to protect yourself from penalties. Sales of options based on narrow-based securities ETFs are treated like securities.
- See our ETF tax treatment blog article.

Tax Treatment - Other

- Foreign futures only receive lower Section 1256 60/40 tax treatment if the foreign futures 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,” except on physically-held currency, which remains in Section 988. Personal-use currency is capital gains treatment and no capital loss is allowed.
- Precious metals have the higher “collectibles” long-term capital gains tax rate (28%) and there are nuances versus base-metals (commodities). Note the difference between futures and physicals too.
- New NADEX binary options are generally treated as Section 1256 contracts. They are options on indexes (Section 1256 contracts).

Tax Treatment Elections

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.
 - After the opt-out election, lower 60/40 tax treatment is possible in Section 1256g (foreign currency contracts) on forex forwards in major currencies for which the trader doesn't take or make delivery of the underlying currency.
 - We make a case to treat "spot forex" like forwards in navigating into Section 1256g. Rev. Ruling 2007-71 bars forex options from Section 1256g. Check back with us soon on further developments on forex tax treatment.

Trader Tax Returns

- Claim trader tax status by preparing business trader tax returns. Sole proprietor traders use Schedule C.
- Trading gains/losses are reported on different forms (Schedule D, Forms 6781, 4797, and Form 1040 line 21 Other Income (forex);
- Problem and solution: Schedule C appears to be a losing business. We show you how to transfer some trading gains to Schedule C to fix this problem and more;
- Entity tax returns look better. Reporting is consolidated on one return which looks more like a business than a sole proprietor trader.

Trade Accounting is Key

- It's a snap for futures & most forex traders as it's provided by your broker and summary reporting is all you need.
- Trade accounting is a responsibility for securities traders. Brokers have better reporting for 2011 but it still comes up short. You need line-by-line reporting of securities;
- Trade accounting for securities is easier with TradeLog® which works well with almost every major broker. Simply download and match your trades and give that report to the IRS.

Entities for Traders

- One simple pass-through entity is all you need. Pass income and loss to your individual return, and don't pay entity-level taxes.
- Married taxpayers should generally use general partnerships, since they are the least costly to set up and there are no state minimum taxes as there may be with LLCs.
- Single taxpayers should use S-Corps, either through a SMLLC or C-Corp.
- The entity helps unlock AGI-deductions (retirement plans and health insurance premiums).

Retirement Plans for Traders

- The individual 401(k) plan is best for traders, since it combines the 401(k) element – where the most tax savings is – with a profit sharing plan too.
- Trading gains are generally not earned income, so you don't owe SE tax, and you also can't contribute to a retirement plan.
- Use the entity to financially-engineer some earned income. Since you can control it, first focus on the 401(k) elective deferral of \$16,500 (plus \$5,500 if over age 50) to save income taxes at a higher rate than the SE tax rate cost of 15.3%.
- Roth IRA conversions are good for traders to build up permanently tax-free income for life.

Contact Information

Green & Company Inc.
info@greengcompany.com;
www.greentradertax.com
www.tradersadvocacy.org
www.greensentrepreneurs.net

888-558-5257 or 646-224-6923;
Copyright © 2011 Green & Company, Inc.

