



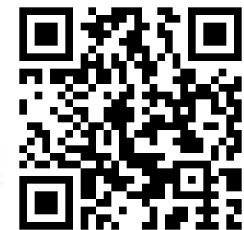
Interactive Brokers

presents

Trader or Investor? What is the best tax position?

**Nancy Nelson, CPA,
Tax Director, Interactive Brokers**

Webinar begins @ 12:00 pm EST



webinars@interactivebrokers.com

www.ibkr.com/webinars



Member SIPC www.sipc.org





IRS Circular 230 Notice

The information in this presentation is provided for informational purposes only, and does not constitute tax advice and cannot be used by the recipient or any other taxpayer to avoid penalties under any federal, state, local or other tax statutes or regulations, or to resolve any tax issue.



Are you an Investor or a Trader?

Focus is on US individual (Form 1040) Taxpayers

Determination that you are a Trader takes Careful
Consideration



What is the difference between Trader and Investor?

Most of us are Investors and this is the default IRS position

Traders are those who trade frequently throughout
Every day.



How does being an investor or trader affect my Tax Return?

Most investors can not utilize investment expenses as deductions

Traders may deduct investment expenses against investment income and other ordinary income

VERY STRINGENT STANDARD TO QUALIFY AS A TRADER



What is the definition of a Trader?

A trader, per the IRS, is a person engaging in the business of Trading securities for their own (and perhaps others') account.

Profit motive is a necessary element, but not alone sufficient to be seen as a business as defined by the IRS.



How do Traders treat Capital Gains and Losses

Same as investors

Tax lots

FIFO or Specific Identification

Holding period (short-term and Long-term) apply



Short vs. Long Term Capital Gains

Short term Capital Gains are ordinary income

Three long term Capital Gain Tax Rates:

- 0% for those in the 10% and 15% tax brackets

- 15% for those in all other brackets but 39.6%

- 20% for those in the 39.6% tax bracket



Mark to Market Election for Traders

For Traders only

Annual Election – by 4/15 of the year it is to apply to

Under Section 475 of Internal Revenue Code



Investment Expenses

For Investors:

Itemized deductions

Subject to the 2% AGI floor before deductible

Pease limitation

Itemized deductions phase out at

AGI > than \$254,200 (Single)

AGI > than \$305,050 (MFJ)



Investment Expenses

For Traders:

Fully deductible on Schedule C:

Account Fees

Data Fees

Investment research Costs

Investment interest

Margin Interest

Payment in lieu Paid

Stock loan fees

Home office Expenses



Impact 3.8% Net Investment Income Tax

What is Net Investment Income Tax (NII)?

Impacts both investors and traders –
however investment income is reduced by allowed
expenses, thus lowering cost to traders



What does the IRS Require to be a Trader?

Three Factors:

- 1) A trader must seek to profit from **DAILY** market movements in the prices of securities and not from interest, dividends or capital appreciation. A trader seeks to catch market place swings and profit from these **SHORT-TERM** changes rather than to profit from long-term holdings.



What does the IRS Require to be a Trader?

- 2) Trading must be Substantial.
- 3) Trading activity must be carried on with continuity and regularity.



Other IRS Considerations:

- Holding Period
- Frequency and dollar amount of the trades
- Extent to which trading is pursued
- Amount of time devoted to activity (business)
- Separate bank accounts, offices and personnel



Tax Court and Federal Court Cases

Long history of challenges in the courts

Generally, the Courts have found for the taxpayer if:

- Trading is substantial
- The taxpayer sought to catch marketplace swings, and
- Profit is from SHORT-TERM trades rather than from long-term holding of investments



What types of things have the Courts considered?

- Total number of Trades
- Holding period
- Timing of Trades



What do the Court Rulings Say?

Most important takeaway's from the court rulings:

- In the Market daily
- Numerous transactions
- Seek to profit from short-term swings



Schedule C Reporting and Audit Risk

Schedule C is a top audit area for the IRS on individual returns

When adopting a position as a trader and reporting on Schedule C, it is best to *plan to be audited* and

Document, Document, Document



Wrap up

Being a trader can result in significant tax benefits

Electing trader status requires careful consideration