

Understanding Trader Tax Status & How Day Traders are Taxed

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Individuals who buy and sell securities for their own account as a primary source of income and spend significant periods of time doing it may qualify for a beneficial tax status. Trader Tax Status (TTS) provides qualifying individuals advantages, such as the ability to write off trading losses and business expenses and to claim employee benefit deductions for retirement plans.

TTS benefits individuals who engage in a substantial volume of short-term trades, commonly known as “day trading”, allowing them to classify their trading income and expenses as business-related rather than those of an investor.

While the IRS does not impose specific guidance or criteria defining the distinction between a trader and an investor, certain parameters are broadly applied to help traders avoid running afoul of the government agency. Additionally, it is typical for tax advisors to apply their own standards when advising clients on TTS eligibility.

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Day Trader Tax Deductions

As mentioned previously, the IRS is light on definitions around TTS, but the following parameters are widely accepted:

- **Trade substantially, regularly, frequently, and continuously throughout the year:** To qualify for TTS, the IRS expects the individual to trade almost every day that the market is open and execute hundreds of transactions per year. The trader also needs to spend about 75% of the week executing trades, which typically means four out of five market days. Most trades should be day trades or swing trades no longer than one month.
- **Seek to profit from daily market movements in the prices of securities:** A trader usually intends to benefit from the short-term price fluctuations in securities by purchasing and selling stocks, rather than relying on dividends, interest, or capital appreciation. The holding periods for positions are generally short-term, resulting in the majority of realized gains (losses) being of short-term nature. Qualified dividend income typically comprises less than 25% of the Fund's gross income.
- **Intention to trade as a business:** A trader should have the intention of running a business or producing income for a livelihood, rather than treating it as a hobby or passive investment.

Benefits of TTS

TTS offers significant tax savings for active traders. Key tax benefits include:

- Traders may take an above-the-line deduction that can offset business expenses with trading income.
Interest expense is deductible.
- Educational expenses, such as the cost of attending trading seminars, are deductible.
- Gains and losses from selling securities from being a trader are not subject to self-employment tax.
- Traders who have made the Section 475(f) mark-to-market election – necessary to receive TTS – are not limited to \$3,000 in losses, and mark-to-

market losses can be offset by trading income.

- Making the Section 475(f) election eliminates tax adjustments like wash sales, constructive sales, and straddles.

Section 475(f) Mark-to-Market Election

Traders can elect Section 475(f) mark-to-market accounting for their trading securities. All open positions are treated as sold at fair market value on the last day of the year and report the unrealized gains or losses as ordinary income or losses. The election is more effective to accelerate unrealized losses and enables taxable individual investors to treat them as ordinary losses, as opposed to capital losses, which are subject to annual limitations. Taxpayers must notify the IRS ahead of filing a tax return by making a mark-to-market election. This involves providing a tax return from the previous year and Form 4868 Application for Automatic Extension of Time to File U.S. Individual Income Tax Return, accompanied by a written declaration of intent to make a mark-to-market election under Section 475(f). The IRS will respond in writing with its decision.

When it is time to file taxes, the taxpayer will use Form 4797 Sales of Business Property to report gains and losses

Flexibility and Drawbacks

TTS allows traders to categorize their attempt to make capital gains (losses) on daily market movements as a sort of ordinary income (losses) for tax purposes under election. It also allows them to write off trading expenses as business expenses, further reducing their tax burden, and eliminating the tax adjustments from wash sales, giving them greater flexibility in their tax planning.

While TTS offers tax benefits by categorizing the individual's trading activities as a business for tax purposes, it does not provide legal protection for one's assets as their stock portfolio remains personally liable to lawsuits. Working with an advisor who can provide guidance on structuring a trading portfolio as a formal business entity, could help protect one's assets and reduce their tax liability. This approach addresses both tax efficiency and asset protection concerns, ensuring thorough

planning for financial security.

[Contact an Anchin Advisor](#)

For further information about how to maximize one's tax status or to consult with Anchin professionals who work with traders and have developed several techniques to assess TTS eligibility, please reach out to [Anna Wong](#) or your Anchin Relationship Partner.