



# TRADER TAX COACH

Tax News for the Active Trader

Trader Tax Report

October, 2012

## IRC Section 475(f): Mark To Market Accounting

One of the biggest advantages of claiming trader status is the ability to elect mark to market accounting (IRC Section 475). The Mark to Market method has the effect of converting capital gains and losses into ordinary gains and losses. A trader makes this adjustment at the end of the year. All open positions are priced as if they were sold on the last trading day of the year (marked to market) and then "bought back" at the same price on the 1st trading day in January. Your unrealized gain or loss is then recorded for tax purposes on Form 4797.

### Advantages of Mark to Market Accounting:

- No wash sale rules:

traders are exempt from wash sale rules

- Losses are **FULLY** deductible!

This is the main reason to take the mark to market election. Losses are converted into ordinary losses (not capital losses), so you are not restricted by the \$3000 capital loss limitation. This allows a trader to deduct all losses in the year that they occur, provided there is other income to offset it. You can even carry back the losses to previous tax years!

Let's look at an example:

Trader X has a \$20,000 trading loss for the year. Under capital gains/loss

rules, Trader X can deduct \$3000 from his taxes and has to carry the remaining \$17,000 loss forward to the next tax year.

If Trader X has elected the mark to market accounting method, the \$20,000 loss is treated as an ordinary loss and the **ENTIRE** \$20,000 loss can be taken against any other income source (W-2 wages, interest and dividend income, etc). If the \$20,000 loss isn't used up in the current tax year, Trader X can elect to carry this loss back up to 2 years and count it against prior year's income! Any remaining loss can then be carried forward up to 20 years until it is used up.

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## Taking the Home Office Deduction

Is a home office deduction really worth it to a trader? I get asked this question quite often so I thought I'd spend some time going over the home office deduction in this month's newsletter.

In my experience, all traders will benefit by claiming the home office deduction, putting thousands of dollars back into their own pockets every year!

So what are the requirements for taking the home office?

The IRS states that:

- The business use must be exclusive and regular AND
- Must be your principal place of business

These 2 requirements are easily met by most traders.

There are 2 ways to calculate the home office expense:

- **Square Footage**

You divide the square footage of your office by the square footage of your home. You are allowed to subtract the square footage of common areas like hallways, entries, stairs, etc.

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## IRC Sect 475(f): Mark to Market Accounting (cont'd)

### Disadvantages of Mark to Market Accounting

- Election is permanent

Once you make the election, you have to use it for all future years. You can change the election **ONLY** with the approval of the IRS, and generally they won't grant this consent if your reason for changing is simply that the election didn't work to your advantage.

- No capital loss carry over

If a trader is carrying over capital losses, electing mark to market will change the classification of the trading gains going forward. Gains will be taxed as ordinary gains and any capital losses cannot be used to offset those gains (capital losses only offset capital gains).

Let's look at an example:

Trader X is carrying over \$20,000 of capital losses from a previous tax year and makes the mark to market election. At the end of the year, he has a \$25,000 trading gain. He cannot use the \$20,000 capital loss carry over to offset his trading gain. He will be able to take \$3000 of the capital loss carry over in the current tax year and will have a \$17,000 loss that will carry over into the next tax year. He will pay ordinary income taxes on the \$25,000 gain (minus any other expenses AND the \$3000 capital loss deduction).

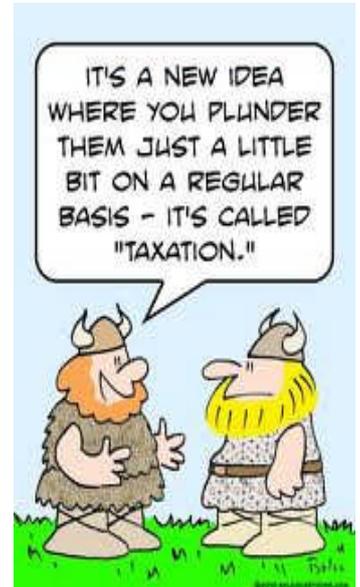
### Making the Mark to Market Election

In order to make the mark to market election, a trader must enclose a statement of intent with the prior year's tax return (or extension

request) by April 15. For example, if you intend to switch to the mark to market method for 2013, you will enclose an election statement with your 2012 tax return by April 15.

Then you'll need to fill out and send in Form 3115 (Change of Accounting Methods) with your tax return for the following year. For instance, if you elect mark to market for the 2013 tax year, you'll fill out and send in Form 3115 with your 2013 tax return by the April 15, 2014 due date.

Be careful when making the election to the mark to market method. If you make any mistakes or miss any deadlines on sending in the right forms, you will lose out on the mark to market tax benefits.



"I am proud to be paying taxes in the United States. The only thing is, I could be just as proud for half the money"

Arthur Godfrey



## Taking the Home Office Deduction (cont'd)

- **# of Rooms Method**

This method is just as it sounds. You take the number of rooms used for business and divide it by the number of rooms in your house. You are allowed to exclude bathrooms, closets, and the garage.

The IRS doesn't stipulate which method you have to use. Trader Tax Coach recommends that you calculate your deduction using both

methods and use the one that gives you the highest deduction.

You are allowed to deduct 100% of the direct expenses (ex. Painting your office, replacing carpet in your office) and the business use % of your indirect expenses (mortgage interest, property taxes, utilities, etc.)

Sole proprietor traders will use form 8829 to claim

these expenses. LLC traders will claim these expenses on Schedule E and S corp traders will claim these expenses on Schedule A of their 1040. Be aware that there are limitations to claiming the deduction on Schedule A.

If you have any further questions on taking the home office deduction, please email us at: [info@TraderTaxCoach.net](mailto:info@TraderTaxCoach.net)

Business traders (S Corp, LLC, Partnerships) can use an **ACCOUNTABLE PLAN** to reimburse themselves for the home office use. Your business gets the deduction and since it is classified as a reimbursement, it is **NOT** taxable income to you personally!

To find out more about how an **ACCOUNTABLE PLAN** might benefit you, contact us at [info@TraderTaxCoach.net](mailto:info@TraderTaxCoach.net)

## Trader Spotlight: George Cavaligos

“Over my career I have been lucky enough to cover some of the best traders that no one has probably even heard of. The first was Leslie Harrison, who ran the funding book for Banque Indo-Suez. She was kind enough and patient enough to take a young broker under her wing and teach me much about trading. Leslie was the ultimate trend follower, always starting small and adding to your winners was the most important lesson I learned from her.

I have many favorite books but will always have a copy of Prechter and Frost’s classic “The Elliot Wave Principle” and Ramki Ramakrishnan’s book “5 Waves to Financial Freedom”.

My best piece of advice to a new trader is to learn as much as you can and try to find an experienced trader as a mentor. The coaching pro-

grams from the top notch authors like Van Tharp and Mark Douglas are a great place to start.

As you may have noticed from my choice of favorite books, I use a lot of Elliott Wave analysis in my trading, especially on the shorter term time horizon that I find most useful. I always start a new trade with a small position and try to add if/when that trade becomes a winner. I always use a stop loss order no matter what!

You asked how do I overcome the emotional roller coaster of trading. I struggle with that daily and try to focus my efforts towards education. I feel if I learn something everyday either about myself or the markets that it is a successful day. I try not to focus too much on the monetary aspects of it all.

My biggest obstacle is the tendency to be too bear-

ish. It might be the result of working on the trading floor for so long. I really have a hard time initiating trades from the long side of the market especially in the financials that I have worked with for so long.

I feel that one of the most important things we can all do as traders is to take a good hard look at ourselves and make sure we have an ongoing study of our own habits and foibles that could sabotage our trading. The biggest thing we all have to learn is the idea that we are right or wrong about the market, and that if we lose money, that somehow we are not a good or smart person. The market is always right and our positions have to be in sync with the market or stopped out before there is too much damage done to our accounts and our psyche.”



### George Cavaligos



George began his futures career in 1980 with

Drexel Burnham Lambert and rose from a runner to a large sales desk manager in the Eurodollar and T-Bill futures pits.

He has been a member of the CME and CBOT since 1984 with Drexel Burnham, Banque Indo-Suez, Carr Futures, Bear Stearns and previously a full service Institutional Futures Broker with MF Global.

He has provided futures and cash based technical analysis to a wide range of domestic and foreign customers.

**At Hamzei Analytics, we have just started our HFT Bonds chat room. We are trying to build a community of traders who will bring a range of experience and ideas to the community. I currently send out a morning email with a recap of the overnight trade and what we expect to hap-**

**pen in the coming trading day. This email contains the support and resistance levels that I see for the 10 yr Note Futures Contract.**

**I also post an afternoon recap video with the days wrap up and a bit of an overview of the upcoming evening ses-**

**sion.**

**This room is oriented towards the active trader who is looking for an environment where they can learn and interact with experienced traders who are willing to share their knowledge and time.**

**The HFT Bonds chat room is currently going for \$149 a month with new subscribers getting a 1 MONTH FREE TRIAL starting no later than October 15. To receive your free month, please email**

**HFT\_BONDS**

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## Tax News for the Active Trader

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**Size DOES matter,**  
especially when it's your taxes!



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## Everyone Knows That Trading is Stressful Enough. Your Taxes Don't Have To Be!



Trader Tax Coach is a full service tax and accounting firm specializing in helping traders from all over the United States use the IRS code to legally maximize their tax deductions. Everything we do is Tax Court tested and IRS approved. This means no "red flags", no "gray areas", and no "aggressive" moves. We help traders slash their taxes the **LEGAL** way by finding every hidden deduction and every tax credit that they are entitled to take.

We are much more than just another accounting firm. We go beyond just putting the right numbers in the right boxes. We **PROACTIVELY** search for ways to save you money, either personally or through your trading business. Ask yourself, "When was the last time my current tax professional came to me with an idea to lower my taxes"?

Some of the services we provide include the following:

- **Trader Tax Preparation**
- **Mark to Market Elections**
- **Trader Tax Planning and Advice**
- **Trader Incorporation Services**
- **Bookkeeping Services**
- **Health & Retirement Plan Consultation**
- **Audit Assistance**

Our fees are extremely competitive and include **UNLIMITED** consultations throughout the year. If you have any tax questions, you can always contact us with the security of knowing that you will not get billed for our time.

## How Long Should You Keep Records?

Here is a list of how long records should be kept:

### Prior Year Tax Returns

Keep for a minimum of 3 years. Keep longer if there are items that affect future years like NOLs, Capital Losses, Depreciation, etc.

### Tax Receipts

Should be kept for a minimum of 3 years. Receipts under \$75 do not need to be kept

### Investment Details

Keep year end brokerage statements and 1099s for a

minimum of 3 years (sensing a pattern yet?). You should shred monthly statements after you get your year end statement.

### IRA Records

You should keep all IRA contribution and distribution records indefinitely! Records of nondeductible contributions are extremely important.

### Business Receipts

Keep payroll records for a minimum of 4 years. Keep the tax return for 3 years following the last year a

NOL is used.

### Travel Receipts

Keep travel related receipts for a minimum of 3 years. You can total incidental expenses into reasonable categories (taxi, tips, etc.) and keep for 3 years.

### Other Personal Documents

Pay stubs, cancelled checks, general bills and receipts, and credit card receipts should be shredded when monthly statements are received, unless the item is needed for tax purposes.



## Don't Keep Us A SECRET!

Our business thrives on the constant stream of referrals from our tax clients. If you know other traders who could benefit from our trader tax expertise, please don't keep us a secret. We relish the opportunity to be of service to them.