PRESTIGE TAX &
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Trader Tax Status: How To Qualify

It's not easy to be eligible for trader tax status (TTS). Currently, there's no statutory law with objective tests for eligibility. Subjective case law applies a two-part test:

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

General Rules/Guidelines to Follow:

Volume, frequency, and average holding period are the "big three" because they are more accessible for the IRS to verify.

- ***Volume*:** 15 trades per week, 60 a month, and 720 per year on an annualized basis. Count each open and closing transaction separately, not round trip (scaling in and out of trades also qualifies)
    - See Tax Court Case *William F. Poppe vs.* Commissioner of Internal Revenue for reference

- ***Frequency*:** Execute trades on close to four days per week, around a 75% frequency rate.

- ***Holding period***: In the Endicott court, the IRS said the average holding period must be 31 days or less. That's a bright-line test.

- ***Trades full-time or part-time***, for a good portion of the day, the markets are open almost every day. Part-time and money-losing traders face more IRS scrutiny, and individuals face more scrutiny than entity traders.

- ***Hours*:** Spends more than four hours per day, almost every market day, working on his trading business — all-time counts.

- ***Avoid sporadic lapses***: A trader has few to no intermittent stoppages in the trading business during the year.

- ***Intention*:** Has the intention to run a business and make a living. It doesn't have to be your primary living.

- ***Operations*:** Has significant business equipment, education, business services, and a home office.

- ***Account size***: Securities traders need to have $25,000 on deposit with a U.S.-based broker to achieve "pattern day trader" (PDT) status. There is no set in stone minimum, but for **substantial test**, we like to see *at least 10% of net worth* being actively traded.

What doesn't qualify?

Don't count four types of trading activity for TTS qualification.

1. Outside-developed automated trading systems. A computerized trading service (ATS) with little to no trader involvement doesn't qualify for TTS. On the other hand, if the trader can show he's very involved with the creation of the ATS — perhaps by writing the code or algorithms, setting the entry and exit signals, and turning over only execution to the program — the IRS may count the ATS-generated trades in the TTS analysis.
2. Trade copying service. Some traders use "trade copying software" (TCS). Trade copying is similar to using a canned ATS or outside adviser, where the copycat trader might not qualify for TTS on those trades.
3. Engaging a money manager. Hiring a registered investment adviser (RIA) or commodity trading adviser (CTA) — whether they are duly registered or exempt from registration — to trade one's account doesn't count toward TTS qualification.
4. Trading retirement funds. Achieve TTS through trading in taxable accounts. Trading activity in non-taxable retirement accounts doesn't count for purposes of TTS qualification.