

# Tax Optimization Checklist

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Signal Pilot Education Hub

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## Tax Optimization Trading Checklist

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### Lesson 40: Tax Optimization

This checklist helps you legally minimize taxes through strategic holding periods, Trader Tax Status (TTS), wash sale avoidance, and entity structuring.

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## Short-Term vs. Long-Term Capital Gains

### Understand Tax Rates

- [ ] **Short-term (<1 year):** Taxed as ordinary income (22-37%)
- [ ] **Long-term (>1 year):** Taxed at 0-20% (favorable rates)
- [ ] **Holding period starts:** Day after purchase
- [ ] **364 days = short-term, 366 days = long-term** (2 extra days = 17% tax savings)

## Strategic Holding Period Planning

- [ ] **If swing trading anyway** - Consider holding winners past 1 year
- [ ] **Calculate tax savings:** \$100K gain × 17% difference = \$17K saved
- [ ] **Balance with risk:** Holding extra days = exposure to reversal (is it worth it?)
- [ ] **Not for day traders:** If intraday strategy, ignore this (short-term unavoidable)

## Example Tax Impact

\$100,000 gain held 364 days:

Tax (short-term, 37%): \$37,000

Net: \$63,000

\$100,000 gain held 366 days:

Tax (long-term, 20%): \$20,000

Net: \$80,000

Savings: \$17,000 (27% more in your pocket)

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## Trader Tax Status (TTS)

### TTS Qualification Criteria (IRS Requirements)

- [ ] **Substantial activity:** 750+ trades/year (guideline)
- [ ] **Regularity:** Trade most days market is open (4+ days/week)
- [ ] **Continuity:** Trading is substantial source of income

- [ ] **Intent:** Profit from short-term price movements (not long-term investing)
- [ ] **Consult CPA:** TTS is complex, professional advice required

## TTS Benefits

- [ ] **Deduct business expenses:**
  - Trading platform fees (\$200/month = \$2,400/year)
  - Market data subscriptions (\$2,000/year+)
  - Home office deduction (\$500/month = \$6,000/year)
  - Computer/monitors (\$5,000 amortized)
  - Education/courses (\$3,000/year)
- [ ] **Estimated savings:** \$10,000-\$15,000/year in deductions

## TTS Application Process

- [ ] **Track trade count** - Document 750+ trades
- [ ] **Keep trade logs** - Prove regular, substantial activity
- [ ] **File Form 3115** - Change accounting method to Mark-to-Market (optional)
- [ ] **Work with CPA** - File Schedule C (business income/expenses)



## Wash Sale Rule (Avoid This Trap!)

### Wash Sale Definition

- [ ] **Rule:** Sell security at loss, buy back within 30 days = loss  
DISALLOWED
- [ ] **Applies to:** Same security or "substantially identical" security

- [ ] **Result:** Loss deferred, added to cost basis of new position (not ideal)

## Example Wash Sale

Jan 1: Buy 100 SPY @ \$500 = \$50,000

Jan 15: Sell 100 SPY @ \$480 = \$48,000 (loss: -\$2,000)

Jan 20: Buy 100 SPY @ \$485 (WITHIN 30 DAYS)

Result: -\$2,000 loss DISALLOWED (wash sale)

New cost basis: \$485 + \$20 (deferred loss) = \$505

You can't deduct the \$2K loss this year.

## Avoid Wash Sales (3 Methods)

- [ ] **Wait 31+ days** - Sell at loss, wait 31 days, then rebuy
- [ ] **Buy similar (not identical) security:**
  - Sell SPY → Buy IVV or VOO (both track S&P 500, not "substantially identical" per IRS)
  - Sell QQQ → Buy QQQM (similar but different ticker)
- [ ] **Mark-to-Market (MTM) election** - Eliminates wash sale rule (but lose long-term capital gains)

## Mark-to-Market Election

- [ ] **What it does:** All positions marked "sold" on Dec 31 (paper gains/losses count)
- [ ] **Benefit:** No wash sale rule (all losses deductible)
- [ ] **Downside:** Lose long-term capital gains treatment (all short-term)
- [ ] **Good for:** Day traders (short-term only anyway)
- [ ] **Bad for:** Swing traders (want long-term rates)



# Entity Structuring (Advanced)

## Individual (Schedule D) - Default

- [ ] **Tax:** Ordinary income rates (22-37% short-term)
- [ ] **Pros:** Simple, no setup costs
- [ ] **Cons:** Highest tax, no business deductions (unless TTS)

## LLC (Pass-Through)

- [ ] **Tax:** Income + Self-Employment tax (15.3%)
- [ ] **Calculation:** \$200K profit = \$64K income tax + \$30.6K SE tax = \$94.6K total
- [ ] **Pros:** Legal protection
- [ ] **Cons:** SE tax kills you (total 47% tax rate!)

## S-Corp (Optimal for \$75K+ Profit)

- [ ] **Structure:** Split profit into Salary + Distribution
- Salary: Subject to SE tax (15.3%)
- Distribution: NO SE tax (just income tax)
- [ ] **Example:** \$200K profit split:
  - \$80K salary (SE tax: \$12.2K)
  - \$120K distribution (SE tax: \$0)
- Total SE tax: \$12.2K vs. \$30.6K (LLC) = **\$18K savings**
- [ ] **Threshold:** Worth it at \$75K+ profit (admin costs ~\$2-3K/year)

# Entity Selection Guide

Profit < \$50K: Stay individual (simplicity)  
Profit \$50K-\$75K: Consider TTS (deductions)  
Profit \$75K+: S-Corp (SE tax savings)  
Profit \$200K+: S-Corp (saves \$15-20K/year)



## Tax-Loss Harvesting (December Strategy)

### Year-End Tax Planning

- [ ] **Review open positions (December)** - Which are gains? Losses?
- [ ] **Identify unrealized losses** - Can sell to offset gains
- [ ] **Calculate benefit:** Loss amount × Tax rate = Tax savings

### Example Tax-Loss Harvesting

Year-end positions:

- SPY: +\$50K unrealized gain
- QQQ: -\$15K unrealized loss
- IWM: +\$5K unrealized gain

Strategy:

1. Sell SPY (+\$50K gain) - Lock in profit
2. Sell QQQ (-\$15K loss) - Realize loss
3. Sell IWM (+\$5K gain) - Lock in profit

Net taxable gain:  $\$50K + \$5K - \$15K = \$40K$

Tax saved:  $\$15K \text{ loss} \times 37\% = \$5,550$

Then: Wait 31 days, rebuy QQQ (maintain exposure)  
Or: Buy QQQM immediately (similar but not identical)

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## Quarterly Estimated Tax Payments

### Estimated Tax Requirements

- [ ] **Who must pay:** Self-employed, traders without withholding
- [ ] **Frequency:** Quarterly (Apr 15, Jun 15, Sep 15, Jan 15)
- [ ] **Amount:** 90% of current year tax OR 100% of prior year tax
- [ ] **Penalty:** Underpayment = IRS penalty + interest

### Calculate Quarterly Payments

- [ ] **Estimate annual income** - Based on YTD performance
- [ ] **Calculate tax owed** - Use tax software or CPA
- [ ] **Divide by 4** - Pay each quarter
- [ ] **Set aside 40% of profits** - Safe rule: 40% to taxes (federal + state)



## Pro Tips

### Tax Optimization Mastery

- **Track everything** - Expenses, miles, home office (TTS deductions)

- **Set aside 40% for taxes** - Don't spend all profits (tax bill in April hurts)
- **Consult CPA annually** - Tax laws change, professional advice pays for itself
- **Plan December harvest** - Tax-loss harvesting = low-hanging fruit

## Common Mistakes to Avoid

- **✗** Not tracking expenses (leaving \$10K+ in deductions on table)
- **✗** Triggering wash sales (negates tax-loss harvesting)
- **✗** Not making estimated payments (penalties + interest)
- **✗** Using LLC instead of S-Corp at \$200K profit (costs \$18K/year)
- **✗** Ignoring state taxes (CA, NY = add 10-13% tax)

## Tax-Efficient Trading Practices

- **Hold winners past 1 year** (if swing trading) - 17% tax savings
- **Harvest losses in December** - Offset gains
- **Avoid wash sales** - Wait 31 days or buy similar security
- **Use tax-advantaged accounts** - IRA/401(k) for long-term holds (tax-deferred)

## Entity Structure Decision Tree

< \$50K profit: Individual (simple)  
 \$50-75K profit: Individual + TTS (deductions)  
 \$75-200K profit: S-Corp (SE tax savings \$10-15K)  
 \$200K+ profit: S-Corp (SE tax savings \$15-25K)





## Related Resources

- **Lesson 39:** Performance Attribution (accurate tracking = better tax planning)
  - **Lesson 41:** Professional Infrastructure (deductible expenses for TTS)
  - **Lesson 42:** Trading Career Path (entity structure as you scale)
  - **Recommended:** GreenTraderTax (CPA firm specializing in traders)
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**Difficulty:** Advanced

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Remember: Taxes are your largest expense (20-40% of gains). Optimize legally. Work with a CPA. Keep more of what you earn. Every dollar saved in taxes = 2 winning trades you don't need.

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