

Tax Optimization Checklist

Signal Pilot Education Hub



Tax Optimization

Trading Checklist

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.



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:** $\$100K \text{ gain} \times 17\% \text{ difference} = \$17K$ 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)

🎯 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 ($\$200/\text{month} = \$2,400/\text{year}$)
- Market data subscriptions ($\$2,000/\text{year+}$)
- Home office deduction ($\$500/\text{month} = \$6,000/\text{year}$)
- Computer/monitors ($\$5,000$ amortized)
- Education/courses ($\$3,000/\text{year}$)
- [] **Estimated savings:** $\$10,000-\$15,000/\text{year}$ 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 IIV 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 \times 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 loss \times 37% = \$5,550

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



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

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< $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)

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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

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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