# Tax Tips

## Deductions of Investor who Manages His Own Investments

You recently asked about the deductibility of your investment-related expenses, including the cost of subscriptions to financial periodicals, clerical expenses, etc. You wanted to know whether you could deduct these expenses as business expenses in arriving at adjusted gross income, rather than as production of income expenses which are deductible only as itemized deductions and thus are subject to the 2% floor on miscellaneous itemized deductions.

In order to deduct your investment-related expenses as business expenses, you must be engaged in a trade or business. The Supreme Court held many years ago that an individual investor isn't engaged in a trade or business merely because he manages his own securities investments, regardless of the amount of the investments or the extent of the work required. If a taxpayer can show that his investment activities rise to the level of carrying on a trade or business, however, he may be considered a trader, who is engaged in a trade or business, rather than an investor, who isn't. A trader is entitled to deduct his investment-related expenses as business expenses. A trader is also entitled to deduct home office expenses if the home office is used exclusively on a regular basis as his principal place of business. An investor, on the other hand, isn't entitled to home office deductions since his investment activities aren't a trade or business.

Since the Supreme Court's decision, there has been extensive litigation on the issue of whether a taxpayer is a trader or investor. The Tax Court has recently developed a two-part test that must be satisfied in order for a taxpayer to be a trader. Under this two-part test, a taxpayer's investment activities are considered a trade or business only where *both* of the following are true:

(1) the taxpayer's trading is substantial (i.e., sporadic trading won't be a trade or business), and

(2) the taxpayer seeks to catch the swings in the daily market movements, and to profit from these short-term changes, rather than to profit from long-term holding of investments.

Thus, the fact that a taxpayer's investment activities are regular, extensive, and continuous isn't in itself sufficient for determining that a taxpayer is a trader. In order to be considered a trader, a taxpayer must show that he buys and sell securities with reasonable frequency in an effort to profit on a short-term basis. Even a taxpayer who made over 1,000 trades a year with trading activities averaging about $16 million annually was held to be an investor because the holding periods for stocks sold averaged about one year.

.If you have any questions regarding the above discussed topic or any other tax matter, please feel free to give me a call at (562) 698-9891.

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