

# TAX TREATMENT OF FINANCIAL PRODUCTS – KEY STRATEGIES FOR TRADERS

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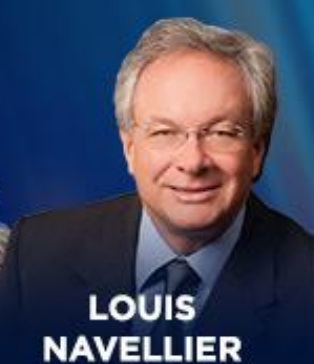
March 12, 2025 @ 9:30 am EST  
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**ROBERT GREEN**  
*GreenTraderTax.com*



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# SECURITIES

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Securities traders have ordinary tax rates on short-term capital gains, wash-sale loss adjustments, and a capital-loss limitation.

# Securities include:

- U.S. and international equities (stocks)
- U.S. and foreign equity (stock) options
- narrow-based indexes (an index made up of nine or fewer securities)
- options on narrow-based indexes
- securities ETFs structured as registered investment companies (RIC)
- options on securities ETF RICs
- commodities ETFs structured as publicly traded partnerships (PTP)
- volatility ETNs structured as debt instruments
- bonds
- mutual funds
- single-stock futures

# The realization method and wash sale losses

- The IRS taxes securities transactions when a taxpayer closes an open trade — hence the term “realization method.”
- With “tax-loss harvesting,” investors sell to realize losses before year-end.
- To avoid wash-sale losses at year-end 2025, do not re-enter those losing positions within 30 days; otherwise, the planned loss might be deferred to 2026 as a wash-sale loss adjustment.
- Wash sales during the year can be okay, provided you close them out before year-end.

# Short-term vs. long-term capital gains rates

- Short-term capital gains (STCG) use ordinary tax rates, with progressive tax brackets currently up to 37% for 2024 and 2025.
- Long-term capital gains (LTCG) rates are significantly lower and apply to sales of securities held for 12 months or more.
- The LTCG rates are 0% for the 10% and 12% ordinary brackets, 15% in the middle brackets, and 20% in the top 37% bracket.

# Trader tax status and Section 475 MTM accounting

- Traders eligible for trader tax status (TTS) can elect Section 475 MTM ordinary gain or loss on securities. For 2025, the deadline is April 15, 2025.
- TTS requires four weekly trades, 75% frequency, and an average holding period of 31 days or less.
- With Sec. 475 mark-to-market accounting, report realized and unrealized gains and losses at year-end.
- Section 475 securities trades are exempt from wash-sale loss adjustments and the \$3,000 annual capital loss limitation.
- TTS traders using Section 475 can get a 20% QBI deduction if they are under the income cap.

# SECTION 1256 CONTRACTS (FUTURES)

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Section 1256 contracts (futures) enjoy lower 60/40 capital gains tax rates, summary tax reporting, mark-to-market (MTM) accounting, and a Section 1256 loss carryback election.

## Section 1256 contracts include (1/2)

- U.S. -regulated futures contracts (RFCs)
- options on U.S. RFCs
- U.S. broad-based indexes made up of 10 or more underlying securities – also known as stock index futures
- options on U.S. broad-based indexes
- foreign futures if granted Section 1256 treatment in an IRS revenue ruling
- non-equity options (a catchall)

## Section 1256 contracts include (2/2)

- CBOE-listed options on commodity ETF publicly traded partnerships (PTP)
- CBOE-listed options on precious metals ETF publicly traded trusts (PTT)
- CBOE-listed options on volatility ETN prepaid forward contracts
- forward forex contracts with the opt-out election into Section 1256(g) on the major pairs for which futures trade (we make a case for spot forex, too)
- forex OTC options (Wright court)

# 60/40 capital gains tax rates

- Section 1256 contracts have lower 60/40 capital gains tax rates with MTM:
  - 60% (including day trades) subject to lower long-term capital gains rates and
  - 40% taxed as short-term capital gains using the ordinary rate.
- At the maximum tax bracket for 2024 and 2025, the blended 60/40 rate is 26.8% — 10.2%, lower than the highest regular bracket of 37%.
- There are significant tax savings throughout the tax brackets.
- See <https://greentradertax.com/trader-tax-center/tax-treatment/section-1256-contracts/>.

# Section 1256 loss carryback election

- Rather than use the Section 1256 loss in the current year, taxpayers may deduct 1256 losses on amended tax return filings, applied against Section 1256 gains only.
- It's a three-year carryback; unused amounts carry forward, and it's the only remaining carryback opportunity for traders.

# EXCHANGE-TRADED FUNDS

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Securities, commodities, and precious metals ETFs use different structures, and tax treatment varies.

# Securities ETFs usually are regulated investment companies (RICs)

- Like mutual fund RICs, securities ETFs pass through their underlying ordinary and qualifying dividends to investors.
- Selling a securities ETF is a sale of a security, calling for short- and long-term capital gains tax treatment using the realization method.
- A securities ETF is a security, so wash-sale loss adjustments or Section 475 apply if elected by a TTS trader.

# Commodities/futures ETFs

- Commodities/futures ETFs are publicly traded partnerships (PTPs).
- Commodities/futures ETFs issue annual partnership Schedule K-1s, which pass through their underlying Section 1256 tax treatment to investors and other taxable items.
- Add the 1256 income to the cost basis, as 1099-Bs don't have that information.
- Selling a commodities/futures ETF is a sale of a security, and because it is widely held, it calls for short—and long-term capital gains tax treatment using the realization method.
- As a security, wash-sale loss adjustments or Section 475 applies if elected by a TTS trader.

# Physically backed precious metals ETFs

- Physically backed precious metals ETFs use the publicly traded trust (PTT) structure.
- A PTT issues an annual Schedule K-1, passing through tax treatment to the investor.
- Selling physically backed precious metals ETFs is taxed at the “collectibles” long-term capital gains tax rate — capped at 28%. (If the ordinary rate is lower, use it.)
- Physically backed precious metals ETFs are not securities, so they are not subject to wash-sale loss adjustments or Section 475 if elected.

# OPTIONS

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Options are derivatives of their underlying instrument and generally have the same treatment. For example, equity options are derivatives of the underlying equity, and both are securities. Tax treatment for options includes simple (outright) and complex trades with multiple legs.

# Options taxed as securities:

- equity (stock) options
- options on narrow-based indexes
- options on securities ETFs
- **Wash sale rule:**  
For options taxed as securities, wash-sale (WS) loss rules apply between *substantially* identical positions in securities, which means between equity and equity options, such as Apple stock and Apple stock options, at different expiration dates.
- This WS rule applies across *all accounts*, including IRAs.

# Options taxed as Section 1256 contracts:

- non-equity options (a catchall)
- options on U.S. regulated futures contracts
- options on broad-based indexes (stock index futures)
- CBOE-listed options on commodity ETF publicly traded partnerships
- CBOE-listed options on precious metals ETF publicly traded trusts
- CBOE-listed options on volatility ETN prepaid forward contracts
- forex OTC options (Wright appeals court)

# Simple vs. complex options trades

- Simple option trading strategies, such as buying and selling call-and-put options, are known as outright. Tax treatment for outright option trades is relatively straightforward.
- Complex options trades, known as option spreads, include multi-legged offsetting positions like iron condors, butterfly spreads, vertical, horizontal, and diagonal spreads, and debit and credit spreads.
- Complex options trades trigger a bevy of IRS rules geared toward preventing taxpayers from tax avoidance schemes: deducting losses and expenses from the losing side of the trade in the current tax year while deferring income on the offsetting winning position until a subsequent tax year.

## Three things can happen with outright option trades:

- 1. Trade option (closing transaction). It's like the taxation of an equity trade.
- 2. Option expires (lapses). The cost basis or proceeds is zero.
- 3. Exercise the option (a stepping-stone transaction)
- Watch the below Webinar recording dated March 5, 2025:
- [Tips for Options Traders: Preparing 2024 Tax Returns.](#)

# OTHER FINANCIAL PRODUCTS

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# Cryptocurrencies

- The IRS treats cryptocurrencies as intangible property.
- The realization method applies to short-term vs. long-term capital gains and losses.
- Wash sales and Section 475 MTM do not apply to cryptocurrency because it's not a security or a commodity in the eyes of the IRS.
- Tax reporting includes cryptocurrency-to-fiat-currency sales, crypto-to-alt-crypto trades, and purchases of goods or services using crypto.

# Forex

- Forex receives ordinary gain or loss treatment and is not subject to the annual \$3,000 capital loss limitation. (Section 988).
- Investors and TTS traders can internally file a contemporaneous “capital gains election” to opt out of Section 988 into capital gain or loss treatment.
- The capital gains election on forex allows the trader to use Section 1256(g) treatment with lower 60/40 capital gains rates on major currency pairs if the trader doesn't take or make delivery of the underlying currency.

# Volatility ETNs

- Volatility exchange-traded notes (ETN) are structured as “prepaid forward contracts” or “debt instruments.”
- Our tax counsel says that the IRS does not consider an ETN prepaid forward contract a security, whereas ETN debt instruments are.
- Sales of ETN prepaid forward contracts use the capital gains realization method on sales.
- Because it's not a security, ETN prepaid forward contracts (i.e., VXX) are not subject to wash-sale loss adjustments or Section 475 (if elected).

# NET INVESTMENT INCOME TAX

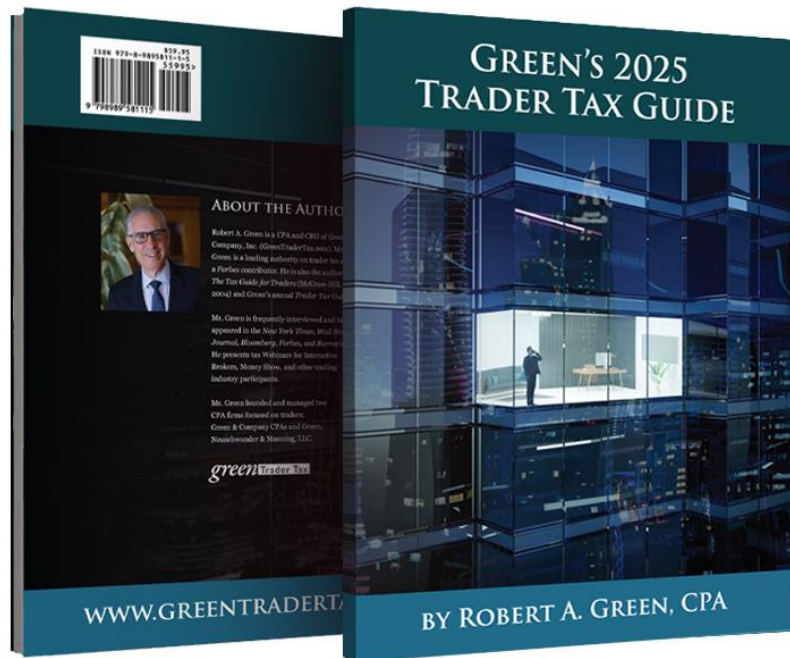
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# Net investment income tax (NIT)

- Initially called the ACA 3.8% Medicare surtax on unearned income, NIT affects upper-income taxpayers.
- It only applies to individuals with net investment income (NII) and modified adjusted gross income (AGI) exceeding \$200,000 single, \$250,000 married filing jointly, or \$125,000 married filing separately.



- Thank you for attending this Webinar or watching the recording. Visit [www.GreenTraderTax.com](http://www.GreenTraderTax.com) for additional information.
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Unlock Tax Savings with Section 475: Avoid Wash Sales and Capital Loss Limits

Section 475 MTM can convert capital gains and losses into ordinary income and losses, providing significant tax advantages. It allows traders to avoid wash-sale rules and capital-loss limitations, mak...

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