

Tax News

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Rules for Deducting Capital Losses

The current recession and stock market decline have resulted in losses on investments and other capital assets for many investors. Most investors have realized significant capital losses from selling investments in taxable accounts. Moreover, these investors may currently have open-loss positions (“paper losses”) they may be considering liquidating. If you are an investor in either situation, it helps to be familiar with the federal tax rules as they relate to deducting capital losses.

The Basics

In general, capital losses are fully deductible – dollar for dollar – against capital gains. A traditional approach to reducing taxes is to time capital losses to offset capital gains in the same tax year. Unfortunately, in the current economic climate, finding capital gains to be offset by losses may be difficult. For individuals with excess capital losses over capital gains, \$3,000 of the net loss is deductible against ordinary income per year (\$1,500, if married filing separately). A taxpayer may carry forward any unused capital losses to be deducted in subsequent tax years, subject to the same restrictions.

Example: John, a single taxpayer, realized \$30,000 in capital losses in 2008 and only \$2,000 in capital gains. John may offset his \$2,000 in gains with \$2,000 of his losses. Then, he can claim \$3,000 of net capital losses against his ordinary income from salary, interest, and dividends. The remaining \$25,000 of net capital losses can be carried forward to 2009 and future years to be deducted in those years.

Short Term v. Long Term

For loss-deduction purposes, long-term capital gains and losses (on assets held for more than one year) must be separated from short-term gains and losses (on assets held one year or less). Federal tax law requires that losses must be netted in a certain order.

Watch Out for “Wash Sales”

Investors should not buy substantially identical securities within a period beginning 30 days before and ending 30 days after the loss sale. Otherwise, the loss will be disallowed.

Hope on the Horizon?

One proposal in Congress would liberalize the deduction for net capital losses so that more net losses can be deducted against ordinary income. However, at this point, the proposal is still just that – only a proposal.

Doeren Mayhew Can Help

Naturally, selling an investment on which you have a paper loss to generate a tax deduction needs to make sense for your portfolio as well as for your taxes. If you have tax questions regarding deducting capital losses, call the professionals at Doeren Mayhew at (248) 244-3000.