Updated March 19, 2020

"HARVESTING" CAPITAL LOSSES IN TIMES OF FINANCIAL CRISIS

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As you may know, an individual is allowed to offset $3,000 of ordinary income against losses in their non-qualified investment accounts. In addition, an individual is allowed to offset capital gains against capital losses, with any excess carried over to the next taxable year.

How does this affect you in these times of economic turmoil? You should be considering selling assets that are trading at a loss in order to offset ordinary income and capital gains in the future!

However, you don't want to miss out on future appreciation in the market. Remember those individuals that sold at the bottom of the markets in February of 2009 and never got back in missed one of the greatest runs of the stock market in history. In particular, the S & P 500 reached a low of 896.07 in February 2009 and reached a high of 3,253.40 in December of 2019, an increase of 363 % in a little over 10 years. Those who sold at the low and never got back in suffered the worst.

Wash Sale Rule

The "wash sale" rule states that if you sell investment for a loss, the loss will be disallowed if you buy that security or one that is "substantially identical" within the period 30 days before and after the date of the sale. In particular, if you sold a mutual fund investment for a loss and bought that same fund within the 61-day window, your loss would be disallowed. You do not lose the loss entirely. It will be included in the cost basis of the replacement investment.

Substantially Equal

The wash sale rule has been refined to prohibit investors from getting around the rule. One is that a substantially equal investment cannot be purchased within the wash sale period. An example of substantially equal would be selling a stock and buying call options on the same stock. The rule applies if you use another account, such as your IRA or a spouse's account, to buy the security.

Mutual Funds

Unlike many other types of securities, the IRS has not given clear guidelines about what would be viewed as “substantially identical” if a mutual fund is sold and another mutual fund is purchased within the wash sale period. Investment advisors and tax planners recommend against selling an index mutual fund from one fund company and buying another index fund tracking the same stock index from another mutual fund company.

Avoiding a Wash Sale

Consider doing the following to avoid the wash sale rules:

1) Sell an index fund and buy an actively managed fund.
2) Sell an actively managed fund and buy an index fund.
3) Sell an index fund and buy an index fund tracking a different stock index.
4) Sell an actively managed fund and buy a fund managed by a different manager.

Lauer Law is here to help you implement strategies that will save you taxes!