Profit From Your Losses

Towards the end of the year, investors begin to size up the performance of their investments for the year. Our winning positions, both realized and unrealized fill us with great satisfaction while our losers sit there and stare us square in the face. Attempting to take advantage of your losses may help you overcome them both psychologically and financially.

First let's cover the basics. Short-term capital gains and losses are incurred in a holding period of one year's time or less. Long-term gains and losses are incurred over more than a one-year holding period. Short-term gains are subject to the individual's ordinary income tax rates, up to a maximum of 35%. For 2009, long-term gains are taxed at a 15% maximum for taxpayers above the 15% income tax bracket and long-term gains are taxed at a 0% maximum for those in the 10% and 15% tax brackets.

The IRS allows taxpayers to match all short-term gains and losses against each other. Long-term gains and losses are also matched against each other. Any overall short-term gain or loss is then netted against any long-term gain or loss. If the result is a negative amount, no capital gains taxes are due and losses can be used to offset ordinary income up to $3,000 in the current tax year. Additional losses may be carried forward to be used in future years.

One last important note is the wash sale. A wash sale occurs when a taxpayer sells a stock at a loss and either has acquired or acquires during a period beginning 30 days before the sale and ending 30 days after the sale substantially similar stock through a purchase, taxable exchange or purchase of an option. If a wash sale occurs, no loss is recognized for tax purposes on the sale. The loss that would have been recognized, but for the wash sale rule, is added to the basis of the newly acquired stock.

With these facts in mind, we can examine tax loss selling as the government's way of letting you recoup a little something from the losses you have taken in the stocks you own. Tax-loss selling does not turn a loss into a gain, but it may put more post-tax dollars into your pocket. If you sell before the end of the year and turn paper losses into real losses, you reduce the taxes you owe on any profits you took during the year. Remember, this strategy is for taxable accounts only.

Psychologically, selling your losers to offset gains in your portfolio can help you to view the loss in a more positive light. Sell the loser and move on. Or, if you are really convinced the stock is not a long-term loser, and that you just experienced unfortunate timing, you can sell the stock under the wash rules and re-purchase it 31 days later. You will take the loss and re-establish your position.

As always, you should discuss and coordinate tax-loss strategies with your financial and tax advisors.

Arthur Rottenstein is a Branch Manager for Raymond James Financial Services, Inc. (Member FINRA/SIPC) in Boca Raton, FL. He may be reached at (561) 391-6961 or at Arthur.Rottenstein@raymondjames.com.