

Beware the “Wash Sale”

In an effort to reduce income taxes, taxpayers can be pretty creative. Generally, this creative energy is trained on deferring income and gains, or accelerating losses and deductions. With respect to accelerating losses, one strategy favored by those who hold taxable portfolios of publicly-traded securities is to engage in so-called tax-loss harvesting.

In essence, tax-loss harvesting is a simple process where investors look at their taxable portfolios just prior to year-end with an eye toward culling positions on which they have losses. By selling such positions, those losses are said to be *realized*. That is, the sale converts a paper loss to an actual loss that can be reported to the IRS. Since the IRS enjoys sharing your financial gains, it's only fair that it share in your financial pain. In general, tax-loss harvesting is a smart strategy – as long as you don't run afoul of the so-called wash sale rules.

What's a wash sale? A wash sale occurs when you sell or trade stock or securities at a loss and within 30 days *before or after* that sale you buy or acquire substantially identical stock or securities in a fully taxable trade, or acquire an option to buy such stock or securities. So, if you recently sold your ACME shares to lock in the loss, but you're convinced that those shares still have investment merit, you may be tempted to reacquire those shares.

That's a reasonable strategy, but be aware that if you reacquire those shares within 30 days of the date you sold them, the IRS will disallow your loss until you sell your re-acquired shares. However, if you wait at least 31 days, you can use your tax loss as intended.

What if you try to beat these rules by having your spouse or a corporation you control reacquire the shares you sold within 30 days of their sale? Nice try, but the IRS already has already closed the door on that.

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