Abstract: When is a loss actually a gain? When that loss becomes an opportunity to lower tax liability, of course. This article discusses the tried-and-true strategy of using capital losses to counter the potentially costly impact of capital gains.

Use capital losses to offset capital gains

When is a loss actually a gain? When that loss becomes an opportunity to lower tax liability, of course. Now's a good time to begin your year-end tax planning and attempt to neutralize gains and losses by year end. To do so, it might make sense to sell investments at a loss in 2018 to offset capital gains that you've already realized this year.

Now and later

A capital loss occurs when you sell a security for less than your "basis," generally the original purchase price. You can use capital losses to offset any capital gains you realize in that same tax year — even if one is short term and the other is long term.

When your capital losses *exceed* your capital gains, you can use up to $3,000 of the excess to offset wages, interest and other ordinary income ($1,500 for married people filing separately) and carry the remainder forward to future years until it's used up.

Research and replace

Years ago, investors realized it could be beneficial to sell a security to recognize a capital loss for a given tax year and then — if they still liked the security's prospects — buy it back immediately. To counter this strategy, Congress imposed the wash sale rule, which disallows losses when an investor sells a security and then buys the same or a "substantially identical" security within 30 days of the sale, before or after.

Waiting 30 days to repurchase a security you've sold might be fine in some situations. But there may be times when you'd rather not be forced to sit on the sidelines for a month.

Fortunately, there's an alternative. With a little research, you might be able to identify a security in the same sector you like just as well as, or better than, the old one. Your solution is now simple and straightforward: Simultaneously sell the stock you own at a loss and buy the competitor's stock, thereby avoiding violation of the "same or substantially identical" provision of the wash sale rule. You maintain your position in that sector or industry and might even add to your portfolio a stock you believe has more potential or less risk.

If you bought shares of a security at different times, give some thought to which lot can be sold most advantageously. The IRS allows investors to choose among several methods of designating lots when selling securities, and those methods sometimes produce radically different results.

Good with the bad

Investing always carries the risk that you will lose some or even all of your money. But you have to take the good with the bad. In terms of tax planning, you can turn investment losses into opportunities — and potentially end the year on a high note.