Abstract: Under this tax rule, if a taxpayer sells stock or securities for a loss and buys substantially identical stock or securities back within the 30-day period before or after the sale date, that loss can't be claimed for tax purposes. This article provides some key details for taxpayers about this often-surprising rule.

Beware of "wash sales" when selling securities

If you're planning to sell capital assets at a loss to offset gains that have been realized during the year, it's important to beware of the "wash sale" rule. Under this tax rule, if you sell stock or securities for a loss and buy substantially identical stock shares or securities back within the 30-day period before or after the sale date, the loss can't be claimed for tax purposes.

The rule

The wash sale rule is designed to prevent taxpayers from benefiting from a loss without parting with ownership in any significant way. Note that the rule applies to a 30-day period before or after the sale date to prevent "buying the stock back" before it's even sold. (If you participate in any dividend reinvestment plans, the wash sale rule may be inadvertently triggered when dividends are reinvested under the plan, if you've separately sold some of the same stock at a loss within the 30-day period.)

Although the loss can't be claimed on a wash sale, the disallowed amount is added to the cost of the new stock. So, the disallowed amount can be claimed when the new stock is finally disposed of (other than in a wash sale).

An example

Assume you buy 500 shares of XYZ Inc. for $10,000 and sell them on November 5 for $3,000. On November 29, you buy 500 shares of XYZ again for $3,200. Since the shares were "bought back" within 30 days of the sale, the wash sale rule applies. Therefore, you can't claim a $7,000 loss. Your basis in the new 500 shares is $10,200: the actual cost plus the $7,000 disallowed loss.

If only a portion of the stock sold is bought back, only that portion of the loss is disallowed. So, in the above example, if you'd only bought back 300 of the 500 shares (60%), you would be able to claim 40% of the loss on the sale ($2,800). The remaining $4,200 loss that is disallowed under the wash sale rule would be added to your cost of the 300 shares.

No surprises

The wash sale rule can come as a nasty surprise at tax time. Contact us for assistance.