

Wash Sales

Loss on the sale of stock can be disallowed

The following is an excerpt from Internal Revenue Service (IRS) Publication 550, Investment Income and Expenses. The full publication can be found by visiting the IRS Web site at www.irs.gov.

Financial Planning Department
Baird Private Wealth Management

You cannot deduct losses from sales or trades of stock or securities in a wash sale unless the loss was incurred in the ordinary course of your business as a dealer in stock or securities.

A wash sale occurs when you sell or trade stock or securities at a loss and within 30 days before or after the sale you:

1. Buy substantially identical stock or securities,
2. Acquire substantially identical stock or securities in a fully taxable trade,
3. Acquire a contract or option to buy substantially identical stock or securities, or
4. Acquire substantially identical stock for your individual retirement account (IRA) or Roth IRA.

If you sell stock and your spouse or a corporation you control buys substantially identical stock, you also have a wash sale.

If your loss was disallowed because of the wash sale rules, add the disallowed loss to the cost of the new stock or securities (except in (4) above). The result is your basis in the new stock or securities. This adjustment postpones the loss deduction until the disposition of the new stock or securities. Your holding period for the new stock or securities includes the holding period of the stock or securities sold.

Example 1 – You buy 100 shares of X stock for \$1,000. You sell these shares for \$750 and within 30 days from the sale you buy 100 shares of the same stock for \$800. Because you bought substantially identical stock, you cannot deduct your loss of \$250 on the sale. However, you add the disallowed loss of \$250 to the cost of the new stock, \$800, to obtain your basis in the new stock, which is \$1,050.

Example 2 – You are an employee of a corporation with an incentive pay plan. Under this plan, you are given 10 shares of the corporation's stock as a bonus award. You include the fair market value of the stock in your gross income as additional pay. You later sell these shares at a loss. If you receive another bonus award of substantially identical stock within 30 days of the sale, you cannot deduct your loss on the sale.

OPTIONS AND FUTURES CONTRACTS

The wash sale rules apply to losses from sales or trades of contracts and options to acquire or sell stock or securities. They do not apply to losses from sales or trades of commodity futures contracts and foreign currencies.

SECURITIES FUTURES CONTRACT TO SELL

Losses from the sale, exchange, or termination of a securities futures contract to sell generally are treated in the same manner as losses from the closing of a short sale

WARRANTS

The wash sale rules apply if you sell common stock at a loss and, at the same time, buy warrants for common stock of the same corporation. But if you sell warrants at a loss and, at the same time, buy common stock in the same corporation, the wash sale rules apply only if the warrants and stock are considered substantially identical, as discussed next.

SUBSTANTIALLY IDENTICAL

In determining whether stock or securities are substantially identical, you must consider all the facts and circumstances in your particular case. Ordinarily, stocks or securities of one corporation are not considered substantially identical to stocks or securities of another corporation. However, they may be substantially identical in some cases. For example, in a reorganization, the stocks and securities of the predecessor and successor corporations may be substantially identical.

Similarly, bonds or preferred stock of a corporation are not ordinarily considered substantially identical to the common stock of the same corporation. However, where the bonds or preferred stock are convertible into common stock of the same corporation, the relative values, price changes, and other circumstances may make these bonds or preferred stock and the common stock substantially identical. For example, preferred stock is substantially identical to the common stock if the preferred stock:

- Is convertible into common stock,
- Has the same voting rights as the common stock,
- Is subject to the same dividend restrictions,
- Trades at prices that do not vary significantly from the conversion ratio, and
- Is unrestricted as to convertibility.

MORE OR LESS STOCK BOUGHT THAN SOLD

If the number of shares of substantially identical stock or securities you buy within 30 days before or after the sale is either more or less than the number of shares you sold, you must determine the particular shares to which the wash sale rules apply. You do this by matching the shares bought with an equal number of the shares sold. Match the shares bought in the same order that you bought them, beginning with the first shares bought. The shares or securities so matched are subject to the wash sale rules.

Example 1 – You bought 100 shares of M stock on September 21, 2017, for \$5,000. On December 14, 2017, you bought 50 shares of substantially identical stock for \$2,750. On December 21, 2017, you bought 25 shares of substantially identical stock for \$1,125. On January 7, 2011, you sold for \$4,000 the 100 shares you bought in September. You have a \$1,000 loss on the sale. However, because you bought 75 shares of substantially identical stock within 30 days before the sale, you cannot deduct the loss (\$750) on 75 shares. You can deduct the loss (\$250) on the other 25 shares. The basis of the 50 shares bought on December 14, 2017, is increased by two-thirds ($50 \div 75$) of the \$750 disallowed loss. The new basis of those shares is \$3,250 (\$2,750 + \$500). The basis of the 25 shares bought on December 28, 2010, is increased by the rest of the loss to \$1,375 (\$1,125 + \$250).

Example 2 – You bought 100 shares of M stock on September 21, 2017. On February 2, 2018, you sold those shares at a \$1,000 loss. On each of the 4 days from February 6, 2018, to February 9, 2018, you bought 50 shares of substantially identical stock. You cannot deduct your \$1,000 loss. You must add half the disallowed loss (\$500) to the basis of the 50 shares bought on February 6. Add the other half (\$500) to the basis of the shares bought on February 7.

LOSS AND GAIN ON SAME DAY

Loss from a wash sale of one block of stock or securities cannot be used to reduce any gains on identical blocks sold the same day.

Example – During 2012, you bought 100 shares of X stock on each of three occasions. You paid \$158 a share for the first block of 100 shares, \$100 a share for the second block, and \$95 a share for the third block. On December 28, 2017, you sold 300 shares of X stock for \$125 a share. On January 11, 2018, you bought 250 shares of identical X stock. You cannot deduct the loss of \$33 a share on the first block because within 30 days after the date of sale you bought 250 identical shares of X stock. In addition, you cannot reduce the gain realized on the sale of the second and third blocks of stock by this loss.

SHORT SALES

The wash sale rules apply to a loss realized on a short sale if you sell, or enter into another short sale of, substantially identical stock or securities within a period beginning 30 days before the date the short sale is complete and ending 30 days after that date.

For purposes of the wash sale rules, a short sale is considered complete on the date the short sale is entered into, if:

- On that date, you own stock or securities identical to those sold short (or by that date you enter into a contract or option to acquire that stock or those securities), and
- You later deliver the stock or securities to close the short sale.

Otherwise, a short sale is not considered complete until the property is delivered to close the sale. This treatment also applies to losses from the sale, exchange, or termination of a securities futures contract to sell.

Example – On June 4, you buy 100 shares of stock for \$1,000. You sell short 100 shares of the stock for \$750 on October 15. On October 16, you buy 100 shares of the same stock for \$750. You close the short sale on November 19 by delivering the shares bought on June 4. You cannot deduct the \$250 loss (\$1,000 – \$750) because the date of entering into the short sale (October 6) is considered the date the sale is complete for wash sale purposes and you bought substantially identical stock within 30 days from that date.

NONDEDUCTIBLE WASH SALES LOSS

If you received a Form 1099-B (or substitute statement), box 1g of that form will show any nondeductible wash sale loss if:

- The stock or securities sold were covered securities, and
- The substantially identical stock or securities you bought had the same CUSIP numbers as the stock or securities you sold and were bought in the same account as the stock or securities you sold.

However, you cannot deduct a loss from a wash sale even if it is not reported on Form 1099-B.

HOW TO REPORT

Report a wash sale transaction in Part I or Part II of Form 8949 with the appropriate box checked. Complete all columns. Enter "W" in column (f). Enter as a positive number in column (g) the amount of the loss not allowed. See the Instructions for Form 8949.