

Business

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PERSONAL FINANCE

Capital gains, losses create tricky tax time

Laws establish boundaries for deductions on sell-offs

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Lost a bundle in stocks last year, you say? The pain could be lessened if you can deduct those capital losses from your 2000 taxes.

The most basic rule is that you can't deduct securities gains or losses on a federal tax return unless you actually sold securities.

That applies whether the taxpayer sells individual stocks, bonds or mutual funds. Such securities sales are reported on Form 1099B.

"Lots of people have losses on paper, but they can't take that loss until they sell it," said Steve Corley, a partner with Murrell, Hall, McIntosh and Co., an accounting firm with offices in Oklahoma City, Moore and Norman.

Assuming that you did sell during 2000, here are some things to know.

Stocks or bonds held longer than a year are treated as long-term property. Those held less than a year are short-term property. That's an important

Tax tips

Stock market losses only count when securities are sold — paper losses don't qualify.

Track dates when securities were bought or sold — long-term and short-term property are taxed differently.

Capital losses cancel out tax liability on an equal amount of gains, but only \$3,000 in losses count against ordinary income in a year.

Capital losses on securities can be carried over to future tax years.

Taxes: Rates drop for 2001

From Page 1-C

distinction, because the different categories are taxed at different rates.

Individuals doing their own taxes should be sure to "correctly code the losses as long-term or short-term," Corley said. If that's done, everything should fall into place when filling out Schedule D, the form used to report capital gains and losses.

It's just as important to understand that gains and losses can be netted together so that losses cancel gains. Beyond that, however, only \$3,000 of losses can be taken as a general deduction.

Here's how it works. Say you had a \$5,000 stock gain and a \$10,000 stock loss in 2000. For tax purposes, you can use \$5,000 of those losses to cancel out your tax liability on the \$5,000 gain.

That will leave you with a \$5,000 net loss, but \$3,000 is the maximum amount deductible in 2000 against "ordinary income" such as wages, interest and dividends.

The other \$2,000 in losses can be carried over to the next year.

The good news is, stock losses can be carried over indefinitely.

Joshua Jenson, an Oklahoma City CPA, said one thing to remember is to include both year-end capital gains distribution or other dividend distributions from stock or mutual funds, which are reported on Form 1099-DIV.

Even if you reinvested dividends into additional stock — which many people do — that dividend is taxable for the year in which the dividend was issued.

Moreover, Jenson said, many people forget that dividend reinvestment needs to be added to the original cost basis for their stock.

In other words, if you invested \$10,000 in a mutual fund or a stock and got a \$1,000 dividend that you reinvested, that's the same for tax purposes as if you had originally invested \$11,000.

This is important to know. Then, when you eventually sell your holding, you'll know what part of it counts as a nontaxable return of your original investment and what counts as taxable capital growth.

"From tax planning standpoint, you need to start tracking that, if you haven't already," Jenson said.

In sophisticated tax planning, he explained, individuals can follow a number of strategies relating to securities losses.

Here's one example:

Suppose you had a large capital-loss carry-over from 2000 — say \$30,000.

Suppose you also own another stock that's done well. Let's call it Super Corp. — you bought at \$20 a share and it's now at \$40.

Believe it or not, you might want to sell your Super Corp. stock position one day and buy it back the next.

You see, if you sell stock at a gain, you can buy it right back under U.S. tax rules. (If you sell at a loss, you can't buy back that position for 31 days or it won't count as a legal tax write-off.)

Selling your Super Corp. at a gain, also could reap several benefits, Jenson said.

First, you would now have a \$40 per share cost basis, not \$20, since you would have sold off the \$20 stock. That's obviously a huge tax advantage if you plan to hold that stock for a long time and you expect it to keep gaining in value.

Second, you could cancel out the paper profit you made from your Super Corp. sale by netting it out using some or all of your \$30,000 loss carryover.

Third, you might be able to drop your capital gains tax rate eventually. New tax law says the capital gains rate drops from 20 percent to 18 percent on stock bought after Dec. 31, 2000 — if you hold on to that stock for five years. In other words, you would start seeing a benefit in 2005.

If you're in the lowest, 15 percent tax bracket, your capital gains tax rate in 2001 drops from 10 percent to 8 percent on any stock you've held for five years or more.

"Two percent may not sound like a lot," Jenson said, "but if someone has a \$100,000 position, 2 percent really adds up."

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