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Defense Against The IRS, Tax Planning, Pension Planning, Business Planning

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CAN YOU DEDUCT THE LOSS ON THAT STOCK SALE?

Just because you sell a stock for a loss at the end of 2008 does not necessarily mean that you can deduct the loss on your income tax return. The Internal Revenue Code has a set of rules dealing with losses on stock sales. The rules apply where a person sells a stock and purchases the same stock within 30 days of the sale. The rules are known as the “wash sale” rules.

Under the wash sale rules, if you sell stock or securities for a loss and buy substantially identical stock or securities within the 30-day period before or after the sale date, the loss cannot be claimed for tax purposes. This rule is designed to prevent taxpayers from using the tax benefit of 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 is even sold.

If you participate in any dividend reinvestment plans, the wash sale rules may be inadvertently triggered when dividends are reinvested under the plan, if you have separately sold some of the same stock at a loss within the 30-day periods.

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

Example. Henry buys 500 shares of ABC Corp. for \$10,000 and sells them on November 5 for \$3,000. On November 30, he buys 500 shares of ABC again for \$3,200. Since the stock was “bought back” within 30 days of sale, the wash sale rules apply. Henry cannot claim his \$7,000 loss. His basis in his “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, then only that portion of the loss is disallowed. Thus, in the above example, if Henry had only bought back 300 of the 500 shares (60%), he would be able to claim 40% of the loss on the sale (\$2,800 under the facts involved). The remaining \$4,200 of loss disallowed under the wash sale rules would be added to Henry's cost of the 300 shares.

Note that while wash sale losses cannot be claimed, gains cannot be avoided. That is, if you sell stock for a gain and buy it right back, you must still report the gain—no special rule applies.

Impact of Traditional IRA to Roth IRA Rollover and Conversions on Year-end Planning.

Rollover Now.

An individual whose income does not exceed \$100,000 for 2008 (and who is not a married individual filing a separate return for the year) may roll over funds this year from a Traditional IRA to a Roth IRA. For purposes of determining whether income exceeds \$100,000, income does not include income resulting from the rollover or conversion of a Traditional IRA to a Roth IRA. Individuals considering whether to roll over or convert for 2008 should keep in mind that unlike the usual IRA rollover, a switch from Traditional IRA to Roth IRA is not income tax free. Instead, it is treated as a distribution from the Traditional IRA, taxable (but generally not subject to the 10% early withdrawal penalty tax) as if it had been distributed and not rolled over into another IRA.

A taxpayer who believes that a Roth IRA is more advantageous than a Traditional IRA, and wants to remain in the stock market for the long term, should consider converting Traditional-IRA money invested in beaten-down stocks (or mutual funds) into Roth IRAs if eligible to do so.

A conversion from a Traditional IRA to a Roth IRA is taxed in 2008 and is subject to the \$100,000 income rule for 2008 if it takes place before the end of the year. As far as rollovers are concerned, even though a distribution in 2008 from a Traditional IRA is taxed in that year, the distributee has 60 days to roll over the distribution to a Roth IRA even if the rollover isn't completed until 2009.

Undoing a Rollover from Early 2008

A person who rolled over or converted from a regular IRA to a Roth IRA earlier in 2008 may find that the move was not wise after all (e.g., the Roth IRA account has declined in value due to the sharp stock market decline), or his AGI may turn out to exceed \$100,000 (thereby disqualifying him from making the rollover or conversion).

Illustration: Early in 2008, Jim converted a Traditional IRA invested in a stock fund to a Roth IRA invested in the same stock fund. At that time, the regular IRA had a \$50,000 balance, all of it attributable to deductible contributions and their earnings. Jim's Roth IRA currently is worth only \$30,000. To avoid paying tax on \$20,000 of evaporated income, Jim can recharacterize the Roth IRA as a Traditional IRA.

The easiest way to make a recharacterization is to do so by the due date (plus extensions) of the taxpayer's return for the affected year, and reflect it on that year's return. Thus, a person who made a 2008 conversion may recharacterize it on the return he files on or before April 15, 2009 (he has until October 15, 2009, if he gets an automatic extension of six months to file his 2008 return). However, a person who timely files his 2008 return without having recharacterized a 2008 conversion may do so as late as six months after the original due date for filing the 2008 return, i.e., by October 15, 2009.

This Newsletter as well as previous Newsletters can be found at www.ConnerHubbard.com.

Referrals are greatly appreciated.



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([Ann. 99-104, 1999-44 IRB](#) ; Instructions to Form 8606 (2007), p. 3) If a 2008 conversion is recharacterized after the taxpayer timely files his 2008 return, he should file an amended return for 2008 reflecting the recharacterization (the notation "Filed pursuant to section 301.9100-2" should be made on the return). (Instructions to Form 8606 (2007), pg. 3).

If the deadline has passed, IRS may grant the person additional time to recharacterize a Roth IRA as a Traditional IRA if he acted reasonably and in good faith, and granting relief would not prejudice IRS interests.

Reconverting a Traditional IRA to a Roth IRA. A person who converted an amount from a Traditional IRA to a Roth IRA may not only transfer the amount back to a Traditional IRA in a recharacterization, but may later reconvert that amount from the Traditional IRA to a Roth IRA. ([Reg. § 1.408A-5](#), Q&A 9(a))

The reconversion cannot be made before the later of:

...the beginning of the tax year following the tax year in which the amount was converted to a Roth IRA; or,

...the end of the 30-day period beginning on the day on which the IRA owner transfers the amount from the Roth IRA back to a Traditional IRA by way of a recharacterization.

This timing rule applies regardless of whether the recharacterization occurs during the tax year in which the amount was converted to a Roth IRA or the following tax year. ([Reg. § 1.408A-5](#) Q&A 9(a)(1)) .

Determining when to recharacterize a Roth IRA as a Traditional IRA and then reconvert depends on how the IRA owner views the stock market. For example, an owner who expects the market to remain low for a while but doesn't expect it to get much lower should recharacterize the Roth IRA now, and then reconvert as soon as eligible if the market is still low.