

Stock sales produce capital losses. Stocks are capital assets and produce capital gain or loss when they are sold. Your capital gains and losses for the year must be netted against one another in a specific order, based on whether they are short-term (held one year or less) or long-term (held for more than one year).

If, after the netting, you have short-term or long-term losses (or both), you can use the losses to offset up to \$3,000 ordinary income (\$1,500 for married taxpayers filing separately). Any loss in excess of this limit is carried forward to later years, until all of it is either offset against capital gains or deducted against ordinary income in those years, subject to the \$3,000 limit. If you have both net short-term losses and net long-term losses, the net short-term losses are used to offset ordinary income before the net long-term losses are used.

If you have realized capital gains during the year from sales of stock or other assets, you should consider selling some of your losing positions to offset the gains. The best tax strategy is to sell enough losing stock to shelter your earlier gains and generate a \$3,000 loss, since this is the maximum loss that can be used to offset ordinary income each year.

Watch out for wash sale rule. If you believe that a stock you own will recover but want to sell now in order to lock in a tax loss, you should be aware of the wash sale rule. Under this rule, if you sell stock at a loss and buy substantially identical stock back within the 30-day period before or after the sale date, you cannot claim the loss for tax purposes. In order to claim the loss, you must buy the new shares outside of the period that begins 30 days before and ends 30 days after the sale of the loss stock.

Worthless stock is treated as sold. In some cases, the stock you own may have become completely worthless during the year. If so, you can claim a loss equal to your basis in the stock, generally what you paid for it. The stock is treated as though it had been sold on the last day of the tax year. This date is important, because it affects whether your capital loss is long-term or short-term.

Shares of stock become worthless when they have no liquidation value, because the corporation's liabilities exceed its assets, and no potential value, because the corporation's business has no reasonable hope of becoming profitable. A stock can be worthless even though corporation hasn't declared bankruptcy. On the other hand, a corporation's stock may continue to have value even after a bankruptcy filing, if the corporation continues to operate and the stock continues to trade.

You may not discover that a stock you own has become worthless until after you have filed your tax return for the year of worthlessness. In that case, your return for that year must be amended to claim a credit or refund due to the loss. This can be done for seven years from the date your original return for that year had to be filed, or two years from the date you paid the tax, whichever is later.