Wash Sale Rules

(From IRS)

You cannot deduct losses from sales or trades of stock or securities in a wash sale. 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:

Buy substantially identical stock or securities, acquire substantially identical stock or securities in a fully taxable trade, or acquire a contract or option to buy substantially identical stock or securities.

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. 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 begins on the same day as 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 ($250) to the cost of the new stock ($800) to obtain your basis of the new stock, which is $1,050.

Example 2. You are an employee of a corporation that has 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. See Coordination of Loss Deferral Rules and Wash Sale Rules under Straddles, later, for information about the tax treatment of losses on the disposition of positions in a straddle.

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 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 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 24, 1999, for $5,000. On December 21, 1999, you bought 50 shares of substantially identical stock for $2,750. On December 28, 1999, you bought 25 shares of substantially identical stock for $1,125. On January 4, 2000, 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 of 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 21, 1999, is increased by two-thirds (50 / 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, 1999, 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 24, 1999. On February 1, 2000, you sold those shares at a $1,000 loss. On each of the 4 days from February 15, 2000, to February 18, 2000, 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 15. Add the other half ($500) to the basis of the shares bought on February 16.

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 1995, 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 23, 2000, you sold 300 shares of X stock for $125 a share. On January 6, 2001, 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.