

TAX TIP: Market's black cloud comes with a silver lining

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SETH WENIG/ASSOCIATED

PRESSA trader works yesterday on the floor of the New York Stock Exchange in New York. Despite rocky times right now, some stocks still have the potential to produce big yields over time.

Investors dropped so much money in the stock market last year, they just might have enough losses to get them to the next century.

Okay. Maybe, not. But at least that's one positive way of looking at portfolios that have been left in shambles by the credit and housing meltdown.

Losses from last year will help reduce your future tax bite. You can reduce your federal income up to \$3,000 when your losses exceed your gains on your investments each year.

"By selling stocks that have declined in value, you can offset any gains realized during the year to minimize the capital gains tax," said Hal Terr, senior tax manager for WithumSmith+Brown in Princeton. "You can reduce your other federal ordinary income up to \$3,000 when your losses exceed your gains. But, unfortunately, residents of New Jersey do not receive the same benefit on their state tax return."

You can use the unused losses in subsequent years to reduce your capital gains on appreciated stock -- assuming you have any, he said.

You also have to determine whether your gain or loss is short-term or long-term. Gains from investments held for more than one year are considered long-term and taxed at preferential tax rates, while gains from investments held for less than one year would be taxed at ordinary income tax rates.

Long-term gains are generally subject to a maximum capital gains tax rate of 15 percent, according to Barry Kleiman, a principal with Untracht Early, a certified public accounting firm in Florham Park. However, the tax rate could be as little as 0 percent for those in the 10 percent or 15 percent tax bracket, he said.

Although some stocks have declined, they may be worth holding on to for the long term if they are good companies. But you cannot sell a stock to take a loss and then buy it back unless you wait 30 days, Kleiman said.

But you can take a tax loss and preserve the same investing strategy by purchasing exchange-traded funds, or ETFs.

"These investments are baskets of securities that track an index or specific sector of the market, but trade like shares of stock," Terr said. "Investors can structure their transaction to avoid the impact of the wash sale rules by selling stock or mutual funds at a loss and purchasing ETFs in a similar index or industry sector."

Another strategy is to convert a traditional IRA into a Roth IRA, which can be done at a much lower cost than when the market was at its peak. For the conversion to work, a taxpayer's modified adjusted gross income cannot exceed \$100,000, he said. The individual cannot be married filing a separate return, unless he or she lived apart from a spouse for the entire year.

Taxpayers who convert should avoid taking distributions from the Roth IRA within five years after the conversion. Investors would be hit with a 10-percent premature withdrawal penalty if money is taken from the Roth IRA within five years of the conversion, according to Terr.

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