Strategies for investors to cut taxes as year-end approaches

The overall stock market has been down during 2022 but there have been some bright spots. As year-end approaches, consider making some moves to make the best tax use of paper losses and actual losses from your stock market investments.

Tax rates on sales

Individuals are subject to tax at a rate as high as 37% on short-term capital gains and ordinary income. But long-term capital gains on most investment assets receive favorable treatment. They're taxed at rates ranging from 0% to 20% depending on your taxable income (inclusive of the gains). High-income taxpayers may pay an additional 3.8% net investment income tax.

Sell at a loss to offset earlier gains

Have you realized gains earlier in the year from sales of stock held for more than one year (long-term capital gains) or from sales of stock held for one year or less (short-term capital gains)? Take a close look at your portfolio and consider selling some of the losers — those shares that now show a paper loss. The best tax strategy is to sell enough losers to generate losses to offset your earlier gains plus an additional $3,000 loss. Selling to produce this loss amount is a tax-smart idea because a $3,000 capital loss (but no more) can offset the same amount of ordinary income each year.

For example, let's say you have $10,000 of capital gain from the sale of stocks earlier in 2022. You also have several losing positions, including shares in a tech stock. The tech shares currently show a loss of $15,000. From a tax standpoint, you should consider selling enough of your tech stock shares to recognize a $13,000 loss. Your capital gains will be offset entirely, and you'll have a $3,000 loss to offset against the same amount of ordinary income.

What if you believe that the shares showing a paper loss may turn around and eventually generate a profit? In order to sell and then repurchase the shares without forfeiting the loss deduction, you must avoid the wash-sale rules. This means that 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. However, if you expect the price of the shares showing a loss to rise quickly, your tax savings from taking the loss may not be worth the potential investment gain you may lose by waiting more than 30 days to repurchase the shares.

Use losses earlier in the year to offset gains

If you have capital losses on sales earlier in 2022, consider whether you should take capital gains on some stocks that you still hold. For example, if you have appreciated stocks that you'd like to sell, but don't want to sell if it causes you to have taxable gain this year, consider selling just enough shares to offset your earlier-in-the-year capital losses (except for $3,000 that can be used to offset ordinary income). Consider selling appreciated stocks now if you believe they've reached (or are close to) the peak price and you also feel you can invest the proceeds from the sale in other property that'll give you a better return in the future.

These are just some of the year-end strategies that may save you taxes. Contact us to discuss these and other strategies that should be put in place before the end of December.