

IRS TAX TIP 2003-29

CAPITAL GAINS AND LOSSES

Almost everything you own and use for personal purposes, pleasure or investment is a capital asset. The IRS says that when you sell a capital asset, such as stocks, the difference between the amount you sell it for and your basis, which is usually what you paid for it, is a capital gain or a capital loss. While you must report all capital gains, you may deduct only your capital losses on investment property, not personal property.

A “paper loss” – a drop in an investment’s value below its purchase price – does not qualify for the deduction. The loss must be realized through the capital asset’s sale or exchange.

Capital gains and losses are classified as long-term or short-term, depending on how long you hold the property before you sell it. If you hold it more than one year, your capital gain or loss is long-term. If you hold it one year or less, your capital gain or loss is short-term. For more information on the tax rates, refer to IRS Publication 544, “Sales and Other Dispositions of Assets.”

If your capital losses exceed your capital gains, the excess is subtracted from other income on your tax return, up to an annual limit of \$3,000 (\$1,500 if you are married filing separately). The loss can be carried forward to later years to reduce capital gains or ordinary income until the balance of these losses is used up. The “Capital Loss Carryover Worksheet” in the instructions for Schedule D helps figure the amount of loss that can be carried forward to later years.

Capital gains and losses, including losses carried forward, are reported on Schedule D, “Capital Gains and Losses,” and then transferred to line 13 of Form 1040. If you have a taxable capital gain, you may be required to make estimated tax payments. See Publication 505, “Tax Withholding and Estimated Tax,” for information on estimated tax.

Additional information on capital gains and losses is available in Publications 550, “Investment Income and Expenses,” and 17, “Your Federal Income Tax.” You may download the publications from the IRS Web site at IRS.gov or order them by calling 1-800-TAX-FORM (1-800-829-3676).

Taxpayers who have experienced investment or other types of financial losses should also check out these other IRS publications:

- 564, “Mutual Fund Distributions”
- 547, “Casualties, Disasters, and Thefts”

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- 527, "Residential Rental Property (Including Rental of Vacation Homes)" and
- 536, "Net Operating Losses (NOLs) for Individuals, Estates and Trusts"

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