

**INTERNAL REVENUE SERVICE**

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CONEX 131680-02  
CC:ITA

[REDACTED]

[REDACTED]

Dear [REDACTED]:

This letter is in response to your inquiry dated May 20, 2002, on behalf of your constituent, [REDACTED]. He wrote about the limitation on a taxpayer's ability to deduct capital losses against ordinary income under section 1211 of the Internal Revenue Code (the Code).

An individual taxpayer can claim capital losses only to the extent of capital gains, plus (if losses exceed gains) the lower of \$3,000 (\$1,500 for married individuals filing separate returns) or the excess of losses over gains [Section 1211 of the Code].

Individual taxpayers can carry capital losses that exceed the limitation forward to future tax years. [Section 1212(b)(1) of the Code].

Generally, income and loss which is not capital gain or loss is considered "ordinary" and is taxed at rates ranging from 10 percent to 38.6 percent [Sections 64, 65, and 1 of the Code]. However, gains from the sale or exchange of capital assets, held for more than one year are taxed at preferential rates of 8 percent to 28 percent, depending on the nature of the asset, the length of time the taxpayer held the asset, and the taxpayer's marginal tax rate [Section 1(h) of the Code].

[REDACTED] asks why the law limits the use of capital losses. In 1976 the Congress raised the capital loss limitation from \$1000 to \$3000. The Staff of the Joint Committee on Taxation explained the reasons for retaining the limitation:

Congress believed, however, that it is appropriate to retain some limitations on the deduction of net capital losses against ordinary income. Because taxpayers have discretion over when they realize their capital gains and losses, unlimited deductibility of net capital losses against ordinary income would encourage

investors to realize their capital losses immediately to gain the benefit of the deduction against ordinary income but to defer realization of their capital gains. [Staff of the Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1976, 94<sup>th</sup> Cong. 2d Sess., 425 (1976), see also Staff of the Joint Committee on Taxation, 101<sup>st</sup> Cong., 1<sup>st</sup> Sess., Tax Treatment Of Capital Gains And Losses 23 (Joint Comm. Print 1989) an excerpt from which is enclosed].

As the Joint Committee explains, the disparity created by the preferential rates for long term capital gains, coupled with taxpayers' ability to control when they sell capital assets, has caused the Congress to limit the extent capital losses may be used to offset ordinary income. However, these losses are allowed in full against capital gains recognized in the current year, or in a future year to which these losses may be carried [Sections 1211 and 1212 of the Code].

I hope this information is helpful. Please call me or Sean M. Dwyer, Identification Number 50-19510, at (202) 622-5020, if you have any questions.

Sincerely,

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Heather C. Maloy  
Associate Chief Counsel  
(Income Tax & Accounting)

Enclosure: (1)