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2018 Last-Minute Year-End Tax Strategies for Your Stock Portfolio

The beauty of tax planning your year-end stock portfolio is that it might cost you pennies in commissions but allow you to pocket real money.

Here's the basic strategy:

- Avoid the high taxes (up to 40.8 percent) on short-term capital gains and ordinary income.
- Lower the taxes to zero—or if you can't do that, then lower them to 23.8 percent or less by making the profits subject to long-term capital gains.

Think of this: you are paying taxes at a 71.4 percent higher rate when you pay at 40.8 percent rather than the tax-favored 23.8 percent.

And if you can avoid that higher rate with some easy adjustments in your stock portfolio, doesn't it make sense to do that now?

Big Picture

Here are the five basic tax rules you need to know to find the tax savings you desire in your stock portfolio:

1. On your short-term capital gains and ordinary income, you pay federal taxes at rates of up to 40.8 percent. The 40.8 percent comes from the top income tax rate of 37 percent plus the 3.8 percent Affordable Care Act (ACA) tax on net investment income.
2. You pay taxes on your long-term capital gains at rates from zero up to 23.8 percent (20 percent for capital gains plus 3.8 percent on investment income) depending on your income level.
3. You pay taxes on your stock dividends at rates from zero to 23.8 percent depending on your income level.
4.

If your personal capital losses exceed your personal capital gains, the tax code limits your capital loss deductions to $3,000 and allows you to carry over losses in excess of the $3,000 to future years until realized.

5. You first offset long-term gains and losses before you offset short-term gains and losses.

Strategy 1

Examine your portfolio for stocks that you want to unload, and make sales where you offset *short-term* gains subject to a high tax rate such as 40.8 percent with *long-term* losses (up to 23.8 percent).

In other words, make the high taxes disappear by offsetting them with low-taxed losses, and pocket the difference.

Strategy 2

Use *long-term* losses to create the $3,000 deduction allowed against ordinary income.

Again, you are trying to use the 23.8 percent loss to kill a 40.8 percent tax (or a 0 percent loss to kill a 12 percent tax, if you are in the 12 percent or lower income tax bracket).

Strategy 3

As an individual investor, avoid the wash-sale loss rule.

Under the wash-sale loss rule, if you sell a stock or other security and purchase substantially identical stock or securities within 30 days before the date of sale or after the date of sale, you don’t recognize your loss on that sale.[1] Instead, the code makes you add the loss amount to the basis of your new stock.

If you want to use the loss in 2018, then you’ll have to sell the stock and sit on your hands for more than 30 days before repurchasing that stock.

Strategy 4

If you have lots of capital losses or capital loss carryovers and the $3,000 allowance is looking extra tiny, sell additional stocks, rental properties, and other assets to create offsetting capital gains.

If you sell stocks to purge the capital gains, you can immediately repurchase the stock after you sell it—there's no wash-sale "gain" rule.

Important. Don't die with large capital loss carryovers—they'll disappear.[2]

- If your carryover originated from you only, then it all goes away if not used on your joint return in the year of your death.
- If your carryover came from joint assets, then your surviving spouse gets 50 percent of the carryover to use going forward.

Strategy 5

Do you give money to your parents to assist them with their retirement or living expenses? How about children (specifically, children not subject to the kiddie tax)?

If so, consider giving appreciated stock to your parents and your non-kiddie-tax children. Why? If the parents or children are in lower tax brackets than you are, you get a bigger bang for your buck by

- gifting them stock,
- having them sell the stock, and then
- having them pay taxes on the stock sale at their lower tax rates.

You also get a similar family benefit if your parents or children hold the stock for the dividends and then pay taxes at their lower tax rates.

The 2018 dividend and individual capital gain tax rates are[3]

1. 0 percent tax on long-term capital gains and dividends when your taxable income is less than $38,601 on a single return ($77,201 on a joint return);
2. 15 percent tax on long-term capital gains and dividends when your taxable income is greater than what you see above but less than $425,801 on a single return ($479,901 on a joint return); and
3. 20 percent tax on long-term capital gains and dividends when your taxable income is $425,801 or greater on a single return ($479,901 or more on a joint return).

Strategy 6

If you are going to make a donation to a charity, consider appreciated stock rather than cash because a donation of appreciated stock gives you more tax benefit.[4]

“Whoa, did you say more tax benefit?”

Yes. It works like this:

- **Benefit 1.** You deduct the fair market value of the stock as a charitable donation.[5]
- **Benefit 2.** You don’t pay any of the taxes you would have had to pay if you sold the stock.

Example. You bought a publicly traded stock for $1,000, and it’s now worth $11,000. You give it to a 501(c)(3) charity, and the following happens:

- You get a tax deduction for $11,000.
- You pay no taxes on the $10,000 profit.

Two rules to know:

1. Your deductions for donating appreciated stocks to 501(c)(3) organizations may not exceed 30 percent of your adjusted gross income.[6]
2. If your publicly traded stock donation exceeds the 30 percent, no problem. Tax law allows you to carry forward the excess until used, for up to five years.[7]

Strategy 7

If you could sell a publicly traded stock at a loss, *do not* give that loss-deduction stock to a 501(c)(3) charity. Why? If you sell the stock, you have a tax loss that you can deduct. If you give the stock to a charity, you get no deduction for the loss—in other words, you can just kiss that tax-reducing loss goodbye.

Solution. Sell the stock first to create your tax-deductible loss. Then give the charity the cash realized from your sale of the stock to create your deduction for the charitable contribution.

Example. You bought a stock for $13,000, and it's now worth $2,000. If you give the stock to a charity:

- You deduct $2,000 (fair market value).
- The charity receives $2,000 (the value of the stock).
- You kiss your $11,000 tax-deductible loss good-bye ($13,000 minus $2,000).

Instead, do this:

- Sell the stock.
- Collect $2,000 in cash from the stock sale.
- Give the $2,000 to the charity.
- Deduct the $2,000 charitable donation.
- Deduct the $11,000 stock loss.

Note. Whether you do this right or wrong, the charity gets $2,000. But with the "sell the stock at a loss and then donate the cash" strategy, you gain your rightful $11,000 additional tax deduction.

Look at it this way:

1. Do this wrong, and deduct only $2,000.
2. Do this right, and deduct $13,000—the whole enchilada.

Takeaways

Your stock portfolio provides you with the seven great tax-planning opportunities we showed you in this article.

For example, if you give money to charity, your parents, and/or your non-kiddie-tax children, you keep more tax money in your pocket (or the family's pockets) by using appreciated stocks rather than cash.

You absolutely must plan for your opportunities inside the portfolio to offset your gains and losses. With planning, you win free money with the offsets, and you'll find the offset game fun and easy to play.

The bottom line is that the seven strategies in this article give you straightforward ways to keep more of your money and send less to the IRS.

The end of the year is right around the corner. Since it takes time for stock transactions to settle and you don't want to worry about settlement dates, get your portfolio tax-deduction optimized well before the end of the year—say, no later than December 21, 2018.

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1 IRC Section 1091.
2 Rev. Rul. 74-175.
3 IRC Section 1(h)(1).
4 IRC Section 170(e)(5).
5 Ibid.
6 IRC Sections 170(b)(1)(D)(ii); 170(b)(1)(G).
7 IRC Section 170(b)(1)(C)(ii).