

# Capital Loss Limitation and Carryover Rules

This document describes briefly the limitation and carryover rules that apply to capital losses. Also includes information on characterization

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While taxes may be inevitable, the IRS gives taxpayers a break when capital losses are realized on their taxable investments. The following is a brief description of the limitation and carryover rules that apply to capital losses. Your Baird Financial Advisor, along with your tax advisor, can help you develop a strategy that will make the most effective use of these rules in conjunction with your investment portfolio and goals.

## CHARACTERIZATION OF GAIN OR LOSS

- The differentiation of net capital gains or losses in any tax year is necessary before the amount of capital loss deduction can be computed.
- A taxpayer must compare short-term gains versus short-term losses, and long-term gains versus long-term losses, in determining the net short- and long-term gain or loss in any tax year.

## LIMITATION OF CAPITAL LOSS

- An individual taxpayer may deduct up to a maximum of \$3,000 of net capital losses against other ordinary income per year. Net short-term and net long-term capital losses may both be deducted in the same year, as long as the total deduction is \$3,000 or less.
- All capital losses for a husband and wife filing jointly are computed as if they were the losses of one person.
- If a husband and wife file separate tax returns, the capital loss deduction is limited to \$1,500 on each return in any tax year.

## CAPITAL LOSS CARRYOVERS

- The IRS allows an individual or married taxpayer's capital losses to be carried over for an unlimited number of years until the loss is exhausted.
- A capital loss that is carried over to a later tax year retains its long-term or short-term character for the year to which it is carried.
- A short-term capital loss carryover first offsets short-term capital gains incurred in the carryover year. If a net short-term capital loss results, this loss next offsets net long-term capital gains incurred in the carryover year, and then ordinary income, up to the \$3,000 maximum. Any additional short-term losses would be carried to the next tax year, and the comparison to short, long, and other ordinary income would begin again.
- A long-term capital loss carryover first reduces net long-term capital gains in the carryover year, then net short-term capital gains, and finally ordinary income, up to the \$3,000 maximum.