



# Holding Period Adjustment Methods for Wash Sales

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White Paper

When determining holding period adjustments as a result of a wash sale, three methods can be used. **A)** Adjust the new lot's open date (tax lot date) to the date of the previous open trade; **B)** Adjust the new lot's open date backwards by the length of time the previous position was open; and **C)** Adjust the new lot's open date to the latter date based on the results of Methods A and B. In each method, the previous lot's open date may have been adjusted due to chaining effects. This paper explores the intricacies involved in executing each of the three methods and pays special attention to 'chained' wash sale cases.

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## INTRODUCTION

The date adjustments for wash sales are derived from I.R.C. § 1233(3):

*“IN DETERMINING THE PERIOD FOR WHICH THE TAXPAYER HAS HELD STOCK OR SECURITIES THE ACQUISITION OF WHICH (OR THE CONTRACT OR OPTION TO ACQUIRE WHICH) RESULTED IN THE NONDEDUCTIBILITY (UNDER SECTION [1091](#) RELATING TO WASH SALES) OF THE LOSS FROM THE SALE OR OTHER DISPOSITION OF SUBSTANTIALLY IDENTICAL STOCK OR SECURITIES, THERE SHALL BE INCLUDED THE PERIOD FOR WHICH HE HELD THE STOCK OR SECURITIES THE LOSS FROM THE SALE OR OTHER DISPOSITION OF WHICH WAS NOT DEDUCTIBLE.”*

A wash sale is generally described as selling stock at a loss, and buying substantially identical securities within 30 days before or after the sale.

There are three consequences to executing a wash sale:

1. You are not allowed to claim the loss on your sale.
2. Your disallowed loss is added to the basis of the replacement security.
3. Your holding period for the replacement security includes the holding period of the security you sold.

This paper focuses on the third consequence. According to the market, determining how to adjust the holding period of the replacement security, i.e., how the IRS would rule, is open to interpretation. However, regardless of which adjustment method is used, that method MUST be applied consistently to all wash sale instances.

## THE ISSUES

Different interpretations of IRS rulings regarding holding periods and wash sales have yielded the three adjustment methods, which are mentioned above and discussed in further detail below.

**Method A** adjusts the replacement Buy's holding period date back to that of the original Buy.

This method was derived from the original wording of the IRS Publication 550 as of 2009:

*"YOUR HOLDING PERIOD FOR THE NEW STOCK OR SECURITIES BEGINS ON THE SAME DAY AS THE HOLDING PERIOD OF THE STOCK OR SECURITIES SOLD."*

**Method B** adjusts the replacement Buy's date backwards by the amount of days in the holding period.

This method is derived from one interpretation of the new wording of the IRS Publication 550 as of 2010:

*"YOUR HOLDING PERIOD FOR SUBSTANTIALLY IDENTICAL STOCK OR SECURITIES YOU ACQUIRE IN A WASH SALE INCLUDES THE PERIOD YOU HELD THE OLD STOCK OR SECURITIES."*

In this case, "includes the period" is interpreted to mean the period between the open and closing trades, irrespective of when the replacement trade occurs. Method B can potentially result in an adjusted tax lot that precedes the original tax lot, extending the holding period. In the case of an IPO, you could have a tax lot of a security that didn't even exist at the time.

**Method C** is derived from an alternate interpretation of the IRS Publication 550 as of 2010 in which the period you held the old stock or securities accounts for when the replacement trade occurs. This addresses a concern regarding Method B, which may result in extending the holding period. Method C can be most easily evaluated by choosing the latter date (greater value) based on using Methods A and B.

Of the three methods discussed, Method A is more commonly used for two reasons. First, it never adjusts the holding period to before the date of the first Buy, as is the case with Method B. Second, Method A is less complex to evaluate than Method C. Please see the Examples section.

## Chaining

Chaining is yet another factor that adds a level of complexity to the holding period adjustment issue. Chaining is the result of a consecutive series of Buy–Sell–Buy scenarios (Buy–Sell–Buy–Sell–Buy). There is no limit to the number of potential trades in a single chain. Chaining becomes especially complex when the cost adjustment to the original replacement Buy creates a subsequent wash sale. This occurs because the cost basis of the replacement Buy is reduced by a sufficient amount to cause a subsequent sale to be a loss instead of a gain. This scenario creates additional replacement Buys, whose holding periods must be adjusted according to the method chosen.

Chaining impacts the holding period adjustment calculation when Method C is employed. This is because each replacement Buy must be analyzed in order to determine whether to apply Method A or Method B for each link in the chain. Based on the adjusted date of the previous replacement Buy in the chain, this determination can be different for each subsequent replacement Buy. In this example, before recalculating the holding period adjustment of the third Buy, the adjustment must be made to the first wash sale resulting from the second Buy.

## EXAMPLES

The following situations are considered wash sales and need to be adjusted for tax purposes.

1. Buy, then Sell, then Buy the same security at a loss within 30 days of the Sell.

Example 1		TD	Quantity
Buy	ABC	6/01/2011	2,000
Sell	ABC	6/10/2011	(2,000)
Buy	ABC	6/17/2011	1,500

2. Buy, Buy then Sell the same security at a loss within 30 days of the second Buy.

Example 2		TD	Quantity
Buy	XYZ	6/01/2011	2,000
Buy	XYZ	6/10/2011	1,500
Sell	XYZ	6/17/2011	(2,000)

### Method A

Adjust the new lot's open date (tax lot date) to the date of the original Buy.

In Example 1, the Buy of ABC on 6/17/2011 will have its tax lot date adjusted to 6/1/2011.

In Example 2, the Buy of XYZ on 6/10/2011 will have its tax lot date adjusted to 6/1/2011.

### Method B

Adjust the new lot's open date backwards by the length of time the original position was open. For example, if the Sell occurred ten days after the original Buy, the tax lot date of the second Buy would be adjusted ten days backwards.

In Example 1, the Buy of ABC on 6/17/2011 will have its tax lot date adjusted to 6/8/2011.

- **Calculation:** Buy on 6/1/2011; Sold on 6/10/2011;  $6/10 - 6/1 = 9$  days
- Buy on 6/17;  $6/17 - 9$  days = 6/8/2011.

In Example 2, the Buy of XYZ on 6/10/2011 will have its tax lot date adjusted to 5/25/2011.

- **Calculation:** Buy on 6/1/2011; Sold on 6/17/2011;  $6/17 - 6/1 = 16$  days
- Buy on 6/10;  $6/10 - 16$  days = 5/25/2011.

### Method C

Adjust the new lot's open date to the latter date of the results of Methods A and B.

#### Example 1

**Method A** adjusts the tax lot date to 6/1/2011.

**Method B** adjusts the tax lot date to 6/8/2011.

The latter date is **6/8/2011**.

#### Example 2

**Method A** adjusts the tax lot date to 6/1/2011.

**Method B** adjusts the tax lot date to 5/25/2011.

The latter date is **6/1/2011**.

## Chaining

Example 3		TD	Quantity
Buy	IBM	6/01/2011	2,000
Sell	IBM	6/10/2011	(2,000)
Buy	IBM	6/17/2011	1,500
Sell	IBM	6/19/2011	(1,500)
Buy	IBM	6/22/2011	1,000

To adjust for the wash sale rule, the second Buy (first replacement Buy) is adjusted.

**Method A** adjusts the 6/17/2011 Buy to **6/1/2011**.

The second replacement Buy will also be adjusted to **6/1/2011** since the adjustment of the second Buy takes effect before the third Buy.

Effectively, all Buys will be adjusted to the open holding period date of **6/1/2011**.

**Method B** adjusts the 6/17/2011 Buy to **6/8/2011**.

The second replacement Buy will be adjusted to **6/11/2011**.

### First wash sale

- **Calculation:** Buy on 6/1/2011; Sold on 6/10/2011;  $6/10 - 6/1 = 9$  days
- Buy on 6/17;  $6/17 - 9$  days = **6/8/2011**.

### Second wash sale

- **Calculation:** Buy on 6/8/2011 (adjusted); Sold on 6/19/2011;  $6/19 - 6/8 = 11$  days
- Buy on 6/22;  $6/22 - 11$  days = **6/11/2011**.

**Method C** will take the latter date of Methods A and B at each point in the chain. The determination of which method to use is made each time an adjustment needs to be made. So the first adjustment may use Method A and the next may use Method B.

### First Adjustment

**Method A** adjusts the first replacement Buy to 6/1/2011

**Method B** adjusts the first replacement Buy to 6/8/2011

**Method C** uses 6/8/2011

### Second Adjustment

The first replacement Buy is now 6/11/2011

**Method A** adjusts the second replacement Buy back to the adjusted open date of the first replacement Buy 6/8/2011

**Method B** adjusts the second replacement Buy to 6/11/2011

- **Calculation:** Buy on 6/8/2011 (adjusted); Sold on 6/19/2011;  $6/19 - 6/8 = 11$  days
- Buy on 6/22;  $6/22 - 11$  days = **6/11/2011**.

## SUMMARY

How the IRS decides to rule on adjustment holding periods as a result of a wash sale is open to interpretation. The three adjustment methods discussed deliver different results and pose different levels of difficulty. Method A is widely considered the most commonly used method because it's relatively simpler to apply. In addition, it addresses a possible consequence that Method B can produce, where it is possible for a tax lot's date to be adjusted to a date earlier than the investor initially held that security. Whichever adjustment method is chosen, consistency in application is of the utmost importance.

This white paper is part of a series that provides tips and analyzes issues related to cost basis reporting requirements for financial services firms. Launched in July 2011, G2's white paper series examines the challenges firms encounter when tackling the complex process of identifying and analyzing wash sales and other tax events. For more information or additional

free resources on this and related topics, please visit G2's [Cost Basis Advisory Page](http://www.g2ft.com/costbasisadvisorypage) at [www.g2ft.com/costbasisadvisorypage](http://www.g2ft.com/costbasisadvisorypage).

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