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Worthless Stock and Tax Timing

In the last few years, you may have purchased stock in a dot-com that's now out of business, or in another company whose share price is now just pennies. Does this mean you can take a tax loss for a worthless security? Here's a quick look at the rules.

First, the stock must be completely worthless before you can claim a loss. For example, if it's a publicly traded company and the share price is as low as a penny, it still doesn't qualify as worthless. (If this is the case, you may be better off selling it to your broker for a penny and taking a regular capital loss.)

If it is worthless, you must be able to identify an event that caused it to become worthless and a date for that event. For example, even if a company declares bankruptcy, the stock may not be worthless if there's a chance it will reorganize and emerge from bankruptcy. But if it becomes clear at a bankruptcy hearing that the creditors will own the reorganized company, you can consider your stock worthless at that time.

You must claim a worthless security's loss in the tax year it became worthless. Because this is sometimes not obvious until later, the IRS allows you to go back seven years to file an amended return claiming the loss.

Because these are general rules and because it is often a judgment call to decide that a stock is worthless, we encourage you to contact our office with any questions you have.