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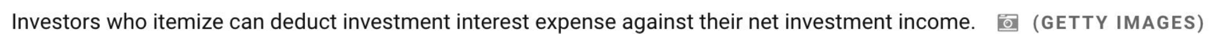
3 Tax-Deductible Investment Expenses

Investors who are filing their 2018 tax return may be able to claim one of these deductions.

By **Debbie Carlson**, Contributor March 8, 2019, at 11:52 a.m.

Investors who itemize can deduct investment interest expense against their net investment income. (GETTY IMAGES)



AS INVESTORS FILE THEIR tax returns, they're discovering they can take fewer deductions related to investment expenses.

The new Tax Cut and Jobs Act, known as TCJA, wiped out a lot of the miscellaneous investment expenses that people wrote off previously, says David Faje, a certified public accountant and partner at Warady & Davis in Deerfield, Illinois.

Those prior federal tax deductions include brokerage fees, investment advisory fees, safe-deposit box fees, tax preparation fees, subscriptions to investing publications, anything that was directly connected to the production of investment income.

Investors who itemized taxes could deduct those types of fees if the costs exceeded 2 percent of their adjusted gross income, adds Jeff Moes, executive vice president and chief fiduciary officer at FineMark National Bank & Trust.

It's likely that fewer people are itemizing their tax returns. While there remain a few tax-deductible investment expenses, as listed in IRS Publication 550, the increased standard deduction means a vast majority of people are no longer able to itemize. The standard deduction is $12,000 for single filers and $24,000 for married couples filing jointly.

The changes in the tax law will expire at the end of 2025 if Congress does not make the law permanent, so it will impact future tax write-offs for at least a few more years. Even with the changes, experts say there are still a few investment-related expenses that taxpayers can take. Here are three tax-deduction strategies that investors may be able to use for the 2018 tax year:

- Use capital losses to offset income.
- Deduct investment interest expenses.
- Turn qualified dividends into ordinary income.

[**READ:** 10 Ways to Maximize Your Retirement Investments.]

Use Capital Losses to Offset Income

Paul Joseph, founder of Joseph & Joseph Tax & Payroll in Williamston, Michigan, says one of the remaining investment-related expenses that people can use to reduce their tax bill is writing off some capital losses.

"That's still in effect, and it's not an itemized deduction as it goes on a different schedule," he says. "It's still $3,000 that you can use to offset income."

Capital losses occur when investors lose money on a security. Investors should keep an eye on their cost basis to see if they're underwater on an investment, Faje says. Cost basis is the original value of an asset. If investors didn't takes capital losses last year, they can't use it to offset income as they file taxes this year. But they should make a plan to do that for next year's taxes, he says.

"Especially toward year-end, investors might want to think about tax-loss harvesting, which is selling securities they've lost money on to recognize that loss," Faje says.

Tax-loss harvesting is a strategy that involves selling off a security that has experienced a loss in order to offset taxes on capital gains and income.

As painful as the fourth quarter sell-off might have been for some investors, that would have been a prime time to sell losing stocks and lock in enough capital losses.

[**READ:** How the Tax Cut Affects Investors.]

Deduct Investment Interest Expenses

Investors who itemize can deduct investment interest expense against their net investment income. This expense occurs when people take out margin loans, which is money borrowed against the value of stocks or mutual funds. The money can be used to buy additional securities or used for other financial needs. That margin interest is deductible.

Moes says investors who want to take advantage of this deduction must do some math to first find their net investment income. To calculate this expense, taxpayers need to take their gross income, subtract qualified deductions, net gains and other investment

expenses – those miscellaneous expenses that can no longer be deducted. That total equals an investor's net investment income. To take advantage of the deduction, the income must be more than the expense.

For example, if an investor has investment income of $1,000 and interest expenses of $500, then he or she can deduct the interest expense of $500 on the tax return. "This is one of the only expenses that relates to production of stock and bond income that you're (allowed) to deduct," Moes says.

[**READ:** How Investing Impacts Your Tax Bill.]

Turn Qualified Dividends into Ordinary Income

When investors buy securities, they may receive dividends, and they paid out as ordinary dividends or qualified dividends. Qualified dividends are taxed at a preferential rate of 15 percent and don't count as net taxable investment income. Ordinary dividends are taxed at an investor's income tax bracket, which means the tax rate could be as high as 37 percent.

Craig Bolanos, founder and CEO of Wealth Management Group in suburban Chicago, says normally people wouldn't want to turn qualified dividends into ordinary income unless they have a lot of investment interest expenses that they can't write off.

"It's one of the little-known things that people should be doing that they're not," he says. "If you can't (take) that investment expense because most of your taxable income is qualified dividends, good gosh almighty I'd be willing to turn those qualified dividends into ordinary income dividends to escape taxation."

For example, if an investor had $1,000 in investment income, but $2,000 in investment interest expenses, he or she could only deduct the first $1,000. By converting $1,000 of qualified dividends into ordinary income, the investor can deduct the other $1,000, which zeros out the net income.

Faje says because the federal tax code changed so much, taxpayers shouldn't just assume that the way they've always filed their taxes will be the best.

"People should run a lot of different scenarios and projections to see how the different changes will impact them, not only this year, but going forward," he says.

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