PERSPECTIVES

ANTICIPATING THE FIFO RULE

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As the effort to reform the U.S. tax code speeds through the legislative process, it is clear that, whatever the specifics of the ultimate bill, it could have a significant impact on investors. Despite the bill's fluid nature, there is one provision that could have such profound implications for taxable investors that we thought it was worth highlighting before the final passage: the FIFO rule.

The latest available draft of Section 13533 of the Senate's version of the Tax Cuts and Jobs Act would effectively force taxable investors to adopt first-in, first-out (FIFO) methodology when determining the cost basis and capital gains from the sale of securities. In practice, this would mean that investors would have to sell their investments in the order in which they were purchased, rather than selectively decide the specific securities to sell so as to minimize their tax liability. This change could upend the practice of tax-loss harvesting, which is an integral part of taxable investing.

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Considering the potential impact of the rule, we believe there is a strong argument for a taxable investor contemplating selling assets to fund certain payments or rebalance assets to do so in 2017. Put another way, while we don't think selling for the sake of selling in anticipation of the rule is worthwhile, to the extent you were going to sell anyway, it may be best to do it before the year-end rather than risk being subject to the new rule in 2018.

Congress is currently working hastily toward a compromise between the two versions of the bill that passed the House and Senate, with concerted lobbying efforts underway as well. We consider nearly every provision to be subject to negotiation right up until final passage, so it is impossible to know whether the FIFO rule will be included in the final bill. We will continue to monitor legislative progress in Washington and keep clients abreast of the latest developments.