Tax Lost Harvesting

by Drew Barnes, CFP®

Experiencing portfolio declines and market volatility isn't enjoyable. Nobody likes to open their statements and see a lower balance. While the elevated volatility in 2022 hasn't been welcomed, it does produce a few opportunities. One of those opportunities is the strategy of tax loss harvesting.

What is Tax Loss Harvesting?

Tax loss harvesting is the strategy of intentionally selling a security at a capital loss in a taxable account. Ideally, once the security is sold and the tax loss has been captured, the investor immediately uses the proceeds from the sale to purchase a similar (but not identical) security. This allows for the capital loss to be captured for tax purposes while the reinvestment allows you to remain positioned to experience the eventual market recovery. The investor will need to be careful not to create a "wash-sale" by reinvesting the proceeds in a "substantially identical" investment.   If the wash-sale rules are violated the capital loss will be disallowed. If the investor wishes to repurchase the same security or a "substantially identical" investment, they will have to let 30 days pass first.

How do Capital Losses Work?

Capital losses can be used to offset current or future realized capital gains. If there are no capital gains to offset, the IRS allows you to use up to $3,000 of capital losses per year to offset ordinary income – essentially a $3,000 tax deduction. Any remaining losses carry forward *indefinitely* to be used in future years. The losses do not only offset capital gains from other investment securities. With property values soaring the past couple of years, if you sold a property at capital gain, tax loss harvesting your investment portfolio is a great way to help lower the net gains on the property sale. Losses can also be used to offset capital gains from selling a business.

When repurchasing a new security your cost basis will be reset at that lower value. Therefore, when the market recovers there will be a gain and at the very worst, tax loss harvesting will be a tax deferral strategy. For those that are approaching retirement this still comes in handy because they are likely to be paying lower taxes once they are no longer earning their wages.

Tax loss harvesting is a great strategy and allows you to take advantage of a (likely) temporary situation when your portfolio is down. If you have investments held in a non-qualified (non-retirement) account, now is the right time to explore this approach. Traction Financial Partners actively engages in tax loss harvesting for our clients and we'd welcome the opportunity to discuss it with any investors that would like learn more.