



Tax-Loss Harvesting—A Year-Round Consideration

Clients like to capture gains. The challenge: Clients don't like the accompanying 1099. Tax-loss harvesting can help clients take gains off the table and manage the resulting taxes.

Capital losses offer some benefits. A capital loss can offset an equivalent amount of short-term and long-term capital gains and up to \$3,000 of ordinary income each year. Unused losses can be carried forward to future years. With tax-loss harvesting, a financial professional can help a client both capture a gain and reduce the overall tax effect.

Tax-loss harvesting is a straightforward concept. The client can sell a portion of an investment portfolio and recognize a loss. The client can then purchase a similar, though not identical, investment to replace it. The loss that is recognized can be used to offset gains and up to \$3,000 in ordinary income on the current year's tax return. The losses also can be carried forward indefinitely and used on future tax returns. For taxpayers who file Married Filing Jointly, losses not used on the final joint return and attributable to the surviving spouse also may be carried forward on tax returns.

For a client with losses, this may create an opportunity to adjust the portfolio and apply the loss against ordinary income, including a Roth conversion. However, watch out for these tax "gotchas."

Mind the "Replacing with Substantially Similar Investment" Rule

The "replacing with substantially similar investment" rule is to keep the seller essentially swapping security A to virtually identical security B. This rule states that the new investment must not be "substantially similar to" the one sold.

Example: A client sells the ABC Growth and Income Fund and replaces it with XYZ Growth Fund. This transaction should avoid the rule as those funds are unlikely to hold identical investments.

However, a client who sells the ABC S&P 500 Index® Fund and replaces it with the XYZ S&P 500 Index Fund has purchased a "substantially similar investment" as both funds replicate the securities in the S&P 500 index.

Actively managed funds are unlikely to have substantially similar investments. For this reason, these funds are typically chosen as replacements.

Be Wary of Wash Sales

A wash sale designation can eliminate any tax benefits resulting from the sale. A wash sale occurs when a security is sold for a loss and is replaced with a substantially identical security within 30 days prior to or after the sale. This includes option contracts on those securities.

There are two areas where investors often make errors that result in wash sales. The first is failing to consider that dividend reinvestment can be considered a wash sale. The second is monitoring IRA and Roth IRA transactions. The wash-sale rule will apply even if the security sold is in a taxable account and a substantially identical security is purchased in an IRA or Roth IRA.

Note that there is no wash-sale rule for gains. An investor is free to capture the gains through the sale of a security and immediately repurchase the same security. A client in the 0% Long-Term Capital Gains bracket may do this to recognize gains at 0%, then immediately repurchase the security to capture the higher basis.

Example: Six months ago, John purchased ABC Corporate Income Fund for \$100,000. Today, that investment is worth \$85,000. If John sells today, he can recognize a short-term capital loss on his investment. He can then use that loss to

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offset all short-term capital gains, all long-term capital gains, and up to \$3,000 of ordinary income taxes this year. Any unused loss may be carried forward against gains on future tax returns. John's advisor suggests another corporate growth and income fund from a competitor because he is concerned about wash-sale rules.

As with all tax matters, the client should consult his or her tax professional. Taxes are a complex area where professional support is key to making decisions.

Tax-Loss Harvesting—a Good Reason to Call a Client

Tax-loss harvesting is often viewed as a year-end strategy. However, opportunities for tax-loss harvesting can occur anytime during the year, and in both up and down markets. When reviewing client accounts, consider reaching out to your client when tax-loss harvesting may be an option. Your client will thank you at tax time.

Additional Resources and Links

[IRS Publication 550: Investment Income and Expenses \(Including Capital Gains and Losses\)](#)

[Capital Loss Carryover: Definition, Rules, and Example](#)

[Skip the Chocolates: Give Clients the Gift of Tax Control](#)

ACTIONS YOU CAN TAKE RIGHT NOW

- **Identify clients with losses in taxable accounts.**
- **Evaluate tax-loss harvesting as an option.**
- **Consider whether replacing the investment with a deferred option might be beneficial.**

**For more information about tax management strategies,
please contact our Retirement Strategies Group at
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