

A Look Into Tax Loss Harvesting

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Tax Loss Harvesting is a term that gets thrown around frequently in the wealth management industry, but is infrequently accompanied by a definition, purpose or real-life example. Let's look at what tax loss harvesting is, why it is important, and one example to help see its value.

To start, here are two definitions. First, tax loss harvesting is the timely selling of securities at a loss in order to offset the amount of capital gains tax due on the sale of other securities at a profit.¹ Second, capital gains tax is the tax apportioned to a profit an investor makes when an investment is sold. It is essential to understand these two definitions in order to see why tax loss harvesting is beneficial.

When using this strategy, investments that are showing losses in value can be sold to claim a tax credit against other investments that were sold in profitable positions during the same year – thus reducing the overall tax burden. This strategy can be deployed at any time during the year, but most investors will wait until the end of the year so that they have a better understanding of their portfolio's performance and tax consequences. Over the long run, tax loss harvesting can save you money which effectively increases your after-tax return.

Let's look at a quick and straightforward example. Suppose an investor achieves a capital loss by selling an investment for \$13,000 when they paid \$20,000. If the investor utilizes the \$7,000 capital loss (\$20,000 minus \$13,000) against an equivalent amount of capital gains, they could reduce their tax bill by \$1,050 (assuming their long-term capital gains rate is 15%: $\$7,000 \times 15\% = \$1,050$).

At MCF, we focus on holistic financial planning. Tax planning is a very important piece of the whole picture. Beyond the noted advantages in the current year, tax loss harvesting can also create losses to carry forward to use in later years. If you have more losses than gains, the IRS limits you to \$3,000 that you may use to offset ordinary income in the current year, while the rest of your losses may be carried forward indefinitely and used against future gains.

Please reach out to me or anyone on the MCF team to see how this strategy may be tailored specifically to you.

Source: ¹ Investopedia "Tax Loss Harvesting"

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