



# Tax-Loss Harvesting: Converting Losses into Advantages

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## How Tax-Loss Harvesting Can Help You Reduce Taxes and Boost Investment Return

Instead of merely aiming to buy low and sell high, you can strategically minimise your tax liabilities by selling investments that have declined in value. This process, known as tax-loss harvesting, is particularly effective in non-retirement accounts. Here are several reasons to consider this approach:

- **Reduce Taxable Income:** You can deduct up to \$3,000 in net capital losses each year.
- **Offset Gains:** Losses can counterbalance profits from other investments, reducing overall tax owed.
- **Carry Forward Losses:** Any losses exceeding \$3,000 can be carried into future tax years.
- **Optimise Portfolio:** This strategy allows for portfolio rebalancing and improved asset allocation.

By lowering your current tax bill, you retain more capital for investment. Selling underperforming assets may also enhance your portfolio's long-term returns. Tax-loss harvesting remains advantageous regardless of market conditions, especially after corrections or significant drops in specific investments.

### Understanding Realised Gains and Losses

Your portfolio's value fluctuates, but these changes become relevant only when an asset is sold, or "realised." A sale for more than the purchase price results in a capital gain, while selling for less leads to a capital loss. The IRS permits you to balance these gains and losses annually, allowing you to deduct net capital losses up to \$3,000 from your taxable income. Losses that exceed this limit can be carried forward indefinitely.

Be mindful of the wash-sale rule when selling and replacing similar investments. Buying a nearly identical asset within 30 days disqualifies the capital loss from being tax-deductible.

### Key Insights:

- Tax-loss harvesting can lower your tax burden by selling depreciated investments.
- This strategy can lead to better portfolio performance by keeping more money invested.
- Engaging with a financial or tax professional is crucial due to the complexities involved.





## Essential Considerations



To effectively harvest losses, you must know how long you've held an asset and its cost basis. Assets held for more than a year are long-term holdings, while those held for less than a year are short-term.

The IRS generally favors long-term investments, with capital gains taxed at lower rates (0%, 15%, or 20%) based on income. Short-term gains are taxed at ordinary income rates, ranging from 10% to 37%, depending on your tax bracket. Determining cost basis can be intricate, with methods like "first in, first out" or average cost. Consulting a financial or tax expert can help prevent mistakes.



## Tax-Loss Harvesting: Effective in Any Market

This strategy is useful regardless of whether your portfolio is thriving or struggling. Even in down years, harvesting losses can reduce your taxable income, with excess losses contributing to future tax years, effectively creating a "tax-deduction reserve" for future gains.

While tax benefits are advantageous, they should align with your broader financial goals. Tax-loss harvesting is a powerful strategy, but ensuring a well-structured portfolio is paramount. Given the intricacies, working with a professional can help maximise benefits and keep your investments aligned with your objectives.



## Wash Sale Guidelines

The wash-sale rule prevents the misuse of tax deductions. Here's how it works:

**Example Scenario:** You buy 100 shares of ABC Motors at \$50 each. Following some recalls, the stock drops to \$40. After deciding to sell the shares to realise a capital loss, the stock begins to rise after positive news. Here's what to consider:

- **Immediate Buyback:** Purchasing the same shares within 30 days will violate the wash-sale rule, eliminating the tax deduction for the loss.
- **Explore Alternatives:** Invest in another automotive company that isn't "substantially identical" to maintain tax benefits.
- **Wait 31 Days:** If you wish to buy ABC Motors again, wait over 31 days to avoid the wash-sale rule while retaining the tax deduction.

Always consult a tax or financial advisor before making decisions about tax-loss harvesting.

### Consult your financial or tax professional to evaluate if tax-loss harvesting could enhance your portfolio.

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