Tax Loss Harvesting: Turning Losses into Gains

Sometimes even stocks that lose value can make you money. Or at least save you money in the form of very real tax savings.

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Matthew Costigan is a Senior Financial Advisor in the Pittsburgh, Pennsylvania office of HBKS® Wealth Advisors (HBKS®). He began his career in public accounting in 2003 specializing in individual and trust taxation with a Big Four firm, joined Hill, Barth & King LLC (HBK) in 2006 and then joined HBKS® in 2008. His extensive individual tax knowledge includes planning for the impact of qualified and non-qualified investments.

Mr. Costigan earned dual Bachelor of Science Degrees in Finance and Accounting from Syracuse University. He is a Certified Public Accountant/Personal Finance Specialist, a CERTIFIED FINANCIAL PLANNER® and has his Accident, Life and Health Insurance Licenses.

As a CPA as well as a financial advisor, I look at investing from several different perspectives with the overall goal of enhancing bottom-line returns for my clients. One of the most significant opportunities comes as the year-end approaches and I immerse myself in the art and science of tax planning.

Most people with an investment portfolio find at year-end a substantial tax burden due to "realized gains," be they short or long-term gains. Realized gains don't add to the value of your portfolio or put cash in your pocket, but they are nonetheless real, and more importantly, taxable at up to 39.6 percent. They come in several varieties, but the two most frequently encountered are gains from stocks that rose in value during the year and were sold at a profit over the investment cost, and distributions from mutual funds, which almost all mutual funds make at the end of each year.

Realized gains are an annual ritual, even in years when the overall value of your portfolio declines. But even in years when your portfolio has soared, there are always going to be some stocks or mutual funds that decline in value. You might consider these losers, but they also provide opportunities to offset or at least diminish the tax impact of your gains. Here are a few:

Sell off your losses. This is the most simplistic solution. We look for stocks or mutual funds we can sell at losses to offset the winners dollar for dollar. We can buy the same investments back at a later date, but you might also use the opportunity to reposition your portfolio to some extent. Buy-backs must accommodate the IRS's "wash-sale" rule. Typically, you have to wait 31 days, 61 in some instances, to take the loss. Sometimes you can get around the wash-sale rule by using an ETF to make a tax swap, such as an ETF for a stock or mutual fund, or for another ETF if the two are linked to different indexes.

Sell off more of your losses. You can deduct up to $3,000 of capital losses from other, non-investment income, your "ordinary income." And if you can zero out your taxable income and have losses left over, you can carry them forward to offset capital gains or ordinary income the following year.

Have your gains and pay no taxes. If you are in a 15 percent or lower tax bracket, including your capital gains, IRS statutes forgive all taxes on long-term capital gains. That's right: zero federal tax on your long-term capital gains.

Employing this strategy requires care, because the gains you take might impact other deductions, like healthcare expenditures. It's another aspect of our HBKS tax planning process.

So-called "tax loss harvesting" is not always the best way to deal with capital gains. You might not want to disturb the balance of your portfolio, even for 31 days. Or you might miss a rally in the issues that you are harvesting losses from. Regardless, from choosing investments to selling investments, decisions should always be made with an eye to your individual bottom-line value, and that always involves considering the tax implications. ☐

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