

Tax-Loss Harvesting Explained

Imagine you're shopping and buy two items: one's a winner (like a stock that goes up), the other's a dud (a stock that drops). Instead of paying taxes on the winner, you can "return" the dud to reduce your tax bill—maybe even lower other income taxes. That's tax-loss harvesting: an IRS-approved way to turn investment setbacks into savings by selling losing investments to offset gains.

What Is Tax-Loss Harvesting?

Tax-loss harvesting is selling investments (stocks, bonds, mutual funds, ETFs) that have dropped in value since purchase, locking in a **capital loss**. That loss can offset taxable gains from other sales—like using a coupon at checkout.

It's only relevant in taxable brokerage accounts (not IRAs or 401(k)s, where gains are already tax-deferred). Investors use it to clean up underperformers while lowering taxes. Depending on portfolio size, savings can range from hundreds to thousands of dollars annually.

How It Works: Step by Step

- 1. Track Gains and Losses**
 - Sell for more than you paid = gain.
 - Sell for less = loss.
 - Gains are taxed short-term (held <1 year, taxed like income up to 37%) or long-term (held >1 year, at 0–20%).
- 2. Offset Gains Dollar-for-Dollar**
 - Losses cancel gains of the same type first.
 - Example: \$5,000 in long-term gains + \$7,000 in losses = no tax on gains and \$2,000 in net losses left.
- 3. Deduct from Ordinary Income**
 - Up to \$3,000 of net losses (\$1,500 if married filing separately) can reduce your wages or other ordinary income.
- 4. Carry Forward Remainder**
 - Extra losses roll forward indefinitely to future years.

Brokerage apps often handle the math and suggest harvesting opportunities, reported at tax time on **Schedule D** and **Form 8949**.

The Wash-Sale Rule: The Big Catch

You can't sell a stock at a loss and buy it back within 30 days before or after (a 61-day window). Doing so voids the deduction and adds the loss to the cost basis of your new shares.

Example: Selling Apple at a loss and repurchasing it two weeks later won't work. But swapping into a broader tech ETF (not "substantially identical") keeps you invested without breaking the rule.

Smart Harvesting Strategies

- **Swap, Don't Sit Out:** Replace losers with similar (not identical) investments to keep market exposure.
 - **Monitor Year-Round:** Don't wait until December—use quarterly check-ins or after market dips.
 - **Pair with Gains:** Harvest when selling winners or exercising stock options.
 - **Focus on Short-Term:** Short-term losses are most valuable since they offset higher-taxed short-term gains.
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Example: Putting It Together

Suppose you:

- Sell Stock A: \$4,000 long-term gain
- Sell Stock B: \$6,000 short-term loss
- Have another: \$2,000 short-term gain

Netting it out:

- The \$6,000 short-term loss offsets the \$2,000 short-term gain = \$4,000 short-term loss left.
- That \$4,000 offsets the \$4,000 long-term gain = no taxable gains.
- \$2,000 of net loss remains, deductible against ordinary income.

Savings: At a 15% capital gains rate + 22% income bracket, that's \$1,040 in reduced taxes.

Pros and Cons

Benefits

- Immediate and future tax savings
- Opportunity to upgrade your portfolio

- Low cost to implement (often zero commission today)

Drawbacks

- Missed rebound if a stock recovers quickly
- Wash-sale complexity
- Only works in taxable accounts

For higher earners, note the additional 3.8% Net Investment Income Tax (NIIT) on gains.

The Bottom Line

Tax-loss harvesting is a straightforward, legal way to use losses to your advantage—reducing taxable gains, trimming ordinary income, and carrying forward benefits to future years. When done thoughtfully, it saves real money while keeping your portfolio aligned with long-term goals.

If you'd like to explore how strategies like this could fit into your broader financial plan, schedule a consultation with our team at **Landis Wealth Management**.