Episode 113: Tax Loss Harvesting – Is It Right For You?

Patti Brennan: Hi, everybody. Welcome to "The Patti Brennan Show." Whether you have $20 or $20 million, this show is for those of you who want to protect, grow, and use your assets to live your very best lives. Today is part of the ongoing "Ask Patti Brennan" series. Between all of us, I just got word that people love this series. It's 10, 15 minutes quick, easy, ask a question, get the answer, done.

Thank you so much for tuning in and thank you so much for giving us the content - giving us the questions, so that we could continue to provide this to all of you. Today's question: Here it is, October of 2022. It has been an ugly, ugly year. Markets are way, way down, no matter what you put your money into.

The US market is down 25 percent. International markets are down 29 percent. 20-year treasuries, these are government bonds, are down 31 percent. Real Estate Investment Trusts, another 31 percent. Gold is down - despite being theoretically a hedge against inflation. And Bitcoin, so much for that being a hedge against inflation, down 66 percent year to date.

If this is your situation, how do we get some lemonade out of this lemon? One of the ways may be, depending on your situation, this concept called tax loss harvesting. Let me explain to you how that works. You basically look at your non-retirement accounts. It could be a brokerage account or mutual fund account. You look at the cost basis and compare that to the current market value.

If you have a loss, you could wait until it recovers because eventually, we believe it will. Markets go up and down. Eventually, hopefully, they'll have that upward trajectory, so you could certainly just hold on to it until it recovers, or maybe we squeeze some lemonade out of this thing and do a free exchange from investment A to investment B.

You do a same-day exchange because we don't want to disrupt the integrity of the underlying portfolio. That's important. Your investments are a means to an end and there's an important balance in a diversified portfolio. You don't want to mess that up. We're not going to let the tax tail wag the dog. Let's face it. You can move from blue chip A to blue chip B on the same day.

You're not market timing. You haven't disrupted the integrity of the portfolio, and now, you have a juicy tax deduction. Now, let's explain to you how this really works. You're now in investment B. First of all, investment B has to be different. It can't be moving from one company's S&P 500 Fund to another company's S&P 500 Fund. That's not going to cut it.

That's going to violate something called the wash sale rule. In addition, you can't sell it in one account and then buy it in your retirement account. That also violates the rule. You won't get the tax deduction. There are some certain T's to cross, I's to dot, to make sure that you actually are able to take advantage of this benefit that comes along with tax loss harvesting.

The first question would be, should you do it? Does everybody need to do it? Should you consider it? The next question is, is it something that you should really look at? My answer is, yes, you should, or someone, your advisor, should be reviewing your portfolio literally on a daily, monthly basis to see if there are opportunities to grab these losses.

Now, let me explain to you how this really works. For example, this year, we, at Key Financial, have been doing tax loss harvesting all year long. In fact, we've done four rounds of tax loss harvesting in all our client accounts. Basically, what that means is, because the markets just basically gone straight down every month, we're stacking on top of the losses that we harvested earlier in the year.

What happens if we end the year with absolutely no gains? Basically, the way the rule works is that you first offset long-term capital gains with long-term capital losses and short-term capital gains with short-term capital losses. The best thing about short-term losses, though, is they can be used against long-term gains as well.

Short-term capital losses are even better than long-term capital losses, although they're both very good. Let's fast forward. It's December 31st, and nothing made any money. You end the year and let's assume that you've got a $10,000 loss while the law says that you can only take $3,000 against ordinary income.

You say, "OK, Patti, fine and dandy. That's great. It'll save me, call it $1,000 on my federal tax return, but I have $7,000 of losses that could get completely wasted." I've got good news for you. You're not wasting them. You're literally putting them in this bank account to carry forward until they're all used up.

Capital losses are a very effective tax planning strategy, and it can help with your other tax planning goals as well. For example, maybe because of these losses, less of your social security will be taxable, or there's this thing called IRMA. It's a real pain in the neck when you're 65 years old and you're on Medicare, and you got to pay this extra premium because your income is too high.

With tax loss harvesting, maybe you can bring that down and save yourself a couple hundred dollars every month because of this tool. Tax loss harvesting can be a very effective tool. It's one of those things that comes around only in bear markets. We hope that you don't lose money in your portfolio, but the fact of the matter is, it's going to happen.

When it does, it's important to just take a look at those statements. It's probably the only time I'm going to say it's OK to open those statements and see those drawdowns, because you want to take advantage of those losses if you don't have an advisor already doing this for you.

You want to just really look at them, see if there are losses against the cost basis, and then act accordingly. Again, you want to find a replacement investment that is similar to the one that you already have.

If you are older, it's also very important to understand that when we pass away, there's this thing called the step up in cost basis. Guess what, there's also this thing called the step down in cost basis. Really important. You don't want to die with any losses. If you could arrange for that, that would be wonderful.

Now, the only other thing I'm going to say is many people are charitably inclined, and highly appreciated securities are a great tool to do so. Now, when you're reviewing your portfolio, if you want to donate some of your investments, just make sure that you're not choosing the ones that have capital losses. You want to choose only the ones that have capital gains.

That pretty much covers everything. Again, if you have any questions, feel free to go to our website. We're at keyfinancialinc.com. Give us a call. We're happy to help. That's what we're here for. That's why we do these podcasts.

I'm really grateful that you continue to tune in month after month and share them with other people because that's what makes all of this worthwhile. I am Patti Brennan, and we're Key Financial -Wealth Management with wisdom and care.