B O S T O N   R E T I R E M E N T   A D V I S O R S,   LLC
Registered Investment Advisor
103 Stiles Road, Suite 203   Salem, NH 03079   Tel: 603-896-6400   Toll Free: 888-408-6400   Fax: 1-866-557-0155
E-mail: paul@investwithpaul.com   Website: investwithpaul.com
SPECIALIZING IN INVESTMENT & RETIREMENT PLANNING
PAUL R. PIGNONE, CFP®, CLU, ChFC, AIF®, CSA®
RICHARD E. CHIOZZI, CFP®

November 14, 2014

Tax Loss Harvesting
A useful year-end move to counteract capital gains.

Even though 2014 may end up being a subpar year for stocks, you may realize short-term capital gains. What will you do about them? You could do what many savvy investors do – you could "cash in your losses" and practice tax loss harvesting.

Selling losers to offset winners. Tax loss harvesting means taking capital losses (you sell securities worth less than what you first paid for them) to offset the short-term capital gains you have amassed.

While this doesn't get rid of your losses, it can mean immediate tax savings. It can also help you diversify your portfolio. It may even help you to position yourself for improved long-term after-tax returns.

The tax-saving potential: Sure, you can use this technique to put your net gains at $0, but that's just a start. Up to $3,000 of capital losses in excess of capital gains can be deducted from ordinary income, and any remaining capital losses above that can be carried forward to offset capital gains next year.

So by taking a bunch of losses this year and carrying over the excess losses into 2015, you can potentially shelter some (or maybe even all) of your long-term and short-term capital gains next year. This gives you a chance to shelter winners you've held (even for less than a year) from being taxed at up to 39.6%.

The strategy in action. It is really quite simple. Step A is to pick out the losers in your portfolio. Step B is deciding which losers to sell. Step C is giving the green light to those transactions.

You must watch out for the IRS "wash-sale" rule, however. You can't claim a loss on a security if you buy the same or substantially identical security within 30 days before or after the sale. (The window is actually 61 days wide in some instances.) In other words, you can't just sell a security to rack up a capital loss and then quickly replace it.

But, you might be able to avoid the wash sale rule by using an ETF to make a tax swap: an ETF for a stock or mutual fund, or even an ETF for another ETF if the ETFs are linked to different indexes. Although these tax swaps are widely done, this is still a gray area, so consult a qualified tax advisor first.

Watch the fine print on wash sales. The wash sale rule applies to your entire taxable portfolio, not just one taxable account within it. So as an example, if you sell individual holdings of stock in a company, you still must wait for the wash sale window to close before you can purchase shares of that same firm for your IRA. Also, the wash-sale rule applies to multiple taxable accounts – worth remembering if you and your spouse file jointly or have multiple IRAs. The IRS makes an exception for tax-deferred IRAs and 401(k)s.

The (minor) drawbacks: You may not wish to alter a carefully chosen portfolio to the degree that you must for tax loss harvesting, especially if it has been built for the long term. Also, you could end up missing a rally in which an investment you've sold might take off. Transaction costs do add up, so you want to consider those costs versus the potential savings before you make your moves. (For that reason, a fee-based account might make sense when tax loss harvesting.)

Not just a year-end tactic … also a year-round strategy. Some investors harvest losses throughout the year, not just in December. You may want to ask the financial professional you know and trust how you can harvest losses this holiday season and beyond.

This is a technique and strategy that I am active on, however, if you have other taxable accounts that you or someone else is responsible for, it's wise to consider using this strategy.

Please let us know if you have any questions. Consult your Tax Advisor for specific application before implementing this technique.

Paul R. Pignone, CFP®,CLU,ChFC,AIF®,CSA