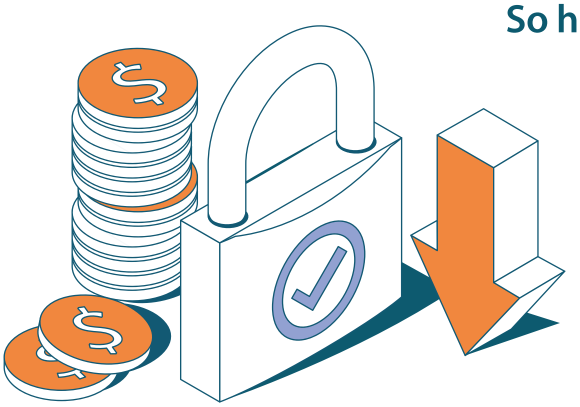
Paying Less Tax:

The Tax-Loss Harvesting Advantage

New York Life Investments

No one likes losing money on investments, but it turns out it can have a silver lining. Through tax-loss harvesting, you can use losses to reduce your taxes.

So how does it work?



Locking in Losses

Tax-loss harvesting occurs when an investor sells investments in a loss position to offset the gains generated by other investments.

Consider an investor who has an ETF tracking the S&P 500 Index. It has lost value since the investor purchased it earlier in the year.

ETF tracking the S&P 500 Index

$100,000
Original investment

$87,000
Current value

$13,000
Short-term capital loss

The investor decides to sell the ETF to lock in the losses, and replaces it with a similar—but not substantially identical—ETF.

Purchases ETF tracking the Nasdaq 100 index

$87,000
Sale proceeds*

$13,000 Loss available to offset gains

*Note that the cost basis of the newly-purchased ETF is now $87,000 rather than the original $100,000 investment. The investor will pay capital gains taxes based on the lower cost basis when they sell, effectively delaying taxes rather than eliminating them. An investment cannot be made directly into an index. Index definitions can be found at the end of this piece.

Now, the investor can apply the capital loss against gains in the following order:

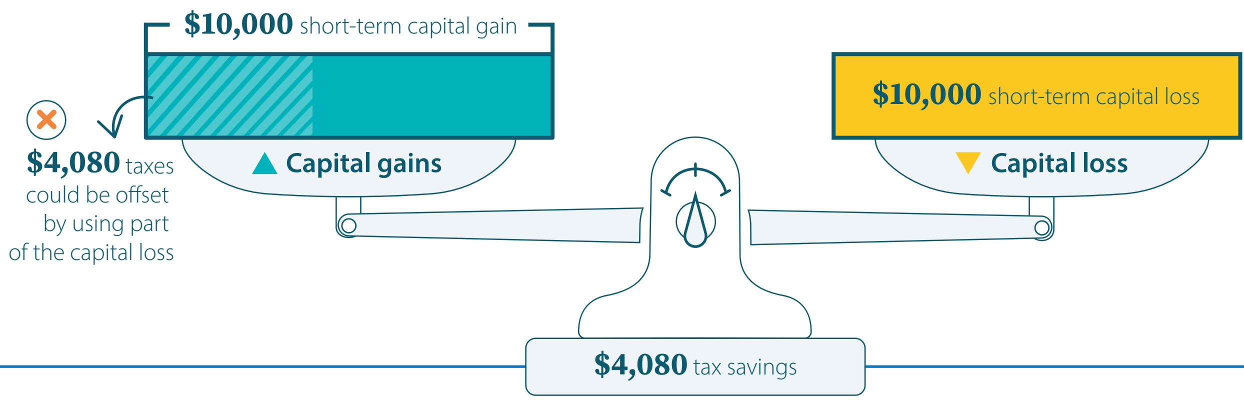
1. **Capital gains of the same type.**
   e.g. short-term losses against short-term gains
2. **Capital gains of the other type.**
   e.g. short-term losses against long-term gains
3. **Up to $3,000 of ordinary income.**
4. **Carried forward to offset gains in future years.**

Here's an example of how the **$13,000** capital loss could be used, making the following assumptions about the investor:

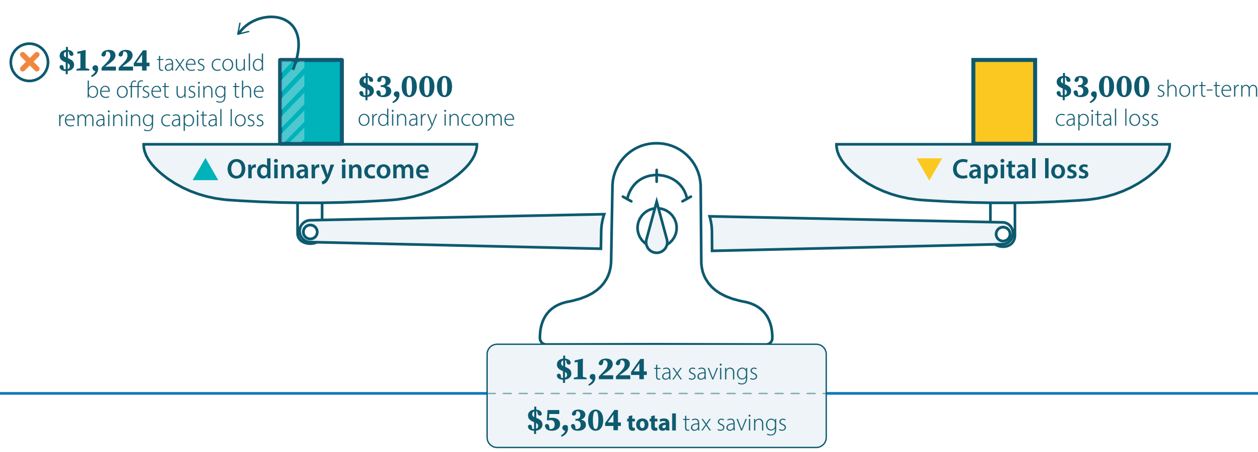
- **They have a $10,000 short-term capital gain**
- **They have $3,000 of ordinary income**
- **They are taxed at the maximum federal rate of 40.8%***

*The 40.8% tax rate includes the top regular income tax rate of 37% plus the 3.8% net investment income tax.

Part of the $13,000 loss offsets the $10,000 short-term capital gain.



The remaining $3,000 loss is applied against ordinary income, reducing taxes further.



The $5,304 in total tax savings are reinvested back into the market. Assuming a 6% rate of return, this would add nearly $2,000 to the investor's earnings in the first 5 years.

This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index.

In this hypothetical example, the initial tax savings and reinvested earnings could amount to $7,098. This can potentially continue to compound if the investor keeps the funds in the market.

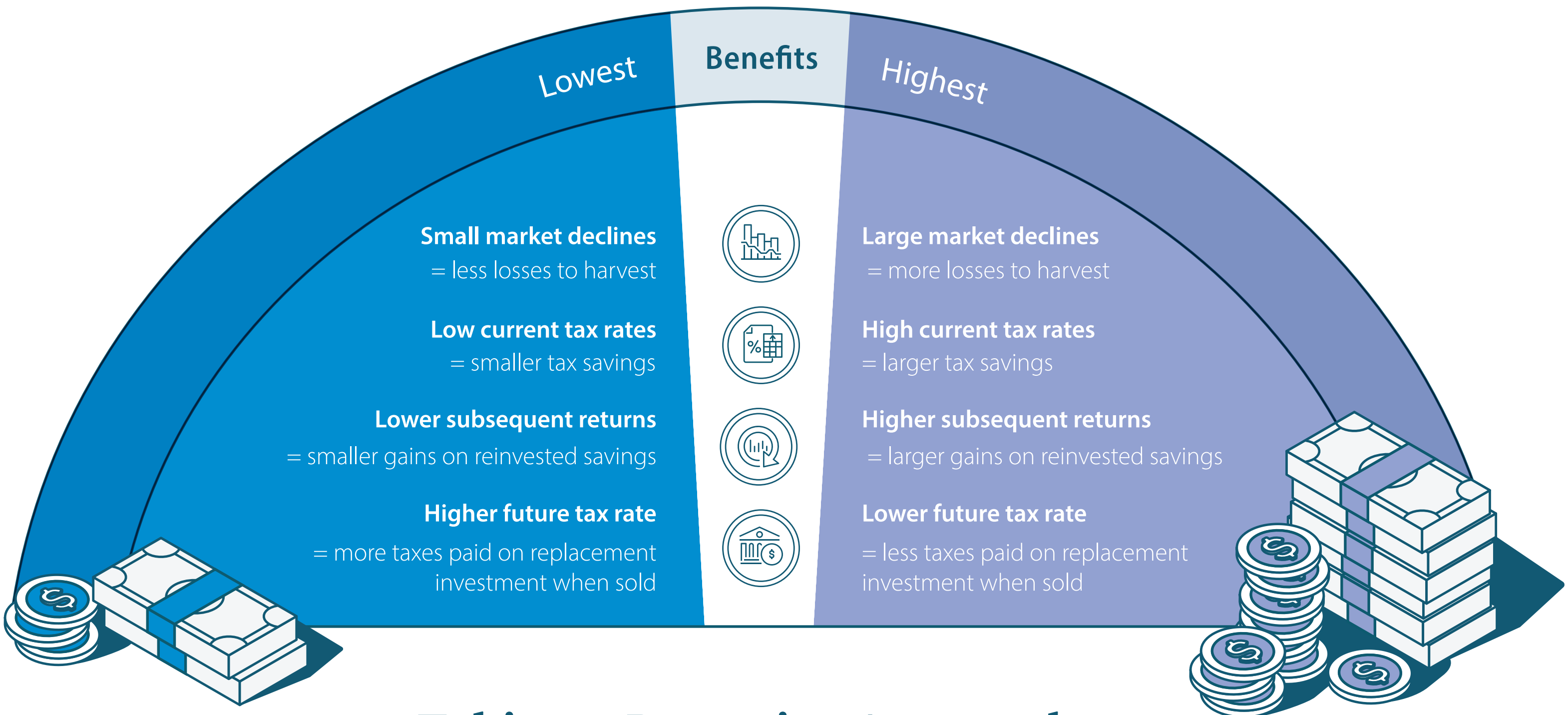
Maximizing the Tax-Loss Harvesting Opportunity

As you consider tax-loss harvesting, there are a few things you can keep in mind.

DO	DON'T
Use a taxable account	Buy the same or a substantially identical security within 30 days*
Harvest losses when you have gains to offset	Harvest losses if you expect your tax rate to go up substantially
Have a strategy for harvesting losses, such as when rebalancing a portfolio	React to every downturn in the market

* The IRS Wash Sale Rule states that if you purchase the same or a substantially identical security within 30 days of the original sale, your tax write-off from the sale is disallowed.

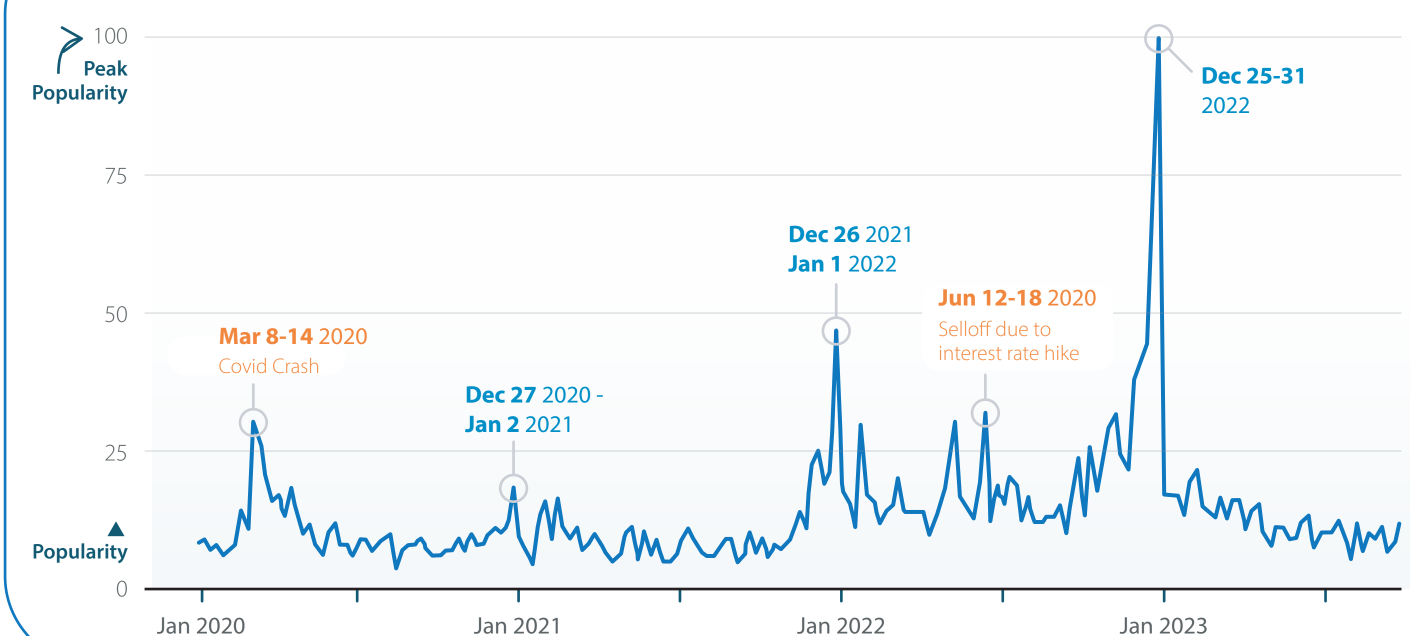
The benefits of tax-loss harvesting tend to be greater under certain conditions.



Taking a Proactive Approach

Public interest in tax-loss harvesting, as measured by Google Trends, typically peaks during market volatility or at the end of the year.

U.S. Google Search Interest in "Tax Loss Harvesting" Over Time

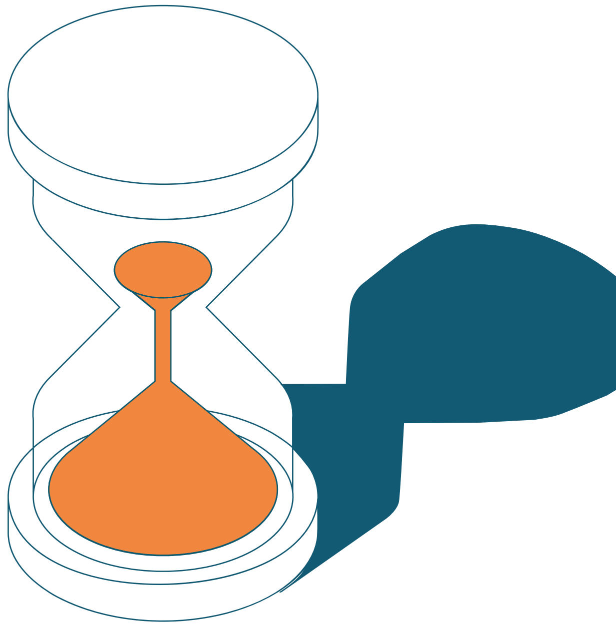


Source: Google Trends (Sep 2023), weekly data.

However, waiting until the end of the year can be problematic for 2 reasons:

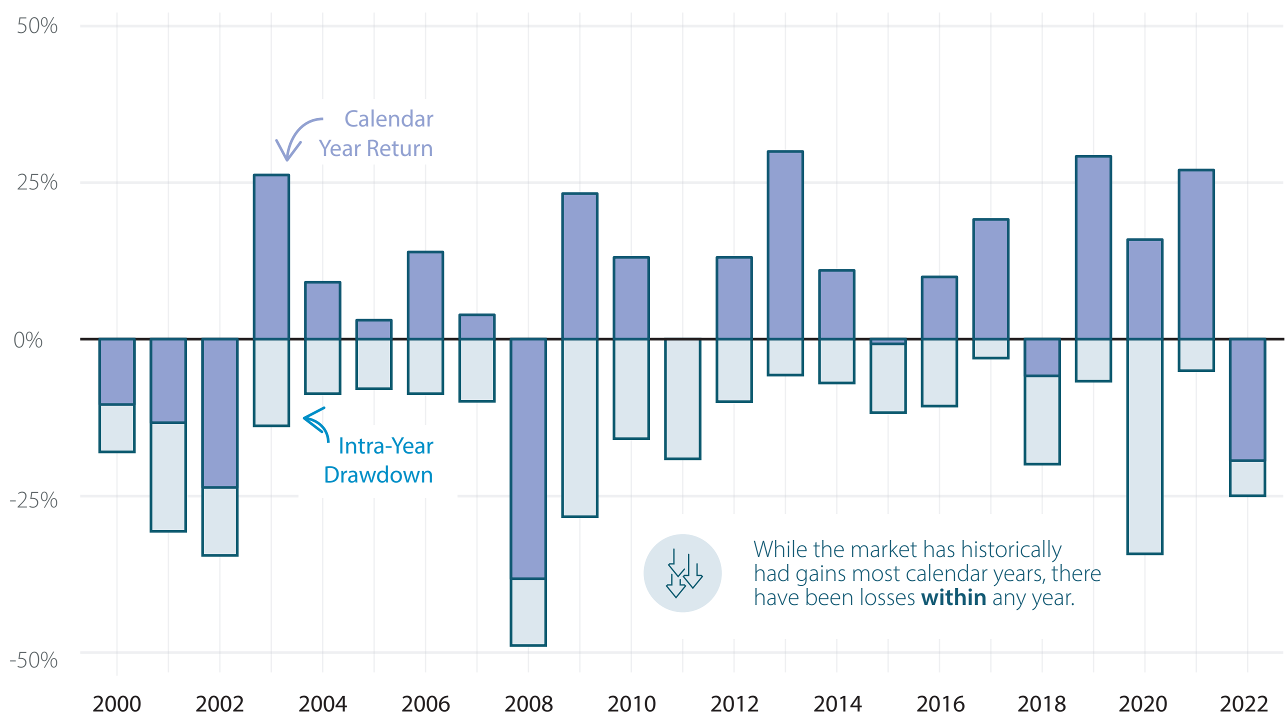
The deadline for tax-loss harvesting is December 31 of each year

There is typically a "Santa Claus Rally" where stocks gain value in December



Instead, investors can periodically look for tax-loss harvesting opportunities throughout the year, especially around periods of high volatility.

S&P 500 Returns and Intra-Year Drawdowns, 2000-2023



While the market has historically had gains most calendar years, there have been losses **within** any year.

Source: Macrotrends, Yahoo Finance, author calculations (Oct 2023). Price returns are shown. Intra-year drawdowns are calculated as the largest market drop in a year from a peak to a trough. Past performance is no guarantee of future results. An investment cannot be made directly into an index. Index definitions can be found at the end of this piece.

Investors who plan ahead can take advantage of these intra-year losses.

A Tool for Investors

By strategically harvesting investment losses, you can offset gains and lower your current tax bill. Not only that, you can reinvest the tax savings to grow your investment return potential.

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