



Tax Loss Harvesting

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Disclaimer: Mr. Bogle was not the source of any of the following material. He is, of course, the inspiration for Bogleheads and the Bogleheads Forum where I learned much about this

What is Tax Loss Harvesting (TLH)?

- A technique to get current tax benefits if current value of any investments is lower than what you paid for them
 - Meaningful only in taxable accounts, i.e. not for tax-sheltered accounts such as traditional or Roth IRA, 401k, etc.
- Key (Bogleheads) requirement: Your portfolio needs to remain at its target asset allocation after TLH
 - TLH is only icing on the cake – investment decision (particularly asset allocation/location) is the cake itself
 - *Don't let this tax tail wag the investment dog*

How do you do TLH:

- Sell one investment at a loss and immediately invest proceeds in a “similar but not substantially identical” asset
 - See Bogleheads Wiki (link on last slide) for examples of substitute funds
 - E.g. Ford Motor Company and General Motors shares
- Specific lot identification for sale of existing securities would be very helpful but not a requirement

Advantages

- Current year tax benefit:
 - This capital loss can be used to reduce capital gains realized elsewhere in the portfolio; **and after that,**
 - Any capital loss still remaining can be used to reduce \$3000 per year of ordinary income; **and after that,**
 - Any capital loss still remaining can be carried forward to future years and can be used to:
 - Reduce future capital gains **and**
 - Reduce up to \$3000/year of future ordinary income
 - Defers capital gains taxes to future (see also Disadvantages on next slide)
 - Future taxes arising from capital gains could end up being zero if:
 - If these new lower-basis investments get step-up in basis:
 - For the second-to-die of a married couple (100% step-up in a community property state such as CA, TX), or
 - If inherited by any non-spouse,
 - If donated to a charity
 - Allows portfolio to be rebalanced without associated tax cost
 - Allows portfolio to be simplified without associated tax cost
- Near-term (~2022/2023) investment decision opportunity if you've always wanted to do this but didn't want a tax hit**

Disadvantages

- Sets you up for higher capital gains taxes in future as your tax basis in investments has now decreased
- Locks you into the new security
 - Since you bought it at a “dip”, chances are its prices will be higher in future and you won't be able to exchange out of it without capital gains tax cost
- TLH can realistically be done primarily with more-recently purchased shares
 - As stock markets have been on an overall march upward over long periods, current prices are more likely to be higher than purchase price of shares bought a long time ago
- Total (current + future) tax cost after TLH could potentially be higher:
 - If tax rates go up in future **due to changes in tax law**. This is always an unknown so *can't/shouldn't plan for this*
 - If tax rates go up in future **due to your own future taxable income being higher**
 - If you are currently in a low/zero income tax state (e.g. WA), i.e. current tax benefit of TLH is low, and potentially **future to a higher income tax state** (e.g. CA), i.e. future tax cost is high as a result of TLH **move in**

Mutual Funds vs ETF/Individual Stocks: Process

- Mutual Funds:
 - Selling at loss and buying of similar security can be simultaneous as you can directly exchange, executed at 4 p.m. Eastern
- ETFs and Individual Stocks:
 - Slight lag between the two transactions:
 - First – sale of current investment, followed by
 - Second – use of unsettled funds to purchase “similar but not substantially identical” investment
 - Can execute the process during the trading day, without needing to wait till end of day
 - Incur transaction costs related to bid/ask spread

Key Considerations / Gotchas

- How frequently: once every few **years** may be sufficient (e.g. 2001, then 2008, then 2020, then 2022).
 - *Don't let this tax tail wag the investment dog*
- Gotchas:
 - 61-day wash sale rule:
 - can't buy the sold investment 30 days before or after sale, in any account you or a family member control (incl IRA/401k)
 - Not all is lost if you have a wash sale – you don't get current year tax benefit, but future capital gains tax cost can be lower
 - Watch out for automatic dividend reinvestment – *switch from automatic to manual if you can be more hands on*
 - Don't change investment philosophy – so *don't sit on cash for 31 days waiting to buy the same security again. Instead buy "similar but not substantially identical" right then*
- Tax gain harvesting is something very different:
 - Could be useful if you are currently (but only temporarily) in a lower capital gains tax and expect future rates to be higher
 - No wash sale rule if you realize gains

Other Considerations

◦ What about Direct Indexing?

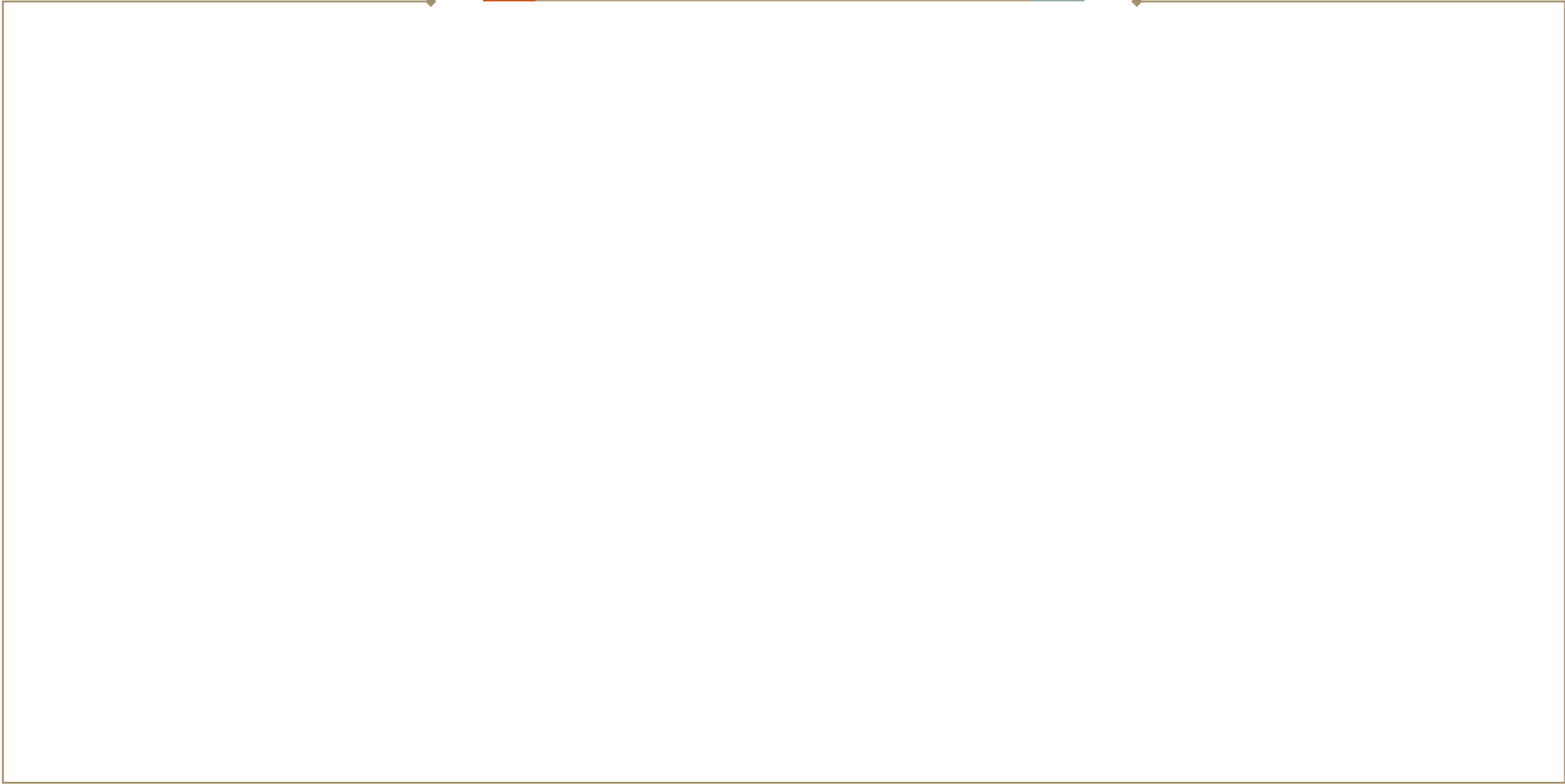
- Pros:
 - Individual stocks could provide more TLH opportunities (vs. index funds which may be less volatile)
- Cons:
 - Hotel California: Since basis in investment would be low after TLH, tax cost to exit portfolio could be high, unless another custodian/brokerage is willing to accept “in-kind” and manage your basket of stocks
 - Also, could you end up with a 500-page form 1099 every year (even if you don’t trade actively, there could be mergers, spin-offs, other tax events)? How do you file a tax return with this level of detail?
- *Don’t let the tax tail wag the investment dog*

◦ Betterment/Wealthfront:

- TLH is just icing on the cake – investment decision (particularly asset allocation/location) is the cake itself
- *Don’t let the tax tail wag the investment dog*

Resources

- Bogleheads Wiki: [Tax loss harvesting – Bogleheads](https://www.bogleheads.org/wiki/Tax_loss_harvesting) (https://www.bogleheads.org/wiki/Tax_loss_harvesting)



Vanguard Total Stock Market Index Fund (VTSAX) ☆

Nasdaq - Nasdaq Delayed Price. Currency in USD

99.08 **+1.57** **(+1.61%)**

At close: March 3 08:01PM EST

⊕ Indicators ⊕ Comparison ⚡ Events **V+** | 📅 Date Range 1M 3M 6M YTD 1Y 2Y 5Y **Max** | 📄 Interval 1W ▾ 📈 Line ▾ 📏 Draw ⚙️ Settings



Vanguard Total International Stock Index Fund Admiral Shares (VTIAX) ☆

Nasdaq - Nasdaq Delayed Price. Currency in USD

29.63 +0.35 (+1.20%)

At close: March 3 08:01PM EST

+ Indicators + Comparison ⚡ Events 📅 Date Range 1M 3M 6M YTD 1Y 2Y 5Y **Max** 📅 Interval 1W 📈 Line 🔗 Draw ⚙️ Settings



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