Is tax-loss harvesting the right choice for you?

It seems obvious that the goal of most investors is to earn positive returns. Therefore, it would seem counterintuitive to sell an investment for the express purpose of incurring a loss. However, because individual securities from time to time do experience price volatility, some investors do exactly this, applying a practice commonly called tax-loss harvesting.

What is tax-loss harvesting?

Tax-loss harvesting involves selling a security which has decreased in value from when it was purchased and, in doing so, incurring a capital loss.

A capital loss occurs when an investor sells an underlying asset at a price which is lower than the cost basis at which it was purchased. These losses may be valuable to investors because they can be used to offset tax liabilities that are caused by profits from the sale of other capital assets, dividends and a limited amount of ordinary income.

Capital losses can be carried forward by investors; if all of the capital losses incurred by an investor in the current tax year are not used, they may be able to be used in subsequent years. It is important for investors to work with investment and tax advisors as they consider how capital losses may affect their personal financial situation.

The cash raised by the sale of these below-cost-basis securities can then be used to buy another asset similar to the one just sold (similarity can be defined in several ways, including asset class, risk or geographic exposure). By taking this two-step approach, the investor can retain their original portfolio strategy while also realizing a capital loss, helping to offset capital gains and reduce taxes. A word of caution is necessary here. It is important when using this strategy to avoid triggering the "wash sale rules" which can limit an investor's ability to use the loss realized on the sale of an asset.

While tax loss harvesting may seem relatively complex, by working with your advisor you may be able to attain your goals more quickly because of the compound impact of reducing tax liabilities over time. Of course, as always, we recommend you consult with a tax professional regarding your unique financial situation as well.

The potential power of tax-loss harvesting

The following examples illustrate the potential power of tax-loss harvesting (assume that all assets have been held for at least one year):

Tax-loss harvesting generates capital losses to offset capital gains.

- In 2025, up to $3,000 of unused capital losses may be deducted against ordinary income.
- Unused capital losses may be carried forward to another tax year.

Example with tax-loss harvesting

Jane started the year with an investment portfolio valued at **$1 million**. During the course of the year, the financial markets experienced some short-term volatility and the value of her investment portfolio at one point had fallen by 10%, leaving her portfolio at a value of **$900,000**.

Jane's investment advisor helped her capitalize on this short-term volatility by selling the individual securities which had contributed to the $100,000 reduction in her portfolio value, thereby generating a **$100,000 long-term capital loss** for Jane. Further assume that Jane reinvested the proceeds from the sale in similar assets to those that had been sold and did not trigger the wash sale rules.

After Jane's advisor rebalanced her portfolio, the market rebounded and Jane's portfolio increased in value by 17%. Through the course of the rebound, Jane's advisor actively managed the portfolio — which generated **$50,000 in realized long-term capital gains** — and left her portfolio at the end of the year with a value of **$1.05 million.**

Bottom line

When it came time for Jane to file her tax return, she did not owe any capital gains tax on her portfolio because she was able to utilize $50,000 of her $100,000 long-term capital loss against her $50,000 capital gain. Jane also now has $50,000 in capital losses that she is able to carry forward for future use against capital gains or (to a limited extent) ordinary income.

Example *without* tax-loss harvesting

Like Jane, John also has an investment portfolio that started the year at **$1 million**, which subsequently lost 10% at one point in the year.

However, unlike Jane, John did not sell any of the securities that lost value in the course of the year, but did make changes to his portfolio as it recovered 17% throughout the remainder of the year. These changes resulted in **$50,000 of long-term capital gains** and left John's portfolio value at the end of the year at **$1.05 million**, just like Jane's portfolio.

Bottom line

When John prepared his tax return he owed $7,500 in capital gains taxes ($50,000 in capital gains multiplied by the 15% long-term capital gain tax rate assumed for purposes of this example).

Jane and John had similar results in how their portfolios declined and then regained value. Their portfolios ended with the same value, but since Jane's advisor proactively harvested losses during the year, her after-tax return on her portfolio was actually higher (5.0% for Jane versus 4.25% for John). She also created a future tax benefit in the form of the deferred capital loss.

The "wash sale rule" is an IRS regulation that prohibits investors from taking a tax deduction on losses incurred from selling an investment if they then purchase the same or a "substantially identical" investment either 30 days before or 30 days after selling the original asset. If a wash sale occurs, the investor cannot use the loss to offset any tax liabilities.

Is tax-loss harvesting right for you?

There are many technical considerations to take into account when utilizing a tax-loss harvesting strategy (including timing of asset sales, asset-class allocations and investment selections). By working with an advisor you can increase the likelihood of achieving your long-term goals by managing their tax liabilities in the context of your unique financial situation.

For more information, please contact your PNC Private Bank® advisor.