Bahl&Gaynor

Unlocking Potential Tax Benefits

Tax-Loss Harvesting

As we approach the end of 2Q 2022, the S&P 500 is officially in "bear market territory" defined as a price decline of 20% or more from recent highs.[1] Bond markets and other safe havens have suffered similar hardships leaving no place to hide. **While investment losses are painful, the ability to 'harvest' losses to offset capital gains and income taxes represents a small silver-lining.** A global pandemic, volatile monetary and fiscal policy, and geopolitical strain are the driving factors fostering current market conditions. These factors are largely unpredictable and certainly uncontrollable. We harp on the recurring theme: *control what you can control.* There are situations when tax-loss harvesting, among other strategic financial planning and investment management tactics, fits the bill.

The Opportunity

To put this strategy into context, applicability is limited to taxable investments such as individual or trust-owned brokerage accounts, for example. IRA's and other tax-deferred retirement savings vehicles are not eligible because tax is deferred until funds are distributed or withdrawn. 'Tax-loss harvesting' describes the strategic and sometimes systematic realization of investment losses to offset the effect of (taxable) realized investment gains. The realized gain or loss referenced is generally the difference between the purchase price and the sale price of the investment.

The Rules

The Internal Revenue Code outlines the rules and regulations. Here are the key takeaways:

Capital losses can be used to offset capital gains from the sale of a position in a broad range of asset classes and securities.

For example: a loss from the sale of shares of common stock can be used to offset capital gain from the sale of a bond ETF, a balanced mutual fund, real estate, etc.

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Ordering & Holding Period:

1. First, capital losses are used to offset capital gains of like-character.
   - 'Short-term': Gain/loss on the sale of investment property held 1 yr. or less.
   - 'Long-term': Gain/loss on the sale of investment property held more than 1 yr.
2. Second, remainder amounts of short/long-term capital gain or loss are balanced.
3. Third, excess capital losses (if any) can be used to offset ordinary income

Excess capital losses beyond total capital gains and $3,000 of ordinary income can be carried forward to offset gains and or income in future years.

1. Capital losses cannot be carried backward to offset prior gains.
2. Capital losses carry-over amounts expire at death.

Example:

Investor A purchased 50 shares of Procter & Gamble common stock at $115 per share ($5,750) in a taxable brokerage account in June of 2020. Investor A purchased 400 shares of the iShares Aggregate Bond ETF at $115 per share ($46,000) in the same brokerage account in June of 2021. If investor A wants to sell the shares for cash, at recent prices, the P&G stock ($140 per share) would have a capital gain of $1,250 and the bond ETF ($100 per share) would have a capital loss of $6,000. If all shares are sold, Investor A's capital loss can offset the capital gain from the sale of P&G stock eliminating tax exposure. Further, assuming no other capital gains are realized during the year, $3,000 of capital loss can be used to offset ordinary income and the remaining $1,750 can be carried forward into future years.

Considerations:

Don't let the tax 'tail' wag the investment 'dog'.

Be careful not to jeopardize long-term investment goals by selling out of positions solely for tax purposes. Consider both the investment and tax effects.

Wash-sale rules:

The IRS discourages abusive behavior by postponing the use of loss deductions if an investor purchases a "substantially identical" security within 30 days before or after the sale.[2] In other words, an investor must wait 31 days before buying back into the same or a substantially similar investment.

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An important wash-sale exception:

Under current tax law, cryptocurrencies such as Bitcoin and Ethereum are not regarded as "securities"[3]and therefore, the wash-sales rules mentioned above do not apply. If applicable, contact your CPA or tax professional for guidance on the viability of action. Consider both the investment and tax effects.

Take the low hanging fruit.

The Internal Revenue Code allows investors to shelter $3,000 of ordinary income (wages, interest, etc.) from tax. Where losses exist and investment-related effects are considered, taking advantage of at least a $3,000 loss has merit even if no capital gains are realized during the year. Consider both the investment and tax effects.

Bahl & Gaynor Financial Planners are acquainted with a variety of strategies to help you achieve your financial goals. While we can never control company valuations, together we can work to manage the variables to help protect your wealth and your future.

Planning is important to your overall financial success. Bahl & Gaynor is here to answer any questions you may have. Our financial planners stand ready to discuss customized strategies to grow and use your assets as your needs and situation demand. You can reach us at info@bahl-gaynor.com or by calling 513-287-6100.

[1]https://www.wsj.com/articles/bear-market-explained-11652973167
[2]https://www.irs.gov/pub/irs-pdf/p550.pdf[3]https://ir.aboutamazon.com/quarterly-results/default.aspx
[3]https://www.reuters.com/legal/transactional/are-cryptocurrencies-securities-sec-is-answering-question-2022-03-21/#:~:text=In%20 2018%2C%20Clayton%20clarified%20in,%22%20June%206%2C%202018).