MAKE LEMONS OUT OF LEMONADE
BY CAPITALIZING ON INVESTMENT LOSSES

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Pumpkins are usually the first image we conjure when thinking about autumn harvests. The fall can also be an opportune time to search for a potential harvest in your investment holdings.

Tax-loss harvesting is a practice in which investors sell stocks, bonds or mutual funds at a loss so that they can essentially cancel out gains elsewhere in their portfolios, or in the future, for tax purposes. There's plenty of wisdom in harvesting losses early in the year if the opportunity presents itself. But it's beneficial to consider harvesting as part of an annual fall review because investors typically have a good idea of how they've fared, in terms of gains or losses for the tax year, by this point.

How Does Harvesting Work? | Harvested losses can offset as many gains, for tax purposes, as investors can find in the same calendar year. If investors have more losses than gains, then they can carry their extra losses forward to subsequent calendar years, and apply up to $3,000 in losses per year to cancel out taxable gains or even ordinary income.

A word of caution: Tax-loss harvesting can present a tempting excuse to sell and forget about poorly performing parts of your investment portfolio. But a thoughtfully constructed investment strategy should have a long-term horizon, and can be expected to experience declines from time to time.

Investors should think of harvesting as a temporary pause in their investment strategies, and it's important to re-invest with a sense of urgency. You can actually re-invest immediately after harvesting, but take care to avoid triggering the "*wash-sale rule*." Harvested losses can be disqualified if an investor sells, and then re-purchases within 30 days, the same or a substantially identical investment. This means you're not allowed to repurchase the exact same company stock or a different mutual fund with the exact same portfolio inside of the 30-day window. However, there are plenty of funds pursuing very similar strategies that would not be considered substantially identical.

Combine Harvesting with a Conversion | Harvesting only applies to taxable brokerage accounts, and can't be used in IRAs. One of the greatest advantages of saving in an IRA is that there are no taxes on the growth of your portfolio, whether via capital gains or income from dividends or bond payouts. As a result, there are also no losses to harvest for tax-offsetting purposes.

On the other hand, the proceeds from harvested losses in your taxable account could potentially serve as a smart source of funding for IRA contributions. In fact, the lower value after losses would create a great opportunity to consider a Roth conversion.

Converting a Traditional or Rollover IRA to a Roth IRA triggers a lot of upfront taxes because the IRS considers the entire converted amount to be income in your current calendar year. It stands to reason, then, that you can considerably lower the income taxes associated with a Roth conversion by doing so after a downturn in the value of your investments. A lower value on your Traditional or Rollover IRA account means lower income taxes at conversion.

Convert Without the Harvest | You might have noticed that the potentially tremendous benefit to converting an IRA is not really dependent on tax-loss harvesting. Savers are always allowed to convert Traditional or Rollover IRAs into Roth IRAs; usually, the key point of consideration is whether you want to pay taxes at withdrawal in retirement or upon contribution. Traditional IRAs delay taxation until retirement since contributions are tax deductible when made; similarly, Rollover IRAs funded with 401(k) contributions, typically are made on a pre-tax basis. Roth IRA contributions are made on an after-tax basis, so retirees have already satisfied their tax obligation and don't need to worry about the implications of their withdrawals.

The overarching principle at work in converting to Roth assets after losses is that it's better to pay taxes on a smaller sum than a larger one. This can alter the usual retirement-planning calculation about whether to pay taxes on contributions today or withdrawals as a retiree.

Optimizing the value of your investment assets can involve just one of these steps or all of them. Tax and investment professionals can help weigh all of the aspects in determining which path best suits your particular situation.

For more information, please call **407.585.1160**