Tax Loss Harvesting: Turning Lemons into Oranges

Joe Delaney

Have you ever heard of a Meyer lemon? Much sweeter than regular lemons, this tasty fruit is generally available from December through May.

While that piece of information may be nice to know, what does the Meyer lemon have to do with investing? More, it turns out, than just its availability during tax season.

We've all heard the expression, "When life gives you lemons, make lemonade." One of the most fitting uses of this adage in the world of investing is when it's applied to the topic of tax loss harvesting. Tax loss harvesting (the "lemonade") may be the one bright side of experiencing a significant loss in stock value (the "lemon"). Should that occur, you have an opportunity to "realize" the loss, sell off the stock and report the difference from the purchase price to offset future capital gains. You can then reinvest the recovered funds to keep your portfolio balanced.

Pursuing these opportunities can become a great benefit come tax season, if done correctly. You must keep a number of factors in mind to maximize the benefits on your return while remaining cognizant of your portfolio's overall health.

These include, but are not limited to:

- **Income Threshold** – There are limitations to how much of a loss (or losses, because looking out for chances to tax loss harvest should be a year-round occupation) you can use to reduce taxable income.
- **Administrative Cost** – It makes sense to harvest the tax loss only if the benefit in tax savings outweighs the administrative costs of the transaction.
- **IRS Regulations** – The reinvestment of remaining stock value may be made in a similar asset to keep your market exposure (degree of risk) relatively constant, but the asset must not be considered "substantially identical" to avoid the IRS "wash-sale" rule. The wash-sale rule applies to the 30 days before and after the sale.
- **Long Term versus Short Term** – Tax losses in taxable accounts can be more valuable when they are short-term. Why? Short-term losses are first deducted against short-term gains, which would otherwise be taxed at the higher ordinary income tax rates. Long-term losses are first deducted against long-term gains, which would otherwise be taxed at the lower capital gains rate.

The whole process is a bit like pruning a tree. You need to know when to prune, how much and where to ensure the overall health of the tree. If you don't follow the rules, you'll wind up hurting more than you're helping. That's why it's important to consult your financial advisor and tax professional before implementing a tax loss harvesting strategy. Any orchardist will take advantage of the opportunity provided by a sour lemon harvest to make lemonade, but lemonade is still a

What if, next year, we did even better and turned our lemons into oranges instead?

This isn't unheard of in nature. The Meyer lemon is actually a cross between a lemon and an orange. They appear smaller, rounder and more orange in color. In other words, they are, somewhere along the evolutionary line, lemons turned oranges. You can't expect to plant a lemon tree and get oranges from it in a single season, but with the help of an experienced financial advisor to guide you through the tax loss harvesting process, you can use the resources you've gleaned this year to get a sweeter fruit in the next.

About Joe Delaney, Managing Director, Lifeguard Wealth, San Rafael, CA

Joe Delaney founded Lifeguard Wealth to help others realize their goals and dreams. As a fee-only financial advisor, he is dedicated to putting clients first. Joe has more than 30 years of financial-industry experience as a CPA and CFO; he has held senior positions with institutional investment and wealth management firms. Since 2001, he has focused his career on creating and executing wealth management strategies for individuals and families. He is licensed to provide investment advisory services, and he holds a BA in economics from Stanford University and an MBA in finance from UCLA Anderson.

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