

MAKING TIME TO HARVEST TAX LOSSES

Harvesting your investments can help reduce taxes on capital gains.

While investment losses are never easy, there is one distinct advantage to selling at a low point – applying this tax loss against investment gains and regular income on your tax return. The process is known as tax-loss harvesting, the selling of stocks, bonds, mutual funds and other investments that have lost value to potentially help reduce taxes on capital gains realized from more prosperous investments.

Judiciously pruning your portfolio can be helpful for any investor, but especially so for those who fall in the top federal income tax bracket and are subject to the long-term capital gains being taxed at 20%, and those subject to the 3.8% Medicare tax on unearned (portfolio) income. Harvesting underperforming investments can free up money to purchase securities that have greater potential and could improve your portfolio's overall performance.

And there's no better time to tackle this than at year-end, ahead of tax season, when a realized tax loss can be applied against investment gains and, in some cases, regular income on your tax return.

START BY THINKING SHORT-TERM

Generally, investors aim for the long-term, but because short-term gains are taxed at a higher rate, it makes sense to analyze those first when deciding what to trim from your portfolio before tax season.

The tax code specifies that short- and long-term losses must be used first to offset gains of the same type. However, if your losses of one type exceed gains of the same type, you can apply any excess to the other. In other words, if you have \$15,000 in short-term capital gains, \$5,000 in long-term capital gains and \$20,000 in long-term losses, you can use the \$15,000 difference to offset your short-term capital gains. Using long-term losses to offset short-term gains can be very beneficial, as short-term gains are taxed at higher rates than long-term gains.

Remember that it can be valuable to realize a capital loss even if you don't expect to have short- or long-term gains this year. Up to \$3,000 a year in net capital losses can be used to reduce ordinary income, including that from nonqualified dividends. Any capital losses you still have after applying them to capital gains and ordinary income can be carried forward and used in future years.

	SHORT-TERM	LONG-TERM
▲ Gains	\$15,000	\$5,000
▼ Losses		(\$20,000)
Net	\$15,000	(\$15,000)

TIME FOR ADJUSTMENTS

Many investors may be sitting on large potential gains after six-plus years of rising stock prices – and many may also have seen their intended portfolio mix stray from their original plan. A portfolio meant to contain a 60/40 weighting of stocks to bonds might now be at 70/30 because of stock price appreciation. Rebalancing your portfolio to bring it back in line with your original allocation will probably mean taking some profits, but taking losses at the same time can help to reduce your overall gains.

When you're considering which losses to harvest, remember that the long-term investment strategy you and your advisor have decided on should remain intact afterward. It's also important not to be sentimental about your choices. If you can't make a convincing case

for owning a stock, you may want to sell it (even if you don't anticipate any capital gains to offset the loss) and look for opportunities to invest in something that may better suit your needs and goals.



A NOTE ABOUT WASH SALES

Selling a security at a loss and purchasing another “substantially identical” security – within 30 days before or after the sale date – triggers what the IRS considers a “wash sale,” an action that disallows the loss deduction. The IRS looks at all of your accounts to determine whether a wash sale has occurred, so selling the stock at a loss in a taxable account and buying it within that 61-day window in your 401(k) or IRA isn't a viable option.

SALE DATE



TAX-LOSS HARVESTING DOS AND DON'TS

DO

Try to sell depreciated investments that don't fit your financial plan.

...

Only sell an investment after researching your records and cost basis carefully.

DON'T

Undermine your long-term investing goals for tax purposes.

...

Buy a substantially identical security within 30 days before or after the sale.

Source: Fidelity

REAP THE BENEFITS

Successful tax planning is a year-round activity, and tax-loss harvesting is an important part. But remember, it's just one part of a comprehensive financial strategy. Tax planning should complement, not undermine, a diversified financial plan. It's a good idea to make decisions in conjunction with your tax and financial advisor.

Please note, changes in tax laws may occur at any time and could have a substantial impact upon each person's situation. While we are familiar with the tax provisions of the issues presented herein, we are not qualified to render advice on tax or legal matters. You should discuss tax or legal matters with the appropriate professional.

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