Tax-Loss Harvesting

LAIRD NORTON TYEE

Sam wants to sell Stock A, with a basis of $10,000, for $100,000. It is a concentrated position, out of place in his portfolio. His tax at 15% on the $90,000 gain is $13,500. After tax, Sam has $86,500.

Step 1:

- Recognize the gain, but offset that gain with a loss on another security, Stock B, worth $10,000, that has a tax basis of $100,000.
- The $90,000 loss on B offsets the $90,000 gain on Stock A. After eliminating the gain, the tax is zero and Sam has $110,000.

Step 2:

- Replace Stock B with similar security, Stock C, cost $10,000.
- Now, Sam has $100,000 and has maintained the stock mix in his account. He has $13,500 more than if he only sold Stock A and he has maintained his stock mix.

Option 1: Sell stock A at a gain and pay tax.

Sell Stock A

	Tax	Cash
Sale Proceeds	100,000	100,000
Tax Basis	(10,000)	
Gain	90,000	
Tax @ 15%	13,500	(13,500)
After-Tax Cash		86,500

Option 2: Sell the stock with the gain but "harvest" the loss on another stock to eliminate the tax.

Sell Stock A

	Tax	Cash
Sale Proceeds	100,000	100,000
Tax Basis	(10,000)	
Gain	90,000	
Offset with Stock B Loss	(90,000)	
Remaining Gain	0	
Tax @ 15%	0%	
After-Tax Cash - Stock A		10,000
After-Tax Cash - Stock B		110,000
Total After-Tax Cash		

Sell Stock B

	Tax	Cash
Sale Proceeds	10,000	10,000
Tax Basis	(100,000)	
Loss	90,000	
Tax @ 15%	0%	
After-Tax Cash		10,000

But Sam is not done yet. It is important to replace stock B with a similar security to maintain your asset allocation. Sam would purchase $10,000 worth of stock C.

The above examples are intended to demonstrate hypothetical, mathematical calculations based on assumptions of tax rates and investment returns that may or may not be realized. These illustrations are designed as examples of the strategies presented and not as actual results that may be achieved in any particular managed investment account.

Personal Worksheet

LAIRD NORTON TYEE

Use this worksheet to evaluate your benefit from tax-lost harvesting.

Step 1: • Recognize the gain in stock A.

Step 2: • Sell stock B at a lost and offset the gain from stock A.

Step 3: • Replace stock B with similar security.

Option 1: Sell stock A at a gain and pay tax.

Sell Stock A	Tax	Cash
Sale Proceeds		
Tax Basis		
Gain		
Tax @ 15%		
After-Tax Cash		

Option 2: Sell the stock with the gain but "harvest" the loss on another stock to eliminate the tax.

Sell Stock A	Tax	Cash
Sale Proceeds		
Tax Basis		
Gain		
Offset with Stock B Loss		
Remaining Gain		
Tax @ 15%		
After-Tax Cash - Stock A		
After-Tax Cash - Stock B		
Total After-Tax Cash		

Sell Stock B	Tax	Cash
Sale Proceeds		
Tax Basis		
Loss		
Tax @ 15%		
After-Tax Cash		

But you are not done yet. It is important to replace stock B with a similar security to maintain your asset allocation. You would purchase $10,000 worth of stock C.

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Capital Gain Assessment

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Sell or Hold?

Alex has securities worth $1,000,000 that have an unrealized gain of $500,000. He plans to sell them in three years to purchase a house. The securities grow at 10% per year. Alex expects the capital gain rate to increase to 20% next year.

Sell and pay the tax:

- After paying $75,000 of tax (15%) on his current gain, Alex has $925,000. After reinvesting that for three years at 10% growth, he'll have $1,231,175. Assuming that he pays tax at 20% on the $306,175 increase in value, he'll have $1,169,940 to use for the house purchase.

Hold:

- Alex's $1,000,000 would grow to $ 1,331,000 in three years at 10%. After paying tax at 20% on the total appreciation of $ 831,000, he'll have $1,164,800.

Answer - Sell Now

Sell or Hold?

- *What if Alex thought the capital gains tax would be at 20% but he was going to hold for four years instead of three?*

Sell and pay the tax:

- After paying $75,000 of tax (15%) on his current gain, Alex has $925,000. After reinvesting that for 4 years at 10%, his funds would grow to $1,354,293. After paying tax at 20% on this gain of $429,293, he'll have $1,268,434.

Hold:

- Alex's $1,000,000 would grow to $ 1,464,100 in three years at 10%. After paying tax at 20% on total appreciation of $ 964,100, he'll have $1,271,280.

Answer - Hold

Sell or Hold?

- *What if Alex thought the tax rate would increase to 28% in 2010?*

Sell and pay the tax:

- After paying $75,000 of tax (15%) on his current gain, Alex has $925,000. That $925,000 grows to $1,354,293 in four years at 10%. After paying tax at 28%, he'll have $1,234,091.

Hold:

- Alex's $1,000,000 would grow to $ 1,464,100 in four years at 10%. After paying 28% tax on the appreciation of $964,100, he'll have $1,194,152.

Answer - Hold

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