

WHAT IS TAX LOSS HARVESTING?

Michael Barrer — Director of Capital Markets
10/19/2021

All references to tax matters or information provided on this site are for illustrative purposes only and should not be considered tax advice and cannot be used for the purpose of avoiding tax penalties. Investors seeking tax advice should consult an independent tax advisor.

How an Investment Loss Can Become a Tax Win

Did you know that you can use an investment loss to help you improve your tax situation? It's true. Through a strategy called tax-loss harvesting, you may be able to use your loss to your advantage.

It's a fairly simple idea. By selling the investment, you can realize or "harvest" the loss and use it to offset your capital gains, reduce your taxable income, and maybe even improve your portfolio returns.

Using Your Loss to Offset Gains

Every time you sell an investment for more than you paid for it, you create a capital gain. And as you probably know, the government likes to tax those. Generally speaking, the amount of the tax will depend on your tax bracket and how long you've held the investment.

And you may not realize it, but some investments can create capital gains even when you don't sell them. These gains are generated by the manager's trading or from the actions of other shareholders. When this happens, you might owe capital gains taxes on fund shares that you haven't sold.

Capital Gains Overview

Timeframe	Type of tax	Amount of tax
Asset held for less than a year	Short-term capital gains	10-37% (same as your income tax bracket)
Asset held for more than a year	Long-term capital gains	0%, 15% or 20% (depending on your taxable income and filing status)

But what if you have something in your portfolio, like a stock or a fund, that has lost value during the year? If you decide to use tax-loss harvesting, you would sell this investment and take the "loss". The loss offsets your portfolio's short- or long-term capital gains, lowering the amount you will be taxed on. And, of course, you have the option of reinvesting the cash from the sale in some other way.

How a Loss Can Reduce Ordinary Taxable Income

If your losses are more than enough to offset your capital gains, you may also be able to use them to reduce your ordinary taxable income by as much as \$3,000. Let's take a look at how that could work.

Imagine you invested \$20,000 at the beginning of the year in security X. But toward the end of the year, security X is down by 10% and is worth \$18,000. What can you do?

First, you could just hold on to the security. Second, you could sell the security, take the \$2,000 loss, deduct that loss from your taxable income, and pocket the remaining cash. Third, you could sell the security, take the loss and the deduction, while reinvesting your proceeds in a different security.

Here's a breakdown of the potential outcomes of these three options if you're in the 37% tax bracket:

Hold, Sell, or Sell-And-Reinvest?

Option	Hold Security X	Sell Security X	Sell Security X and Buy Security Z
Potential tax savings	\$0	\$740 (\$2000 offset at 37% tax rate)	\$740 (\$2000 offset at 37% tax rate)
Potential return	-10%	-6.3% (the loss is offset by the tax savings)	-6.3% (the loss is offset by the tax savings)
Market exposure	Position stays the same	None	Still invested in the market
Potential benefit	Can benefit if security X rises	Tax advantage	Tax advantage and can benefit if security Z rises

What Is the Wash-Sale Rule?

With tax-loss harvesting, there's a key rule you should be aware of: the "wash-sale rule." This IRS regulation says you cannot buy an investment that is "substantially identical" to the one you've sold within 30 days of the sale or you risk losing the ability to claim the loss and any tax benefits that came with it.

It's worth noting that ETFs are not currently considered substantially identical to mutual funds. You may be able to use this fact to maintain your investment exposure, while still capturing losses for tax purposes.

The bottom line is that tax-loss harvesting can help you manage your investment losses.

Important Risks Related to this Article

Neither WisdomTree Investments, Inc. nor its affiliates, nor Foreside Fund Services, LLC., or its affiliates provide tax advice. All references to tax matters or information provided on this site are for illustrative purposes only and should not be considered tax advice and cannot be used for the purpose of avoiding tax penalties. Investors seeking tax advice should consult an independent tax advisor.

Investing involves risk including possible loss of principal.

Investors should carefully consider the investment objectives, risks, charges and expenses of the Funds before investing. U.S. investors only: To obtain a prospectus containing this and other important information, please call 866.909.9473, or go to wisdomtre.com. Read the prospectus carefully before you invest.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our [Economic & Market Outlook](#)

View the online version of this article [here](#).

IMPORTANT INFORMATION

U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.