TAKING ADVANTAGE OF TAX LOSS HARVESTING WITH ETFS

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For financial advisors, this is the time of the year to talk taxes with their clients, especially if they have capital gains. Investors may be unaware that their mutual funds can have capital gains—even when the market is down. In fact, even when a mutual fund's NAV is down, it may have had capital gains from the sale of a security (ETFs can have capital gains too; it's just far less frequent due to their tax efficiency). And with capital gains come capital gains taxes. One effective way to potentially reduce capital gains taxes (and potentially even ordinary income taxes) is tax loss harvesting. **Tax loss harvesting** This practice enables investors to sell an investment that is down to create a capital loss that offsets the gains in another investment. Doing so can help you reduce, or eliminate, the capital gains taxes. Some investors even use this practice to help reduce ordinary income taxes in a year without capital gains (for this purpose, you can only claim a loss of up to $3,000 per year). Of course, in order to meet long-term goals, it's best to remain invested, so what's an investor to do? Often, after selling the "losing" investment, investors desire simply to buy it—or something similar—back at the lower cost. But this is where the 30-day wash-sale rule comes in. **The 30-Day Wash-Sale Rule** The rule basically states that if an investor buys a "substantially identical" investment within 30 days of the sale of another investment, it essentially cancels out that earlier sale. In other words, they won't receive the tax benefit they had hoped for. This is where ETFs can be extremely helpful. Not only are ETFs created and managed in a way that makes it easier to manage capital gains taxes within them, but the IRS also does not yet (and perhaps never will) consider them "substantially identical" to mutual funds. **Strategies for Tax Loss Harvesting** Here are some ways investors could implement a tax loss harvesting strategy. • **Strategy 1:** Sell security B to offset gains in security A. Buy an ETF with exposure to the sector or industry that security B is in. On day 31, you can sell the ETF and reinvest in security B, or you can keep holding the ETF for the long term. • **Strategy 2:** Sell mutual fund D to offset gains in mutual fund C. Buy an ETF with a similar objective to mutual fund D. On day 31, you can sell the ETF and reinvest in mutual fund D, or you can keep holding the ETF for the long term. • **Strategy 3:** Find ETF alternatives for all your mutual fund holdings. As ETFs tend to be more tax efficient (they do not need to sell securities for redemptions and are able to use in-kind distributions, so they tend to have capital gains far less frequently), they may be a wise move for the long-term health of your portfolio. 'Tis the Season—for Considering Tax Efficiency of Investment Vehicles

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Some mutual funds have an objective of tax efficiency.

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Capital gains : Positive difference between the sale price of an asset and the original purchase price.

Net Asset Value (NAV) : The calculated assets minus liabilities divided by shares outstanding. NAV is the straightforward account of the actual assets in the fun.

Tax Loss Harvesting : Selling securities at a loss to offset a capital gains tax liability. Tax gain/loss harvesting is typically used to limit the recognition of short-term capital gains, which are normally taxed at higher federal income tax rates than long-term capital gains.