

# ETFs: A Smart Choice for Tax-Loss Harvesting

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## What Is It?

Tax-loss harvesting involves selling a security at a loss and purchasing another security with a similar investment profile. This strategy enables an investor to maintain the portfolio's positions relatively unchanged while deducting the loss from any gains for that year. The losing security can be repurchased 30 days after the sale, resulting in a reduced tax basis. Essentially, the strategy enables individuals to minimize the tax impact on their investment portfolios. Moreover, it can be employed to decrease ordinary income taxes in a year without capital gains, limited to a loss of \$3,000. Tax-loss harvesting is a prudent strategy to minimize the tax impact on your bottom line. More than mutual funds and stocks, ETFs tend to be more cost-effective for tax-loss harvesting thanks to their lower fees and infrequent capital gains distributions.

## Why ETFs?

ETFs facilitate tax-loss harvesting by enabling investors to comply with the Securities and Exchange Commission's (SEC) "wash-sale" rule, which prohibits the repurchase of an identical or substantially similar security within 30 days of selling it at a loss. ETFs, comprising diversified portfolios, offer greater ease in finding identical tracking objectives, such as large-cap or tech-only stocks, while adhering to different underlying indexes to avoid breaching the SEC rule.

## Applying a Tax-Loss Harvesting Strategy

Let's assume Investor A just sold 500 shares of a food and beverage company. Investor A chooses to put the post-sale cash into a broader food and beverage sector-focused ETF. In doing so, Investor A avoids the wash-sale rule without compromising the portfolio's original investment thesis and diversification.

## What If You Sell at a Profit Instead of a Loss, as Shown Above?

Now, if an investor happens to receive capital gain distributions from an ETF or, simply put, sells the securities at a profit, [a handy tool on WisdomTree's website estimates capital gains for U.S. ETFs](#). Since short-term capital gains, long-term capital gains and ordinary income are all taxed differently, the tool provides an estimate of how all three will look. Of course, none of this is investment advice, and investors should ultimately consult a tax advisor for the best understanding.

## Bottom Line

Enhancing the bottom line involves more than solely capital gains. A discerning and efficient investor places great emphasis on using all available resources, including tax-loss harvesting. Tax-loss harvesting serves as a tax-engineering tool to mitigate both short-term and long-term tax liabilities. However, it is important to note that it may result in tax deferral at a later period instead of an immediate tax break. This approach carries the risk of higher taxes in the future. Nonetheless, we believe it remains a wise method to reduce the tax burden on your finances and improve your bottom line.

For more insights, visit our [ETF Education page](#).

## **Important Risks Related to this Article**

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