

Tax Loss Harvesting (TLH)

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Feb 10th, 2020

“Capital loss is valuable”

Hypothetical Trade

1. Bought shares of FXI in your “taxable” account on Jan 3rd at ~ \$44 per share (**primary**)
2. A month later, the ETF lost ~10% of value after the coronavirus outbreak
3. Harvest the loss (\$4 per share) and reinvest the proceeds in **similar but not substantially identical** ETF (**replacement**)
4. No sooner than 31 days, sell the replacement ETF and return to the primary ETF



The “round-trip” generates capital loss to report on your taxes without altering your asset allocation

What is Tax Loss Harvesting (aka TLH)?

*“TLH is a practice that allows investors to partially reduce, or entirely eliminate, accrued tax liabilities by selling securities **[taxable account]** that have depreciated in value, thereby netting out **[or postpone ¹]** realized losses from gains on their taxes.”*

¹ If you cannot realize full benefit in current year, you can move your losses to future years via tax-loss carryforward (\$3000/yr)

Benefits of Tax Loss Harvesting

- Offsetting realized gains
- Deduct \$3000 from regular income tax
- Until all losses are used up, they are rolled over into subsequent years
- TLH defers taxes in the future
- Heirs will receive a stepped-up basis

TLH Example 1: Year End TLH

	Trade date	Symbol	Name	Transaction type	Price	TLH
Replacement	12/26/2018	VTI	VANGUARD IX FUN/VANGUARD TOTAL STK	Buy	\$41.73	
TLH	12/26/2018	VGK	Vanguard FTSE Europe ETF	Sell	\$47.80	-13%
	12/26/2018	VDE	Vanguard Energy ETF	Sell	\$76.14	-26%
	12/26/2018	VIOO	VANGUARD ADMIRA/S&P SMALLCAP 600 IX	Sell	\$122.83	-21%
	12/26/2018	VOOG	VANGUARD ADMIRA/S&P 500 GR IX FD ET	Sell	\$131.14	-13%
Original	05/08/2017	VGK	Vanguard FTSE Europe ETF	Buy	\$55.05	
	01/31/2018	VDE	Vanguard Energy ETF	Buy	\$102.27	
	07/12/2018	VIOO	VANGUARD ADMIRA/S&P SMALLCAP 600 IX	Buy	\$156.26	
	11/08/2018	VOOG	VANGUARD ADMIRA/S&P 500 GR IX FD ET	Buy	\$151.43	

TLH Example 2: Round-trip

	Trade date	Symbol	Name	Transaction type	Price	TLH
Round Trip to original	09/20/2019	VWO	VANGUARD FTSE EMERGING MARKETS ETF	Buy	\$41.73	
	09/20/2019	EEM	ISHARES MSCI EMERGING MARKETS ETF	Sell	\$41.80	7%
Replacement	08/05/2019	EEM	ISHARES MSCI EMERGING MARKETS ETF	Buy	\$39.08	
TLH	08/05/2019	VWO	VANGUARD FTSE EMERGING MARKETS ETF	Sell	\$39.24	-10%
Original	05/07/2019	VWO	VANGUARD FTSE EMERGING MARKETS ETF	Buy	\$42.05	-4%
	05/03/2019	VWO	VANGUARD FTSE EMERGING MARKETS ETF	Buy	\$43.74	

TLH Example 3: Multiple Round-trips

	Trade date	Symbol	Name	Transaction type	Price	TLH
Replacement	02/11/2016	VEU	VANGUARD FTSE ALL WORLD EX US ETF	Buy	\$38.24	
TLH	02/11/2016	VXUS	VANGUARD TOTAL INTL STOCK INDEX FUND ETF	Sell	\$39.73	-7%
Replacement	01/07/2016	VXUS	VANGUARD TOTAL INTL STOCK INDEX FUND ETF	Buy	\$42.60	
TLH	01/07/2016	VEU	VANGUARD FTSE ALL WORLD EX US ETF	Sell	\$41.23	-6%
Replacement	11/13/2015	VEU	VANGUARD FTSE ALL WORLD EX US ETF	Buy	\$44.08	
TLH	11/13/2015	VXUS	VANGUARD TOTAL INTL STOCK INDEX FUND ETF	Sell	\$45.67	-4%
Original	10/30/2015	VXUS	VANGUARD TOTAL INTL STOCK INDEX FUND ETF	Buy	\$47.34	

TLH Example 4 - Tax efficient allocation

	Trade date	Symbol	Name	Transaction type	Price	TLH
Round Trip	10/30/2015	VXUS	VANGUARD TOTAL INTL STOCK INDEX FUND ETF	Buy	\$47.34	
	10/30/2015	Cash	Money Market Fund	Sell		
	10/30/2015	VBTLX	VANGUARD TOTAL BOND MARKET INDEX ADMIRAL CL	Buy (exchange)	\$10.76	
	10/30/2015	VWILX	VANGUARD INTL GROWTH ADMIRAL CL	Sell (exchange)	\$69.48	10%
Replacement (IRA)	09/25/2015	VBTLX	VANGUARD TOTAL BOND MARKET INDEX ADMIRAL CL	Sell (exchange)	\$10.75	
	09/25/2015	VWILX	VANGUARD INTL GROWTH ADMIRAL CL	Buy (exchange)	\$63.30	
TLH	09/25/2015	Cash	Money Market Fund	Buy		
	09/25/2015	VXUS	VANGUARD TOTAL INTL STOCK INDEX FUND ETF	Sell	\$44.16	-5%
Original	08/21/2015	VXUS	VANGUARD TOTAL INTL STOCK INDEX FUND ETF	Buy	\$46.39	

Before you TLH - Things to consider / nuances

Applies to taxable accounts only. Replacement fund can be bought in taxable or tax-sheltered

Replacement fund cannot be substantially identical (to avoid wash sale). ¹

- if a security is simply a different share class of the same fund they clearly are substantially identical
- if they follow the very same index they may or may not be (swapping one fund family's S&P 500 fund for another family's, for example, might be an ambiguous case), and
- if they follow different indices or are actively managed they probably aren't

Simple “rule-of-thumb”

- Any two active funds
- Any active fund with an index fund
- Any two index funds tracking different indexes

Example

- VTI can be replaced with SPY, VV or VOO
- VWO can be replaced with SCHE, or EEM
- VDE can be replaced with XLE

¹ Boglehead Forum <https://www.bogleheads.org/forum/viewtopic.php?t=172178>

Finer points / Caveats

- | | | |
|----------|--|---|
| 1 | Delay in reinvesting / waiting on the sidelines | <ul style="list-style-type: none">● Compromise your asset allocation.● Uninvested cash may offset benefits of TLH |
| 2 | “Bad” replacement fund choice or reallocate to an entirely different asset class | <ul style="list-style-type: none">● “throws -off” desired asset allocation● Stuck with an undesired fund / asset class |
| 3 | Round-trip to original fund | <ul style="list-style-type: none">● Switching back can trigger Short Term gains when selling the replacement fund |
| 4 | Dividend reinvestment / Capital Gains | <ul style="list-style-type: none">● Trigger wash-sale thereby eliminating the TLH benefits |
| 5 | Cost Basis Accounting | <ul style="list-style-type: none">● Do not use “average cost basis” when selling shares |

Popular TLH Funds “pairs” with Bogleheads

Asset Class	Vanguard ETF	Vanguard Benchmark	Replacement ETF	Replacement Benchmark
US Stocks	VTI	CRSP US Total Market	ITOT	S&P Total Market
			SCHB	DJ Broad US Market
Foreign Stocks	VXUS	FTSE Global All Cap ex US	IXUS	MSCI ACWI ex USA IMI
Foreign Developed Markets	VEA	FTSE Developed Markets Ex-North America	IEFA	MSCI EAFE IMI
			SCHF	FTSE Developed Markets Ex-US
Emerging Markets	VWO	FTSE Emerging Markets	EEM	MSCI Emerging Markets Index
			IEMG	MSCI Emerging Markets Investable Market Index
Dividend Stocks	VIG	NASDAQ US Dividend Achievers Select	SCHD	Dow Jones U.S. Dividend 100
TIPS	VTIP	Barclays Capital US TIPS 0-5 Years	SCHP	Barclays Capital US TIPS
FAANGs			QQQ	

Tax Gain Harvesting ¹

With tax-gain harvesting, you strategically sell appreciated investments in years your income / tax rates are relatively low.

Scenario:

- LT Capital Gains tax is ZERO for married couples filing jointly with up to \$78,750 in taxable income (single: \$39,375).
- Since the 2019 standard deduction is \$24,400 for married filing jointly, a MFJ can earn at least \$103,150 and not pay federal income taxes on these long-term capital gains.

Example:

- MFJ income: \$80,000 before taking SD, and own investments with unrealized long-term capital gains
- Sell enough investments to recognize LT gains of \$23,150 (to get to \$103,150)
- Immediately buy back the investments again (no need to wait for 31 days as wash-rule does not apply to gains)
- Rest the cost basis to that higher price; less capital gains for future taxes [assuming future income will be greater e.g., delayed SS and/or RMD from IRA or 401(k)]

¹ <https://www.aarp.org/money/investing/info-2019/tax-gain-harvesting.html>

Final Thoughts

- Identify / know your “replacement” fund in advance
- Invest your riskiest investments in a taxable account
- Upon TLH don't wait on the sidelines, reinvest proceeds right away
- Wash sale is not a crime ... it's just that you can not claim tax loss from wash sale

Portfolio return is not enhanced by tax loss selling because your AA remains the same.

But you can better manage that year's taxes