Episode 39: It's Looking Like a Good Harvest: Should you use Tax Loss Harvesting in Your Portfolio?

Bob French 00:00
The purpose of Retire with Style is to help you discover the retirement income plan that is right for you. The first step is to discover your retirement income personality. Start by going to risaprofile.com/style and sign up to take the industry's first financial personality tool for retirement planning. It's time for everyone's favorite topics taxes and interpreting SEC regulations. Wade, no, it'll be fun, I promise. Hey, everyone, welcome to Retire with Style. I've I've apparently taken this over because I'm running right in from the intro. But, but we're here here with Alex and Wade as my guests this week to talk about tax loss harvesting. So guys, if you want to introduce yourselves,

Wade Pfau 01:11
sure. We got the Don Pardo of retirement style is here on duty today.

Alex Murguia 01:21
He gets the voice of Johnny Mathis.

Wade Pfau 01:28
That being said, I'm guessing after last week, we better get to the point real real quick this week.

Alex Murguia 01:36
subscribers by the second, my inbox, my inbox is out of control. We

Bob French 01:43
this is how we ended up doing those 10 minute intros.

Wade Pfau 01:50
Make sure that everyone's clear. This week, we're going to be talking about tax loss harvesting, which in a year, like 2022 has a lot of practical application. And so it's very fortunate for us to have Bob join us to be able to walk us through some of the issues just on an ongoing basis. And then also I can bring into that conversation as well, just with retirement and how tax gain harvesting can potentially play a bigger role in retirement at the same time. There's a lot to cover this week. Do you have any other small chat small talk there? Alex before we get started?

Alex Murguia 02:27
Don't Don't tempt me way. And by the way, when you said that, you know that probably some percentage of our viewers are rolling their eyes like oh my god, here we go. Let's do the Fast 30 Fast really fast.

Wade Pfau 02:43
That's an important.

Alex Murguia 02:44
I got nothing. Oh, I got one. So Wade, what do you what do you guys gonna be for Halloween? Any thoughts?

Wade Pfau 02:50
Yes, I've got a Pokemon in the household and ketchup, I guess. outtake from Stranger Things where they said hello, I'm ketchup and mustard. And so her two friends are going to dress up as ketchup and mustard. Really,

Bob French 03:06
I would also point out this is going to be going out like more than a week after Halloween.

Alex Murguia 03:13
Okay, so evergreen, so So Bob, what's your what's your favorite Halloween candy? And tell us all about candy corn and how much you hate

Bob French 03:21
it. I don't I like candy corn. Believe it or not.

Wade Pfau 03:26
David comes out on election day. You may be tired of candy.

Alex Murguia 03:30
Oh, really? Okay, and I got I got one more buff.

Bob French 03:35
I'm not the one egging you on. is doing.

Alex Murguia 03:40
What Why don't vampires eat ghosts?

Bob French 03:43
I don't know.

Alex Murguia 03:45
Wade?

Wade Pfau 03:49
They have boo instead of blood? I don't know.

Alex Murguia 03:52
Because it tastes like sheet

Wade Pfau 03:59
podcast for this?

Alex Murguia 04:01
No, no, no. It works. It works. We'd cover the listen to

Bob French 04:17
but, but yeah, let's actually dive in and see if we can keep it under four minutes before we jump into it.

Alex Murguia 04:24
This is a full service podcast. That's right.

Bob French 04:28
But yeah, obviously as Wade said 2022 has been a less than awesome year in the markets and you know, with that comes a lot of stuff. But one of the things that pops up a lot, or that we hear about a lot is tax loss harvesting. You know, is this something you should be doing? What is it you know, doesn't make sense for me all all of the questions. So we want to take a little bit of time and walk through will what is tax loss harvesting You know, how do you do it? Does it make sense? You know, and as Wade alluded to, there's the flip side of the coin, the tax gain harvesting? And how do we approach all that type of stuff? You know, basically, how do we manipulate our capital gains taxes? And does it makes sense to go down that road? So

Alex Murguia 05:24
just before to start that just because I'm thinking like most common denominator here, listeners, tax loss harvesting? Bob, that's for losers. We should focus on gains. No, I mean, I've heard like advisors even say is like tax loss harvesting. That's an American, you know, that kind of thing. Right here all of a sudden recognizing losses? Don't give up. Don't ever give up. Yeah, that kind of silliness. Yeah, what's, what's your take on this? And where I'm going with this is just dispersion of individual stocks, and mutual fund asset classes, but even, you know, normal dispersions. And you'd be silly not to capture them. But I like to use

Wade Pfau 06:05
background to Bob as the very basic background. I think it's probably also worth defining the idea of cost basis, and what that means and how that's relevant to this. Yeah. Well, we'll

Bob French 06:15

we'll try and keep the discussion of investment taxes relatively high level, but I think we do need to talk about cost basis here, unfortunately. And okay,

Alex Murguia 06:24
so, two points, we'll just sit back and listen, go on. Okay.

Bob French 06:29
So we'll start off by by officially calling out, none of us are CPAs. Here, none of us are handling your tax situation. So talk to your tax professional. But, you know, the idea with tax loss harvesting one, it's definitely something that a lot of people can use. It we'll talk about the provisos around that can statement and a little bit, but markets bounced up and down, they're moving all over the place. And even in good years, there are going to be certain asset classes, and certainly certain stocks that are going to go down. And, you know, depending on the specifics of your situation, you might be able to harvest those losses, and reduce your taxes in the current year. Now, we'll talk about, you know, some of the things going on in that statement. But they're absolutely, you know, to the extent that we can reduce taxes, as good. You know, we want to pay as little to the government as we possibly can, as we realistically can, while still maintaining our asset allocation, we want the highest after tax return and after tax Well, specifically, that we can possibly get, because we're, we're doing this for a reason, it's not just we want big numbers on our statement, we want to be able to spend this money. And that's really the goal with tax loss harvesting to manage our taxes through time. So let's touch a little bit on cost basis and investment taxes and kind of set the stage here for what we're talking about tax loss harvesting. So there's really well a couple of things. First off, there's three different types of investment accounts, or basically three different types of investment accounts. There's your taxable money, your tax deferred money, and your tax exempt money, your tax deferred and tax exempt. You'll also hear those tax advantaged, but it's your IRA, it's your 401, k 403. B, all of the kind of accounts with letters and numbers associated with them. tax deferred means that generally, you're going to be able to write that money off on your current year's taxes, and then you're going to pay basically income tax, when you pull that money out in retirement or whatever the case might be. Tax Exempt money accounts, you're putting in after tax money, so you don't get that tax write off. This is your Roth accounts. But you're done paying taxes, you're just done. That money is yours free and clear. You don't pay taxes on it, well, it's invested, you don't pay taxes on it, when you pull it out to spend it. Your taxable accounts are the ones we're going to be talking about here. These are the ones where you're paying taxes on everything that happens as it happens. So this is your brokerage account, basically. So within this account, there's basically I'm gonna be saying basically a lot this episode, so sorry. But there's basically two types of it are two big categories of investment taxes that I think is a fair way of phrasing this. So there is your you know, wealth, income tax, so dividends, you know, other forms of distributions and stuff like that interest income to where you're just goes into your your income, and you pay whatever your income taxes. There's also capital gains. You know, these are, you know, basically the gains you've made from selling an asset or an asset being sold in your name in the case of mutual funds, or ETFs, or things like that. That's the stuff, we're going to be really talking about what tax loss harvesting, by and large, there's one exception. Now, what Wade was getting with his statement about cost basis, is how those capital gains taxes are figured out. So let's say I own I don't know $100 worth of Ford, just to pick a random company. And I go and sell that $100 of Ford stock, my capital, what I'm paying tax on is not going to be the $100, it's not going to be the amount of money I got from selling that stock, it's

going to be the amount of money I got from selling that stock minus how much I paid for it. So if I paid $80, when I bought that Ford stock, my capital gain is going to be that $20. So the $100, I sold it for minus the $80, I bought it for my gain, my profit is going to be that $20. And then I'm going to be taxed at whatever my capital gains rate is on that $20. Now, one of the really important things here is that if I've held that stock for more than a year, it's considered a long term capital gain. And that long term capital gain for most people, is going to be a lot lower than their income tax rate, I'm taxed at a lower rate on those capital gains than I am on the things that are in that income bucket again, like most dividends, interest income, you know, returns of capital, all sorts of fun stuff when we start going down that rabbit hole. But that's really what we're getting at with cost basis is how much you paid for something. Now, I think way to correct me if I'm wrong, I think that's as much accounting as we actually need to go into, to get into the statement or get into the discussion here. But that idea of cost basis is really, really crucial when we start talking about basically manipulating cost basis here. Alex, you look like you're about to say something there.

Alex Murguia 12:38
No. So just to even drive home the beginning point, like if you're invest, think about the s&p 500, just just to go back to the statement that there always going to be loss, especially we have a lot of individual securities, you know, think about the s&p 500 500 stocks, the s&p 500 is up 10% That year, not every stock is up 10%. You know, there's a dispersion around that number and a handful, in fact, disproportionately, I would say a lot more of them are down than up me and up, because it's usually the winners that kind of carry the day, if you will. So there's always opportunities, especially with individual securities, you have a diversified portfolio with let's say, 10 or 12 asset classes, invariably, you're going to have an opportunity along the way. And we're doing this right now, because this year, you know, we wanted to give people some time, because it's, you know, you there are more months to begin to, you still have a few months left to develop a tax plan around it. But, you know, unless you're extremely lucky, you're going to have significant opportunities to harvest losses this year. That thought and it's had nothing to do with investment acumen. It's just, you know, as an investor, your role is to capture stock market returns and some years, you know, it's a negative return. Right?

Bob French 13:53
Absolutely. Man, that works both ways. You know, even during really bad years, you know, there's gonna be some stocks that do really well, you know, back in 2008, when the market as a whole was down, or was up 44%. You know, I mean, it was there were companies that that was an awesome year for them, you know, during the, the height of the pandemic, you know, zoom and peloton, and you know, all of those companies, everyone else is, you know, their stock crashed. They did really well. You know, there's always going to be examples and you know, during good years, there's going to be stocks that do really poorly, as Alex said. So, getting back to the idea of tax loss harvesting, you know, what we're really doing is, well, we're harvesting those losses, we're harvesting those situations where a stock has dropped below what your cost basis is, no, I put that in there specifically in that way, because it's not just If a stock has gone down over the past week or month or something. It has to have gone down relative to where you bought it, you're losing money on it, if I lose money on it exactly. So if you bought a TN T back in 1960, you know, a one bad quarter, you know, you're probably not going to have a tax loss on that there's probably nothing to be doing. You know, the stock has gone down a little bit more significantly, there might potentially be something. And, you know, if you really want to go

down the rabbit hole, you know, you can start looking at tax lots and, you know, manipulating that and figuring out exactly which shares you want to sell, you know, to really, really dive into it, but I think that's probably gonna be overkill for a lot of people. But you know, what I really wanted to get into,

Wade Pfau 15:48
I thought you have tech slots to be able to, well,

Bob French 15:51
you know, most people haven't set up or have it set up for them, I think, is a better way of phrasing it as average cost basis trading, you know, so you can see, you know, if you have your account statement, and it says, you know, the Vanguard s&p 500 fund, your cost basis is x, you know, that's going to be the average cost basis. So, you know, for most people in most accounts, that, you know, if you go and make a trade, they'll be trading at, at least for the mutual fund level. You know, there'll be trading at your average cost basis.

Alex Murguia 16:26
Yeah, we can get into LIFO and FIFO. Some other time. Yeah. And maintaining it, once it started. Its,

Bob French 16:34
we as a retirement researcher, will be having something coming out shortly, you know, much more in depth on tax loss harvesting, and really tax efficient investing in general, but there's obviously a good chunk on tax loss harvesting in there. And we do get into all those different strategies and things like that, but keep it a little higher level than that here.

Alex Murguia 16:57
So then, okay, you're reassessing your portfolio, you've given up faith. That peloton you bought peloton in January, you've given them faith that it's going to come back all of a sudden, because their new rowing machine, right? So you're down whatever you bought it for $100? It's $20, you're done. $80. Yet, what can you do to turn that into lemonade?

Bob French 17:20
Yeah, so you know, and that is a really important point, this is very much kind of a silver lining type of strategy, you would prefer not to take the loss overall, but since we have it might as well do something with it. So the mechanics are pretty straightforward. You know, we'll get into something called the wash sale in a little bit, which is always the difficult piece here. But you know, you sell, you know, peloton, you, you know, and you take the money and you know, you can do what you want with it at that point, again, or the wash sale. And then with that $80 loss, you now get to reduce all of your other capital gains for the year. And that's a really important point, because your capital gains on your taxes every year, are netted. You know, it's all added together. And it's just saying, here's how much you made or lost in terms of, you know, capital sales basically. Now, one of the really, really interesting things here is that if you have more losses than gains, if you have a capital loss overall for the year, you actually are able, again, this is very kind of situation specific, but in a lot of cases, you're actually able to write off a certain amount on your income taxes for most people who are married filing jointly, you know, it's $3,000 per year, or in a year, I should say, and you'll remember what we said earlier about income

taxes being higher than capital gains taxes, that's worth a lot. You know, that's a, that's a good chunk of change, that you're able to do that just by harvesting those losses.

Alex Murguia 19:07
Now, you may want to be clear offset versus deduct, what's the difference?

Bob French 19:12
So it's a straight reduction. So, you know, if I'm just working and I say, you know, let's say I have $1,000 of other capital gains from just whatever else I'm doing in my portfolio in the year, or whatever distributions are sent my way or whatever it might be. And I have an I am able to harvest $100 of losses. Well, now my capital gain overall is $900. You know, I'm gonna be taxed on that $900 gain, rather than 1000 gain. The same thing on your income taxes, if I'm able to deduct $3,000 If I have, you know, $5,000 of losses and I'm able to to take $3,000 of that and apply it to my income tax, well, my income for the year is $3,000 less. And then with that other $2,000, I get what's called a capital loss carry forward. And that's just a really fancy way of saying, we're going to apply that 2000 Or you have the option of applying that $2,000 loss at some point in the future.

Alex Murguia 20:27
Is there a limit on cap gains that you can offset?

Bob French 20:31
No, it's It's purely netted. You know, because, again, let the, you know, at the taxpayer level, you know, it's saying, Okay, what were your gains on sales of assets this year? Well, it doesn't matter how much stuff you're doing. You know, it's just your profit and loss statement. Basically. If you're looking for more personal advice, please note that our show is sponsored by McLean Asset Management. Learn more at McLeanam.com. That's McLeanam.com. McLean Asset Management is a wealth management firm, where we help you design and implement the right retirement plan for you.

Wade Pfau 21:12
And you are netting the long term. Did we mention the difference between long term and short term?

Bob French 21:18
Probably not as much as we should? So you know, the there are two types of capital gains, there are short term capital gains, and long term capital gains, long term capital gains are gains on things you've held for a year or more are actually wait, you might know this better than I Is it a year or more or more than a year? So

Wade Pfau 21:41
right, that's a good question. I would always wait until 365 days plus one just to be safe.

Bob French 21:53
Because that is definitely something that they will get very particular about, I'm sure. But the the big reason there is this differentiation is short term capital gains are taxed like income, long term capital gains have a lower tax rate applied to them. So you know, you want to be focusing on making sure that

your trades are going to be in the long term capital gain bucket, rather than the short term capital gain to the point that I've actually seen financial advisors decide they're going to rebalance every 13 months, rather than every year, just to be sure they never have to worry about it. So.

Alex Murguia 22:35
So I've bought the Vanguard s&p 500 Index Fund, I'm 13 months into it. I'm down, whatever, let's just say 20%. I'd still don't want to be out of the market, though. Yep. What what, what am I to do?

Bob French 22:52
So this is where the wash sale rule comes into play, actually. So basically, what the wash sale rule is, is, with all this stuff, the IRS wants to make sure that when you do tax loss harvesting, you're actually taking a loss, you're not just taking money from one pocket and moving it to the other and basically resetting your cost basis, at a higher level. So you'll pay less taxes in the future if you pay more taxes in the future. So the rule states that if you're going to take a loss on a sale, you can't buy that security 30 days on either side of the sale, so you can't buy it 30 days before, or 30 days after you sell the security to generate that loss. So there's two things that are really important to unpack there. And the first is, who is you, you know, you is actually a little bit of a slippery term there. Because it's not just you. It's anyone in your household, or any accounts that you have control over. So the household piece is relatively easy to understand, you know, if your spouse is, you know, buying that same security you're selling, you know, that can trigger the wash sale rule or like if you have a business account or something like that, again, the IRS wants to make sure the state tax boards, whichever one whatever it's called in your particular state. They want to be sure that you're actually taking that loss and not just moving it from one account to another. So that's definitely something you want to be paying attention to. And that's actually one way that a lot of people trip up here. Because this is actually where people get caught up with basically automated purchases. So like say you are automatically saving into your 401 K or something like that. If you go out and you harvest a loss, let's continue with, you know, the s&p 500. You know, I have an s&p 500 index fund in my, you know, my 401k, I have money taken out every paycheck, and you know, as part of my allocation, so it just gets sent there, you know, every two weeks. If I then turn around in my taxable account and sell even a different s&p 500 Index Fund, we'll talk about this now part and the minute or two here, I'm likely to trigger trigger the wash sale rule, because I'll sell that generate my loss of whatever it happens to be. But then they'll want I've probably already bought it within the past 30 days, but I'll also probably buy it again in the next 30 days. So I would actually not be able to take that. So you really need to have a tight control, or at least a tight idea of what's happening in your portfolio at a pretty holistic level. So that's if we're going to be going down this road, you need to have really good clarity on what's out.

Alex Murguia 26:13
And I want to make the point, Bob, your example is you're not detailing an example of two taxable accounts.

Bob French 26:21
Nope. It could be even your spouse's.

Alex Murguia 26:24

No, but what I mean is you're saying, you know, yeah, exactly a four week of 401k account, could be, you know, automatically buying the s&p, you know, whatever the SPX, you know,

Wade Pfau 26:37
really making that purchase decision, you might not even think about it.

Bob French 26:40
Exactly, that is a really, really common way for

Alex Murguia 26:44
people to kind of just different account altogether.

Bob French 26:47
Yep, you might not be I mean, there's a lot of couples that, you know, even if they keep their finances separated, you literally might not even know that your spouse is buying, you know, has the s&p 500 in their account, you know, the IRS doesn't care. It's, you know, money under your household. So it's, you're responsible for it. So the other piece, there is the substantially identical part, which I didn't call out specifically, when I said the, when I gave you the rule. So the rule is not just you can't buy that specific security. But you can't buy anything substantially identical to that security within that 30 day period on either side of the sale. And substantially identical is definitely a term of art. But it's actually an understandable term of art. You know, so getting back to that s&p 500 example that we're using here. So if I want to harvest a loss in an s&p 500 Index Fund, I can't go out and well, one, obviously, I can't go out and buy that same s&p 500 Index Fund, I can't go out from harvesting from the Vanguard, s&p 500 Index Fund, I can't, you know, turn around and buy that Vanguard s&p 500 index fund in another account, but I also can't go out and buy another fund that tracks the s&p 500 index fund. That would be substantially identical, because there are going to be very slight differences in the fund, you know, they're not going to be exactly the same thing. But they're actively trying to be exactly the same thing. Basically, they're trying to be, you know, they're trying to deliver that same risk profile. On the other hand, if I were to go out and buy another large cap index fund, so say, Russell 1000, index, that would be fine. Those are different funds, those are things that are not substantially identical. If for no other reason, the Russell 1000 has 500 more names in it than the s&p 500. It's, you know, if we take a look at it in terms of market cap, it's going to be a little bit smaller than the s&p 500. It's going to have a slightly different risk profile, it's probably going to fit in that same bucket for your asset allocation, which is really important, as we'll talk about in a little bit. But it's going to keep you on the right side of the wash sale.

Alex Murguia 29:34
Hey, Bob and something we do practically, practically and I'll bring McLean into this. Yeah, you know, we have asset class selections, you know, these are the funds or the ETFs or what have you that we want within the asset class. We want to talk we have the main ones that we can afford but we have a bullpen substitute funds because, you know, around the fourth quarter of the year we start taking a look did it. And we look for opportunities in which if there was an opportunity for tax loss harvesting, we're we're somewhat agnostic with regards to capturing these factor exposures, and let's say the Russell

1000 versus the s&p 500. And so you'd be well served to do that within your own portfolio of having like, substitute phones at the ready, you want to maybe, just

Bob French 30:24
Yeah, absolutely you should mention the McLean angle here, because last month, we had Jason Dai, who is the head of McLeans investment operations department on within the academy of our quarterly investment review, to talk about some of this type of stuff, and how McLean kind of handles it. But absolutely, McLean has kind of a backup list. And actually, for nearly all asset classes, kind of a tertiary list of funds, you know, basically the the top three funds that they like for that, that asset class, and if there's a tax loss harvesting in large value, just to pick a random one, they'll, you know, we can sell the fund that is representing that large value asset class where there's a loss, and then just turn around and buy whatever is the second best fund in the asset class. And there now, I'm sorry,

Alex Murguia 31:24
I was gonna say, there's a couple of caveats to that you have to be you have to feel comfortable enough with that fund. Because if you buy it, and during the span of a month, where your quote unquote, waiting, if it doesn't move, fine, you can, you know, it's just a transaction, cause if at all, if you want to, like get back into it, but if it goes up by 1015 20%, you're gonna stay with it. Yeah, I just wanted to throw that out there, ya

Bob French 31:48
know, and that's actually a really big thing that you need to be thinking about this. And if we step back for a second, when you do tax loss harvesting, you know, when you get that money, and when you sell the thing with the loss, you have a choice. Ideally, you've made the choice before you do the transaction, but there's a choice to be made there. You know, you can just hold cash and wait out the wash sale rule, and then just, you know, on day 31, go back in and buy the original funds. That means we're sitting out of the market for, you know, however much we sold over that period, which, you know, shoot once in a while, that's probably a good thing, because the market went down during that period. But that's not the way to kind of bet it's random. That's random. Exactly. The alternative, obviously, is to well put that money to work, to invest that money in that, as we've been talking about that backup fund, or as the case may be that tertiary fund if we've been doing a lot of this stuff. So, you know, what happens at that point is kind of a binary, well, I guess, three possible outcomes, the market kind of gone, or at least that security can go down, which as Alex said, you know, obviously, we don't want it to go down. But you know, in terms of this, our decision is pretty simple. Well, we move to the original Fund, which presumably we prefer to the backup fund, otherwise, it wouldn't have been the backup fund. It can just stay about the same, you know, neither materially went up or materially went down. Again, same thing, you know, it's very easy to move back into that primary fund, or the security could have gone up, you know, and at this point, we now have capital gains to deal with, we now have another tax question. And as we discussed earlier, or now we're dealing with a short term, capital gain taxed at your income tax rate. So now, it's really weird to talk about the market going up being a problem, especially in the context of we're dealing with losses here. But we do have a problem. You know, we're now in a fund that we've already said is suboptimal? Not by much, but it's not as good as our original funds have

Alex Murguia 34:12
to be bothered, but sometimes it's just, honestly, no, well,

Bob French 34:17
there's presumably, at least some sliver of difference between the two, you would have picked one or you there had to be a reason you pick one or the other. It's very rarely a coin flip. But that gets to the point here that I'm going at that, you know, you have to decide how aggressive you want to be in getting back to your original font. You know, if it's a situation like Alex is getting at where there's no meaningful difference, you know, this thing is, you know, one basis point the little slightly more expensive, or, I don't know you'd like the color on the account statements a little bit better.

Alex Murguia 34:56
That's a nice difference. Thank you for bringing that up.

Bob French 34:59
I know that How you make decisions about your portfolio, Alex, you know, then you're not going to be willing to pay all that much to move back into the original fund. If it's a big deal, if there's a lot going on there, you know, there is a real reason why you pick the original fund over the backup fund, well, you might be willing to pay a little bit more, you might be a little bit more aggressive in moving back to your original fund. And there's a couple of ways that this might happen. You know, there's definitely situations where, you know, it's relatively easy to kind of get trapped in your backup fund, you know, if you get a really big market move during that month, which happens, you know, you may have to wait until wait for a year, you know, wait until that's a long term capital gain again, you know, to be able to get back to that original font, you may just bite the bullet and say, Well, you know, it's a big enough difference, there's a big enough expected return difference between these two funds, that I'm willing to pay, you know, whatever this short term capital gain is, it's really gonna come down to the specifics of the difference between the funds, and also what the tax is going to be how much you would actually owe on the trade. Curious if you should be looking at a Roth conversion, or what a Roth conversion even is, head over to them McLeanam.com/roth to get McLean's free ebook, here's a Roth conversion right for you, and learn about when you might want to do a Roth conversion. And when you might not just head over to McLeanam.com/roth To download your free ebook today.

Alex Murguia 36:47
Now, something that we a reoccurring theme in our podcasts about like the dynamic distribution strategies, and all of this stuff was sometimes this level of stress, sometimes a level of specificity is just not worth the calories. Yes. And so there could be a subset of our audience that's thinking, you know, this is this is this is crazy talk, I'm not going to do all of this, I'm going to stick to my preferred investment, because that will net out, you know, better. And your thoughts. I have thoughts on that. I'm sure what he does, but what do you think

Bob French 37:23
I don't do tax loss harvesting in my own portfolio? That I don't think it's worth for myself, I don't think it's worth the the tax benefit. You know, I just, I don't want to spend that much time looking at it. There's a

lot of a lot of kind of fiddling with stuff that you got to start doing when you you do tax loss harvesting. It makes sense for a lot of people but not everyone.

Wade Pfau 37:48
And you know, how you feel when your phone chargers at 100%? I get the same feeling although you said you did this without considering the tax lots. I feel much better about life when I have one tax slot instead of tons of tax slots. So I took an opportunity in 2020. And again this year to consolidate more or less. But that's because otherwise Yeah, I mean, you make the point maybe there isn't. Other we don't want to say there's actionable content. But also you've for retirees, you do have the step up and basis that wipes out if you're harvesting gains against losses, well, any large gains that you may have get reset with that step up and basis at death. Plus, if you make charitable contributions, low basis, stock can just go directly to your donor advised fund or to a charity. And then you don't have to worry about paying the capital gains taxes on that either. You don't necessarily have to offset all that with gains, or losses.

Bob French 38:50
And I'm glad you called out the charitable contribution fees we are getting towards the end of the year. So that's something that people are gonna start looking at. Definitely look at contributing low basis stock or just holdings to charity. That's a really good way to manage your time.

Alex Murguia 39:06
I think there's a lot of financial planning thing and look, it just depends on your temperament. Obviously, Bob has his I'm kind of go along with Wait, I actually take advantage of tax loss harvesting, you know, when when it presents itself, I have no issues with it. And I think there are a lot of financial planning benefits that come along with it such as you were thinking about gains from stocks, but you can offset gains from a sale of a property a sale of a business. If you know that in five years. You have an upcoming gain, you can start you can start harvesting losses specifically for the offset purposes, which which I think can be huge, especially when you when you're talking nominal amounts. I mean, they're we're not going to talk about it today. But you know, you can do direct indexing strategies where you're you know, you're effectively mimicking the returns of the s&p 500 with let's say 150 stocks, in which there will be losses Along the way, but that gets complicated over time, I don't want to get into that right now you're just talking about straight up losses. But I do agree to the degree, I simplify it from the the tax law standpoint, you know, per wage comment, but when it's there, I take them in, and they're actually quite, quite valuable for myself. So

Bob French 40:20
it's very much going to be a question of how much you know, if you're looking at an event driven strategy. You know, that's one thing. You know, if you're looking at saying, you know, shoot the markets been down, let's go take a look. And that's one thing. You know, there's also you can be looking at this as a regular part of just your portfolio management strategy. When you go in to rebalance your portfolio, you can also go in every year and look to see, you know, is there something I can harvest? Is there some losses that I can be looking at? But, you know, one of the things you want to be thinking about is, you know, as Alex said, is the juice worth the squeeze? You know, if you do this tax loss, harvesting, trade, you know, are you actually going to come out ahead, when you think about

everything, you know, depending on your account, you know, you've got potential trading costs, you've got potential gain, you got potential, not just potential you got your time to consider. But what you want to be doing is, you know, really what this is coming down to is, you don't want to be looking to try and harvest when there's a $5 loss you're looking to harvest when there's a material loss. And it's up to you to determine what material means in that context.

Alex Murguia 41:41
Now, that's loss, is there a flip side to this? Wade, I know you had an idea, maybe it's a good time to transition,

Wade Pfau 41:47
since it says retire with style we can't forget about and I don't know if this is the correct technical name, but I just tend to call it capital gains harvesting.

Bob French 41:55
I prefer tax gain harvesting here, when it says gains

Wade Pfau 41:58
harvesting. And this just speaks to something retirees may look at. And also, just to be clear about this point, there's no wash sale rule. If you're harvesting gains, you can realize the gain and then immediately repurchase the same. Trying to offset your money. Why would you do that? The reason why you might do that, just suppose you're retired. And you do have to look at all these other implications. So suppose you're in your 60s, you're not yet claiming Social Security. You also maybe you're not getting your, if you're on Medicare, you're not using the Affordable Care Act. So you're not worried about subsidies for your health insurance, necessarily. If you don't have any income, you have a lot of capacity were in 2023. For those married filing jointly, they have a 0% tax bracket on qualified dividends and long term capital gains, up to $89,250. And if you add the standard deduction, on top of that, for married filing jointly, you're getting close to almost $120,000, where you could just realize $120,000 worth of long term capital gains, and still be at the 0% tax bracket. So you're paying taxes, but at a 0% rate. And that's giving you an opportunity to effectively reset the cost basis of your account at a higher level. And so,

Alex Murguia 43:25
resetting, what does that mean resetting the account at a higher level

Wade Pfau 43:29
like buy realize by selling and then immediately repurchasing my cost basis is now that $120,000, and it was before so that later in retirement, if I need to sell some shares to fund expenses, I would have left realizing less capital gains at that time, because I now have that higher cost basis,

Alex Murguia 43:49
and retirement your tax bracket now that you're getting Social Security and all that will be higher,

Wade Pfau 43:55

right. And that's where you're now getting Social Security, you now may be hit by required minimum distributions. You could, it's this long term capital gains stacks on top of other ordinary income. And you could be getting into situations where the Social Security benefits or the required minimum distributions are now pushing some of your long term gains from the 0% rate to the 15% rate. And by just realizing those gains back when you were able to do so in a 0% rate. You're saving yourself on the taxes over the long term.

Bob French 44:33
Yeah, that I would also say that, you know, if you're in that situation, also you want to be looking at Roth conversions. Another topic that comes up a lot in those points, and actually, I believe McLean has some resources. We'll put them in the show notes again, but some resources on figuring out whether Roth conversion works for you and your situation or not. But yeah, tax gain harvesting is absolutely something that, you know, especially in those periods where you have a lower income, or a relatively low income, where you're in a lower tax bracket than you, quote unquote, normally would be, where you definitely want to take a look at it and see, if you can't take advantage of it, it's really powerful.

Wade Pfau 45:23
And it doesn't get as much attention, because there may be fewer opportunities, there's a very wide range where you're paying 15% on long term capital gains. And if your incomes are at those levels, where that's an issue, there may not be much you can do. Also, once Social Security begins, you might trigger long term capital gains, thinking that you're in the 0% bracket, but that could cause you to be hit by that Social Security tax torpedo, where you're paying taxes on a bigger percentage of your Social Security benefits. And therefore you weren't truly in the 0% marginal tax bracket on those long term capital gains. So there may be fewer opportunities to benefit from this. But when it's there, it's always great to pay taxes at a 0% marginal tax rate. So it's a great point. Good to take advantage of that.

Alex Murguia 46:13
Bob, would you do that? Or will you pass on that as well?

Bob French 46:16
I would, unfortunately, well, no. Fortunately, I get to be. Fortunately, and I am not in that situation. I am still in my my earning yours. So unless you're trying to say something here, Alex. I don't think I'll have any opportunities for tax gain harvesting anytime soon.

Alex Murguia 46:40
If you see a $20 bill on the floor, do you pick it up?

Bob French 46:44
I do. But they don't exist.

Wade Pfau 46:46
You must be an economist? No, because it wouldn't be there if it was real.

Alex Murguia 46:57

already? What do you think?

Wade Pfau 46:59
Yeah, I think we we covered the topic pretty well.

Alex Murguia 47:03
Yeah. So

Wade Pfau 47:05
Well, I mean, this, I think there's actionable content here, especially in 2022, a lot of people may be able to benefit from doing some analysis along these lines and finding potential opportunities to to reset the cost basis at a higher level, which can help over the long term

Alex Murguia 47:25
isn't the only thing I don't listen to.

Bob French 47:27
And we're legally required to say the line you don't let the tax tax tail wag the investment dog, I think that's required to be in every everything talking about tax loss harvesting, it is an important point that, you know, it's easy to kind of screw up your portfolio, if you get too aggressive with the tax loss, harvesting, and move away from your asset allocation. So it's really important to keep in mind that all of the tax optimization we're doing here is, you know, is not a small thing. But it's not as big as making sure you stick with your asset allocation, making sure you stick your portfolio where it's supposed to be and taking the right levels of risk.

Wade Pfau 48:12
I agree. I agree with that. And just make sure to that wash sale rule is really complicated. So if you've never really looked much into this before, study up on the wash sale rule and make sure you really understand it before you start making transactions. Because if you have to unwind things, that gets complicated, as well.

Bob French 48:32
And, yeah, you pay the transactions, you pay all the costs, and you end up with the worst cost basis possible anyway.

Wade Pfau 48:40
Right, right. And if you were trying to offset gains against losses, you still get to pay taxes on all those gains, yet there's no losses to offset against those gains. And so it's, it may lead to a pretty unfortunate tax situation. All righty,

Bob French 48:57
we're done. I don't have any more interjections here. So

Alex Murguia 49:02

now we're good Ben.

Wade Pfau 49:04
Thanks, everyone. And we'll catch you next week on Retire with Style.

Alex Murguia 49:08
Great intro Bob.

Bob French 49:12
This is why I just pre recorded

Alex Murguia 49:16
Hey, Bye, everyone. Thanks everyone.

Bob French 49:19
Wade and Alex are both principals in McLean Asset Management and Retirement Researcher. Both are SEC registered investment advisors located in Tyson's Virginia. The opinions expressed in this program are for general informational and educational purposes only and are not intended to provide specific advice or recommendations for any individual or on any specific securities. To determine which investments may be appropriate for you. consult your financial advisor. All investing comes with a risk including risk of loss. Past performance does not guarantee future results.