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Tax-loss harvesting: upgrade portfolios amidst volatility

WHAT IS TAX-LOSS HARVESTING?

Tax-loss harvesting is a strategy of selling investments at a loss in order to lower taxes. Losses are typically used to offset gains, such as those from sales of investments or capital gains distributions from mutual funds, closed-end funds, or ETFs. For many investors, tax-loss harvesting is a critical tool for reducing their overall taxes. It is also typically part of a broader tax management strategy — since taxes are often the largest cost faced by investors, delaying tax payment keeps more assets available to grow.

How it Works

SELL

Sell investment at a loss compared to the purchase price.

HARVEST

Use capital losses to reduce taxes in one or more of the following ways:

1. Offset current year's realized capital gains,*
2. Reduce ordinary income by up to $3,000,
3. Carry forward the capital loss into future tax years to offset other gains.

REPLACE

Replace the investment just sold with a similar asset to maintain the portfolio's asset allocation and expected risk and return levels.

*Losses can offset either short-term or long-term capital gains. Offsetting short-term gains is especially valuable since tax rates on those gains are typically higher (particularly for high earners).

THE OPPORTUNITY: BENEFITS OF TAX-LOSS HARVESTING

Tax-loss harvesting has numerous potential long-term benefits for investors' portfolios.

Lower taxes and enhance portfolio's long-term value

In the short-term, the primary benefit of tax-loss harvesting is lowering capital gains tax liability [Exhibit 1]. Lowering taxes, in turn, has successive long-term benefits. Consider a portfolio without any tax-loss harvesting. Typically, any taxes paid on gains will come from the portfolio, which reduces after-tax return. Utilizing losses to offset gains, however, minimizes taxes and leaves more assets in the portfolio, allowing a compounding effect to drive long-term wealth accumulation.

Exhibit 1: Tax-Loss Harvesting Lowers Capital Gains Tax Liability

	Portfolio #1: Without Tax-Loss Harvesting	Portfolio #2: With Tax-Loss Harvesting
Short-term capital gains	$10,000	$10,000
Tax-loss harvest	$0	$5,000
Tax liability from short-term gains*	$10,000 x 24% = **$2,400**	$5,000 x 24% = **$1,200**
Long-term capital gains	$50,000	$50,000
Tax-loss harvest	$0	$15,000
Tax liability from long-term gains*	$50,000 x 15% = **$7,500**	$35,000 x 15% = **$5,250**
Total tax liability from capital gains	**$9,900**	**$6,450**

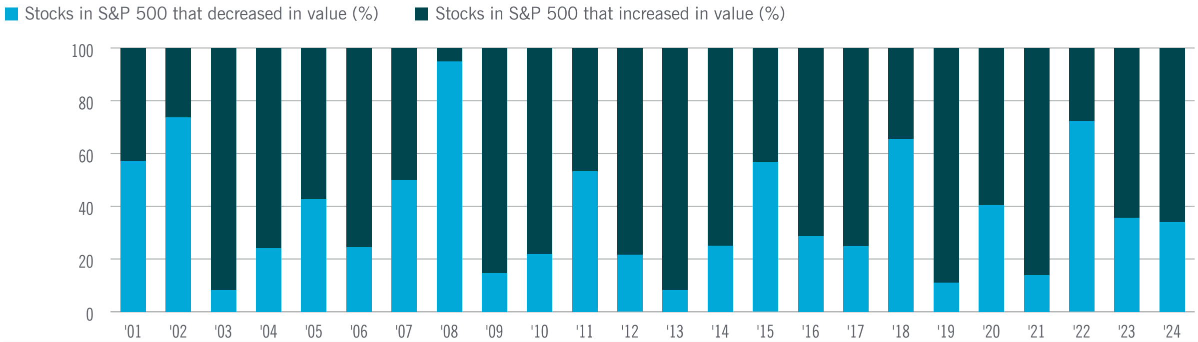
* Short-term gains are taxed at the taxpayer's marginal income tax rate whereas long-term gains generally qualify for a lower rate.
Hypothetical examples are shown for illustrative purposes only and do not represent the performance of any specific investment. Past performance does not guarantee future results.

Use volatility to upgrade portfolios

Although we may prefer for all markets to rise, there are always investments that decline in price regardless of the broader market environment [Exhibit 2]. Tax-loss harvesting allows investors to harness this naturally occurring market volatility to their advantage by using price dips to harvest losses and enhance after-tax return. Normally low return years provide more harvesting opportunities than high return years, but the strategy is relevant throughout market cycles since losses exist in all markets. Additionally, investors who harvest losses as they become available throughout the year (rather than waiting until year end) may benefit from having more opportunities to harvest losses.

Exhibit 2: Losses exist in all markets

Historically, individual stock losses have occurred in both up and down markets, creating advantageous tax-loss harvesting opportunities to offset capital price gains.



	'01	'02	'03	'04	'05	'06	'07	'08	'09	'10	'11	'12	'13	'14	'15	'16	'17	'18	'19	'20	'21	'22	'23	'24
S&P 500 historical annual price return (%)	-13.04	-23.37	26.38	8.99	3.00	13.62	3.53	-37.00	23.45	12.78	0.00	13.41	29.60	11.39	-0.73	9.54	19.42	-6.24	28.88	16.26	26.89	-19.44	24.23	23.31

Source: S&P Global, 2001 – 2024. Different benchmarks and economic periods will produce different results. Other methods and market conditions may result in significantly different outcomes. Historical annual return calculated as the % change to the last trading day of each year from the last trading day of the previous year. Investments cannot be made directly in an index.

Rebalance portfolios with flexibility (but beware of wash sales)

After selling a position at a loss, investors have the opportunity to reinvest the proceeds in a similar asset to maintain their portfolio's asset allocation and expected risk and return levels. In doing so, they must take the "wash sale" rule into consideration. This Internal Revenue Service (IRS) rule mandates that an investor cannot claim a loss on the sale of an investment and then buy a "substantially identical" security within 30 days before or after the sale. The rule prevents people from selling securities at a loss and then immediately buying them back just to get a tax benefit — in short, from gaming the system. Unfortunately, the IRS does not offer a precise definition of what constitutes a substantially identical security. The definition of "substantially identical" depends on the situation and is subject to interpretation. To avoid inadvertently triggering a wash sale when reinvesting proceeds in a similar investment, investors should consider the degree of holdings overlap and degree of difference in prospective returns between the two investments. Common replacements that are generally not considered substantially identical include two mutual funds, closed-end funds, or ETFs tracking the same benchmark but managed by different advisors, or two investments within a similar industry. However, exceptions exist so investors should always consult with a tax professional as to their own facts and circumstances to consider their options.

Exhibit 3: Replacement security considerations

Original investment	Single Stock	Active Mutual Fund or Closed-End Fund	ETF or Index Mutual Fund
Potential replacement	Active mutual fund	Different active mutual fund or closed-end fund	Active mutual fund or closed-end fund
	ETF or index mutual fund	ETF or index mutual fund	Different ETF or index mutual fund
	Stock within a similar industry		
Primary considerations	Degree of holdings overlap Degree of difference in prospective returns		

SUCCESSFUL TAX-LOSS HARVESTING REQUIRES A DILIGENT APPROACH

Selling positions with losses is not without risk. In some cases, short-term tax benefits do not outweigh missing out on a future recovery. Tax-loss harvesting requires a systematic approach which takes into account an investor's broader tax management strategy and most importantly, overall investment strategy. At Nuveen, harvesting losses is an integral part of managing investment portfolios. Our investment team is consistently seeking opportunities to improve the positioning of our portfolios across markets. When executed successfully — particularly during times of volatility — tax-loss harvesting becomes an important driver of investment success.

For more information, please visit nuveen.com.

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