

Capital Gain/Loss Harvesting

The extent in which to recognize capital gains and capital losses each year is dependent on a variety of factors. Generally, there is little or no benefit to recognizing capital losses for the purpose of generating a capital loss carryforward. However, there could be benefits to recognizing capital gains in the current tax year depending on your marginal tax bracket.

The 2026 long-term capital gain tax rates are dependent upon your filing status and taxable income. The taxable income thresholds for capital gains tax rates are adjusted each year for inflation.

Capital Gains Tax Rate	Taxable Income (Single)	Taxable Income (Married Filing Separate)	Taxable Income (Head of Household)	Taxable Income (Married Filing Jointly)
0%	Up to \$49,450	Up to \$49,450	Up to \$66,200	Up to \$98,900
15%	\$49,451 to \$545,500	\$49,451 to \$306,850	\$66,201 to \$579,600	\$98,901 to \$613,700
20%	Over \$545,500	Over \$306,850	Over \$579,600	Over \$613,700
25%	Long-term (Real Estate Depreciation Recapture)	Long-term (Real Estate Depreciation Recapture)	Long-term (Real Estate Depreciation Recapture)	Long-term (Real Estate Depreciation Recapture)
28%	Long-term (Collectibles)	Long-term (Collectibles)	Long-term (Collectibles)	Long-term (Collectibles)

Short Term Capital Gain Rates: If you sell stocks, mutual funds or other capital assets that you held for one year or less the gain is treated as ordinary income and taxed at applicable marginal ordinary income tax rates.

Tax on Net Investment Income

If your taxable income exceeds \$200,000 (\$250,000 for married filing joint) an additional Medicare surtax of 3.8% applies on investment income from sources with which you are not actively involved, such as publicly traded stock. This will most likely affect you if your taxable income bracket is 28% or greater.

Taking a step back, the IRS has specific ordering rules that apply to how capital gains are offset by capital losses with the end result being the amount of "net" gain recognized in the current year or losses carried forward to future years.

1. Short-term losses will offset short-term gains.
2. Remaining short-term losses offset net long-term gains.
3. Long-term losses will offset long-term gains. Long-term losses in any rate category are first applied against the highest tax rate long-term gain (Collectibles & Real Estate).
4. Remaining long-term losses offset net short-term gains.

After capital losses have been fully used against gains, any remaining net capital loss can offset up to \$3,000 of ordinary income (\$1,500 if married filing separately) with any remaining amounts carried forward to the next tax year. There is no limit on the amount of losses that can be carried forward, but the unused amounts will expire at death to the extent they are not used on the final income tax return. Married couples filing jointly will have losses tracked separately for purposes of this rule, although in the

year of death the surviving spouse is able to offset their own gains with their spouse's losses.

Loss Harvesting

Successful investing and recognizing capital gains go hand in hand and attempting to offset these gains is important as long as the integrity of the overall portfolio is not compromised. The following are some items to consider:

- Cost - Trading costs such as commissions and redemption fees
- Wash Sales - To avoid "wash sale" rules, which if triggered will cause losses to be disallowed, you are not able to acquire the same or a substantially identical security within 31 days prior to the sale or 31 days after the sale in any account, inclusive of retirement accounts.
- Investment Allocation - Avoiding the wash sale rule can cause changes in your overall asset allocation. These changes can be mitigated by the purchase of similar (but not identical) securities which can be replaced after 30 days.
- Investment Quality - When adding a replacement security to avoid a wash sale, there is risk of underperformance compared to the original investment.
- Opportunity Costs - Investment gains can be greatly impacted by overall market movement. Over a 20 year period (1/2/2001 - 12/31/2020) the S&P 500 had an annualized return of 7.47%¹. Missing the top 10 market days over the same time period resulted in an annualized return of 3.35%. During the process of security replacement, you may miss out on some level of these gains.
- Holding Period - If the replacement security is sold within 1 year of purchase, it could trigger short-term gains which are taxed at higher tax rates. This may be particularly problematic if a holding significantly increases in value, and you are looking to reduce your exposure.
- Mutual Funds - Capital gains within the fund are generally paid out to shareholders in December if it recognized net gains from buying and selling securities throughout the year. These gains are paid out to all shareholders as of the record date no matter how long they have held the fund. This could result in paying taxes on gains you did not earn if you recently purchased the fund or gains on a fund that may be held at a loss. These gains are taxed at various rates depending on the shareholder's income tax bracket. To avoid the distributions and subsequent tax hit, it is generally advisable to sell the fund in taxable accounts before the record date, especially if the fund is trading at a loss.
- Stock Piling - We generally recommend recognizing losses only to the extent of current year capital gains plus \$3,000, which is the limit on the amount of ordinary income that can be offset with such losses. Recognizing losses in excess of that amount does not result in any current income tax benefit; looking forward there is minimal advantage or disadvantage from a tax standpoint. Excess recognized losses may even result in some other undesirable non-tax consequences as discussed above.
 - New Basis Is Lower: The only difference in gain between selling the security in the current year to recognize the loss and holding a security with unrealized losses is the change in the asset value between the time of sale and subsequent repurchase after 30 days due to the wash sale rule discussed above. This is because the basis in the repurchased security will now be lower which will cause a larger gain when resold later and, as previously discussed, these gains can only be offset to the extent there are capital losses.
 - High Turnover Account: Stockpiling losses in a high turnover portfolio (frequent buys/sells) will likely produce limited benefits as the normal buying and selling may have likely produced the same result anyway over the course of the year. Gains in a low turnover account may not be recognized for several years, and other losses may be available at that time to offset gains.

Exceptions: An exception to this general rule may exist if all four of the following are true:

- There have been significant realized gains in the current year, and you are looking to try and reduce the tax burden.
- There is a high likelihood of substantial capital gains in the coming year.
- The unrealized losses in the current holdings may be eroded in the coming year.

- Substitute securities purchased to maintain asset allocation and avoid a wash sale are not sold for a gain in the coming year.

The tax tail should not wag the investment dog, and we generally recommend pursuing loss harvesting only on positions that, from an investment standpoint, you are looking to trim for asset allocation purposes or truly want to be out of based on investment quality.

Gain Harvesting

While recognizing losses is typically the focus, there are potential benefits to accelerating capital gains. The following are items to consider:

- **Wash Sales** - Wash sale rules do not apply to gain recognition which allows you to maintain the same quality of asset allocation. There is one IRS consideration to keep in mind. If the sale is purely tax motivated then the IRS may disregard the transaction and assess penalties on the tax that should have been incurred upon future sale. This can be avoided by building “economic substance” into the strategy by adding time between the sale and subsequent repurchase. The greater the time period the greater the change in value a taxpayer could expect which adds economic substance. If the security has long-term potential but there is a likely near term drop in value then this strategy may be considered. For the investment reasons previously outlined, it is likely better to only pursue this strategy on holdings you are already looking to trim or exit entirely so you remain invested in a similar holding that fits in the overall investment strategy and avoid being out of the market for an extended period of time.
- **Low Tax Bracket** - There is no income tax consequence from recognizing long-term capital gains if your income is below the thresholds noted in the chart above. If you anticipate being in a higher bracket in future years, it may be worth taking some gains off the table now.
- **Rising Income** - Capital gain rates increase from 15% to 20% once you hit certain income thresholds as noted in the chart above, and an additional surtax of 3.8% applies once your taxable income reaches \$200,000 (\$250,000 for married filing joint). If you anticipate either of these becoming applicable to you in the coming year, it may be advisable to recognize gain now at lower rates after considering the information previously discussed.
- **Capital Gains & Ordinary Income** - Long-term capital gains are taxed under a separate rate schedule from ordinary income. As a result, realizing (recognizing) capital gains does not push your ordinary income into a higher tax bracket. However, the additional gains can increase your total taxable income, which may affect other areas such as eligibility for certain deductions, credits, or the 3.8% Net Investment Income Tax.

¹ Source JP Morgan

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