Should You Harvest Losses?

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A common year-end strategy is to “Harvest” stock and security losses. Taxpayers with stock and security losses may want to recognize those losses before year-end by selling the investments. Whether a taxpayer should Harvest losses requires the taxpayer to consider the following:

1. Harvesting losses generally only makes sense if the taxpayer has taxable gains that the taxpayer can offset with the loss. Thus, to Harvest losses and recognize capital losses does little if the taxpayer does not have capital gains.

2. The taxpayer who Harvests losses may want to quickly repurchase the stock or security sold. This, generally, is not possible. The “Wash Sale” rules will disallow such loss if the taxpayer purchases “substantially identical stock or securities” within 30 days before or after the date of sale of the lost stock or security.

   For Example: Taxpayer A sells 100 shares of stock of Big Corporation for a $100 loss. Two days after selling the 100 shares of Big Corporation stock for a loss, A purchases 100 shares of Big Corporation stock. The Wash Sale Rules prevent A from taking the loss from the sale of Big Corporation.

3. To avoid the Wash Sale rules from applying to A's sale of Big Corporation stock, A can invest in a different stock, Small Corporation, that has a high correlation in the movement to Big Corporation. In the above example, the movement by Small Corporation may have a correlation of 95% to the movements of Big Corporation. For Wash Sale purposes, stocks or securities issued by different corporations are never “substantially identical,” regardless of their correlation of movement.

4. Computer programs have been developed that identify stocks and securities that have a high correlation with each other.

5. If a taxpayer has invested in a fund holding several stocks or bonds, generally, such a fund is not substantially identical to another fund, even if some of the stocks or bonds in both funds are the same. For example, the “High Growth Fund” of one fund would not be considered “substantially identical” to the “High Growth Fund” of another fund.

6. Generally, cryptocurrencies are not subject to the Wash Sale rules. However, legislation to make cryptocurrencies subject to the Wash Sale rules has been proposed.