Eaton Vance

Turning Tax Losses Into Client Wins

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Have you ever attempted to explain tax-loss harvesting and had your client got hung up on the word "loss"? A typical reaction is that the client stops hearing anything other than an investment has declined in value. How can you turn these loss conversations into client wins?

What if you were to say a tax loss is a "coupon" from Uncle Sam? Here's how:

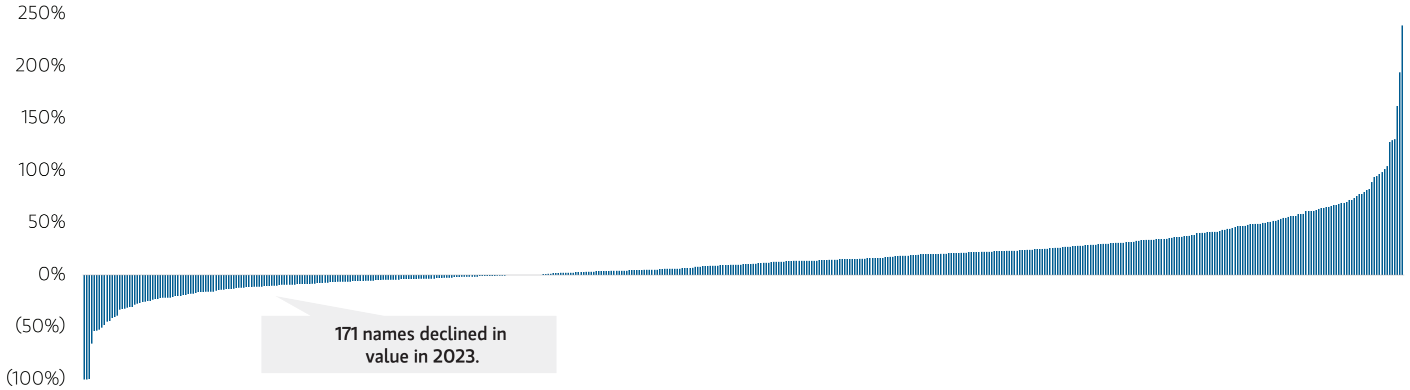
- **Realized capital gains:** Gains resulting from an asset sale in a taxable account may be subject to short- and long-term capital gains tax. This depends on how much time has passed between the original purchase and the sale.
- **Realized capital loss:** If an asset in a taxable account is sold for less than the original purchase price, the client realizes a capital loss. This can be used to decrease the taxable amount of capital gains or, in the event of no realized gains, shield a small amount of ordinary income from taxation — a valuable opportunity for high-income clients.
- **Tax loss carryforward:** A client who has losses and no gains can carry the losses forward to one or more future tax years during which there might be gains, which the losses could then offset.

Beneficial tax losses are obviously available in down markets, yet also can be available in up markets—which may be surprising to some clients (Exhibit A). By shielding some gains from taxation, tax losses can reduce the amount of tax an investor pays and increase the amount remaining in their pocket.

Exhibit A

Beneficial Tax Losses Can Be Available in Up Markets (2023: S&P 500®, Return 26.29%)

72% of the stocks in the S&P 500® had a maximum drawdown of more than 15% at some point during 2023.



Past performance is no guarantee of future results. The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment.

Source: FactSet, 12/31/2023. This information is for illustrative purposes only and is not a recommendation or an offer to buy, sell, or hold any security. It is not possible to invest directly in an index. Indexes are unmanaged and do not reflect the deduction of fees or expenses. All investments are subject to risk, including the risk of loss.

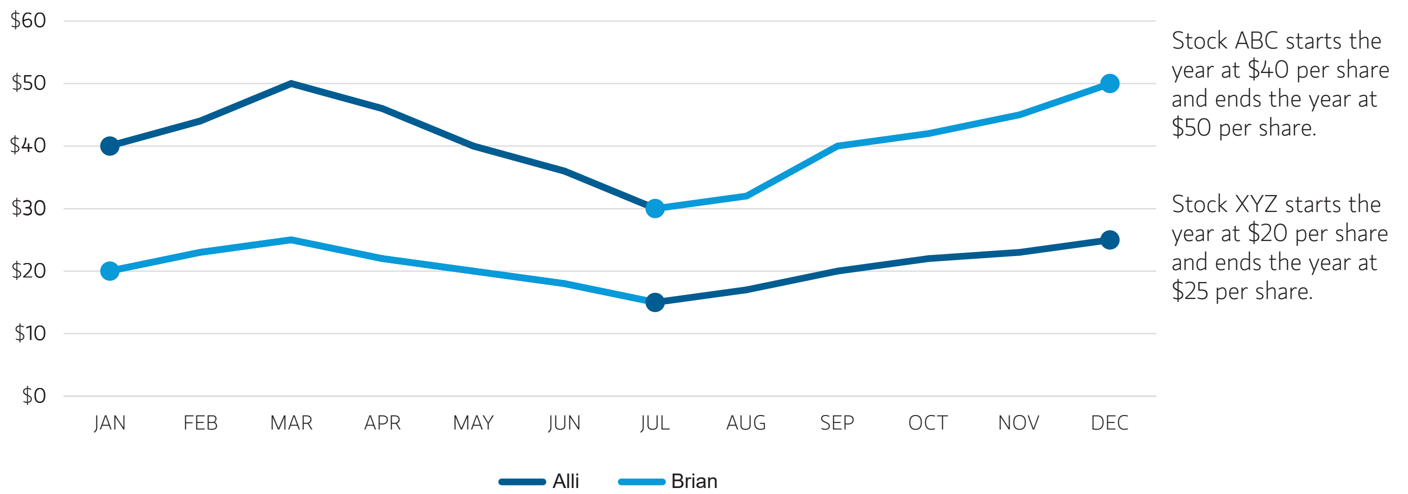
A tale of two stocks

Let's imagine two hypothetical stocks, ABC and XYZ, that are similar in industry, outlook and liquidity. Neither pays a dividend and because their primary difference is share price—they tend to move similarly over time. Let's imagine two tax-aware investors investing in those two stocks, who are both aware of the value of harvesting tax losses.

Alli spends $4,000 at the start of the year to buy 100 shares of ABC, and Brian spends $4,000 at the start of the year to buy 200 shares of XYZ. At midyear, however, they notice comparable price drops in both stocks.

They both SELL their original positions to capture a tax loss — and immediately reinvest the proceeds in the **other** stock. Here's their hypothetical price history:

Hypothetical Example of The Price History Between Stock XYZ and Stock ABC



This hypothetical example is provided for illustrative purposes only.

At year-end, Alli holds 200 shares of XYZ at $25 per share for an account value of $5,000, and Brian holds 100 shares of ABC at $50 per share for an account value of $5,000. Both investors could have had the same pretax return by doing nothing and simply buying and holding their one stock for the full year. By selling and replacing when stocks were down, they each realized short-term tax losses of $1,000 that can be used to offset gains elsewhere in their portfolios.

When framed and used properly, tax-loss harvesting can help turn tax losses into client wins.

We think about the impact of taxes year round to help you do the same

Visit eatonvance.com to explore our suite of calculators with clients who want answers to tax questions like these:

- What could I pay in taxes on my investments?
- What is the potential value of systematic tax-loss harvesting in a rising interest rate environment?
- How should I deal with concentrated stock positions?

Keep the conversation going

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