

Help Improve After-Tax Returns with Tax Loss Harvesting: A Tax Smart Way to Possibly Keep More of Your Money

Tax-Loss Harvesting is a tax savings strategy that involves selling securities at a loss to help offset gains in other investments or income. If your capital losses exceed capital gains, you may also further reduce your taxable income by up to \$3,000.

Tax Savings Yield is calculated against the portfolio value to estimate how much you potentially keep due to a reduction of your estimated tax bill. Morgan Stanley Financial Advisors can tailor your tax-loss harvesting preferences, potentially saving you money at tax time.

Let's look at a hypothetical example to understand the impact of tax-loss harvesting on a \$1,000,000 portfolio with \$50,000 in short term and \$40,000 in long term gains, assuming the maximum federal tax rates of 40.8% on short term gains and 23.8% on long term gains.

Scenario #1 - No Tax-Loss Harvesting

	Short Term	Long Term
Realized Gains	\$50,000	\$40,000
Realized Losses	-	-
Total	\$50,000	\$40,000
Net Impact	\$50,000	\$40,000
Tax Rate	40.8%	23.8%
Total Current Tax Bill	\$20,400	\$9,520

- **\$29,920 Tax Bill**
- **No current tax bill reduction**
- **No tax savings**

Scenario #2 – End of Year Tax-Loss Harvesting to Offset Existing Tax Bill

	Short Term	Long Term
Realized Gains	\$50,000	\$40,000
Realized Losses	(\$60,000)	(\$30,000)
Total	(\$10,000)	\$10,000
Net Impact	No ST Gain	\$10,000 excess ST Loss offsets \$10,000 LT Gain resulting in No LT Gain
Tax Rate	40.8%	23.8%
Total Current Tax Bill*	\$0	\$0

- **\$90,000 in gains offset**
- **\$29,920 current tax bill reduction due to tax-loss harvesting**
- **2.99% Tax Savings Yield due to tax loss harvesting**

*Tax savings yield is the estimated reduction in tax liability because of tax-loss harvesting divided by the total market value of the account

Scenario #3 – Periodic Tax-Loss Harvesting throughout the Year Creating Bigger Losses, Bigger Impact

	Short Term	Long Term
Realized Gains	\$50,000	\$40,000
Realized Losses	(\$80,000)	(\$50,000)
Total	(\$30,000)	(\$10,000)
Net Impact	No ST Gains	No LT Gains
Tax Rate	40.8%	23.8%
Total Current Tax Owed*	\$0	\$0

- \$90,000 in gains offset
- \$29,920 current tax bill reduction due to tax-loss harvesting
- \$3,000 of the excess loss may be applied to ordinary income, reducing the current bill by a potential \$1,224, assuming a 40.8% tax rate
- \$31,144 Total Tax Savings
- 3.11% Tax Savings Yield due to tax-loss harvesting
- \$37,000 in carry-forward losses to be applied against future year gains or income

The Bottom Line



**\$29,000 -
\$31,000
Tax Savings**



**2.99% - 3.11%
Tax Savings Yield**



**No Added
Cost**

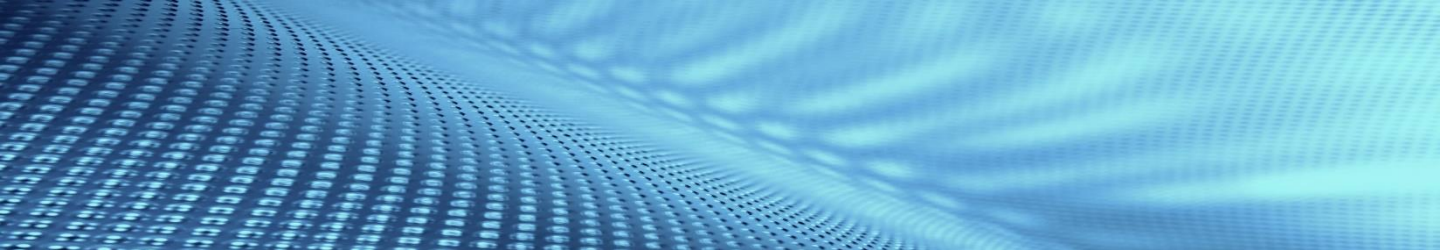


**Highly Customizable
Preferences**

Take Control of Your Tax Loss Opportunities Tax-loss harvesting turns a potential \$30,000 tax hit into a 2.99%–3.11% Tax Savings Yield on your \$1,000,000 portfolio. That's money you can keep invested potentially compounding returns on an after-tax basis. In a Morgan Stanley managed account, we actively monitor and act on these opportunities all-year round.

Curious how much you could save? Contact your Financial Advisor to see if this strategy suits your investments.

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Risks and Opportunity Costs of Tax-Loss Harvesting

While tax-loss harvesting can save you money on current taxes and boost your portfolio's after-tax return, it's not without risks or trade-offs. Here's what you should know about how it could affect your investments, especially if the securities you sell—or the ones you buy to replace them—perform differently than expected.

Risk #1: Risk of Missing Out on Gains (Opportunity Cost)

- ❖ When we sell a security at a loss to harvest the tax loss, we're betting that the tax savings outweigh the growth you might miss in the next 30 days. However, the security's price could rebound quickly and outperform after you sell.

Risk #2: Replacement Securities May Underperform

- ❖ To stay invested and avoid the wash sale rule (which disallows the tax loss if you repurchase the same substantially identical security within 30 days), we seek to buy a similar but not substantially identical replacement security. If this replacement security underperforms compared to the original the tax savings might not offset the lower returns, reducing your overall portfolio value.

Risk #3: Wash Sale Rule Complications

- ❖ The wash sale rule prevents you from claiming a tax loss if you (or your spouse, or even certain accounts you control) buy the same or a "substantially identical" security within 30 days before or after the sale. If this happens, the tax loss is not currently usable, but you've still sold the security. If it rises during that 30-day period, you miss the gains with no tax benefit to show for it.

Risk #4: Underperformance of Sold Securities (Missed Opportunity)

- ❖ If the security you sell continues to decline after you harvest the loss, you might have been better off holding it longer to realize a larger tax loss
- ❖ Selling too early could mean leaving tax savings on the table.

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There is no guarantee that tax-loss harvesting will achieve any particular tax result.

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The Estimated Tax Savings and Estimated Tax Savings Yield shown are subject to the limitations of the specific calculation methodology applied and are not to be used for tax reporting purposes. The client's actual tax rates, the presence of current or future capital loss carry forwards, any disallowed losses and other client tax circumstances will cause the client's Tax Savings and Tax Savings Yield to be over or under the estimates presented here. In periods when net realized losses exceed net realized gains, applying the highest tax rates to our calculations illustrates the highest Tax Savings and Tax Savings Yield that could be expected of the portfolio, and assumes the maximum potential tax benefit was derived. Actual client Tax Savings and Tax Savings Yield will vary.

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