Green Harvest
ASSET MANAGEMENT

Insight

Introduction to Tax-Loss Harvesting

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What is Tax-Loss Harvesting?

Tax-loss harvesting is the process of selling a security at a loss for the purpose of capturing, or harvesting, a capital loss to offset other current or expected capital gains. Capital gains usually come from the sale of appreciated assets which might include securities, a business or even from unwanted and unexpected sources such as mutual fund capital gains distributions. Capturing losses to offset current gains and future gains may be a prudent strategy particularly after the long run of the current bull market.

There are many strategies investors implement to capture losses. Many investors and their advisors capture losses only at year end. However, a rigorous, ongoing process is more likely be a better way to efficiently and effectively capture losses. Here are three of the most popular methods:

Bailing Out Strategy
A security is sold and no attempt to replace the exposure occurs

SELL ABC stock, mutual fund or ETF

Loss is captured; no similar security purchased

Sell and Repurchase
A security is sold and repurchased after 31 days

SELL ABC stock, mutual fund or ETF — Wait 31 days — **BUY BACK** ABC stock, mutual fund or ETF

Loss is captured; cash exposure for 31 days

Simultaneous Swap
Green Harvest Strategy
A security is sold and simultaneously swapped with a similar security

SELL Energy ETF #1 — Same day swap — **BUY** Energy ETF #2

Loss is captured; similar exposure maintained

All three have potential benefits and drawbacks and may be considered in view of a client's overall investment strategy. A closer look at the three uncovers some interesting outcomes.

1. The Bailing Out Strategy

So, you bought the high-flying growth stock everyone was talking about. Unfortunately, you bought it on the day that it hit its all-time high and it has since given up almost half of its value. You have now admitted to yourself it was a mistake and you want to sell it and forget about it.

Benefits: You have captured a loss equal to the difference between the purchase price and the sale price. You may be able to match this loss against a similar gain to reduce your capital gains exposure. If you have no gains for this calendar year, you may be able to "carry the loss forward" into the next calendar year. As you have no intention of re-purchasing the same security, you will not run afoul of any IRS tax rules regarding repurchasing a "substantially identical" security or exposure.

Drawbacks: You no longer have exposure to this company and perhaps its industry or sector. If the security turns higher, you do not own the benefit of any potential upside. If the security is an individual equity, there is likely no "substantially similar" security to "swap" into to maintain exposure.

2. Sell and Repurchase Strategy

As in the first loss-harvesting strategy, you bought the high-flying growth stock everyone was talking about for the same reason and at the same time and you currently have the same loss. Except this time, you still like the story. Perhaps some news outside the company, or even outside its industry, has taken down many companies including the one you purchased. You'd like to own this stock for a longer period of time, but you'd also like to capture a loss. The loss you capture is still the difference between its purchase price and sale price. This time, you wait the 31 days required to avoid violating the IRS' wash sale rules and you then re-purchase the same stock.

Benefits: You have captured a loss. You may match this loss against a similar gain to reduce your capital gains exposure. If you have no gains for this calendar year, you may be able to "carry the loss forward" into the next calendar year.

Drawbacks: For the next 31 days, you will not have exposure to this company and perhaps its industry or sector. If the security turns higher before you re-purchase it, you do not own the benefit of any potential upside. If the security is an individual equity, there is likely no "substantially similar" security to "swap" into to maintain exposure.

3. The Simultaneous Swap Strategy

This is the most complex, yet potentially, the most valuable strategy of the three. It requires a fair knowledge of the rules and time to research your "swap candidate" as well as your initial purchase. Your ability to trade two securities quickly and for the about the same dollar value is also required. Perhaps most importantly, the security should be "substantially similar" but not "substantially identical".

Benefits: You have captured a loss, with all that would imply for any other trade that would have the same outcome. If you have purchased a "substantially similar" security, you should not run afoul of any IRS tax rules regarding repurchasing this exposure. For investors that have a requirement to minimize "tracking difference", this is the only viable strategy because if the security price goes up, your exposure is maintained. If you are actively capturing losses, swapping allows you to capture additional losses.

Drawbacks: Although you may have achieved a similar exposure, you no longer have exactly the same exposure, as this would have violated the IRS' wash sale rule by owning a "substantially identical" security. If you sold a security with a unique and favorable attribute, you might not experience the same benefit. If the security is an individual equity, there is likely no "substantially similar" security to "swap" into to maintain exposure. You may end up swapping one individual company for another and the two companies may not act as similar as you would have liked. If the newly acquired security increases in value in the next 30 days and you need to sell it to buy back the original security, you may incur a gain which may offset your loss. You also need to understand all the nuances of the wash sale rule to avoid other considerations that would disallow a loss.

Whichever approach an investor utilizes, they may benefit from a more rigorous and ongoing process.

Reinvestment of Your Tax Alpha

The statement "a penny saved is a penny earned" has never been more applicable than it is here. The pennies, or dollars you save here can be reinvested and may continue to work for you for years or even decades to come.

Benchmarking Your Loss Capture Efficiency

There are a handful of asset managers and investment advisory firms that offer loss harvesting as a feature or benefit to their investment process. As most of these managers attempt to match the return of a broad index, measuring their success of that part of their process should be a simple exercise. We believe a manager's ability to capture losses versus the availability of potential losses should be benchmarked as well.

Best Products for Loss Harvesting

Although most investors think about harvesting losses with individual equities and municipal bonds, many other securities can be used for capturing losses. Exchange Traded Funds (ETFs) are, in our view, the best overall candidate for constructing an efficient portfolio and an effective loss harvesting strategy.

Disclosures

GHAM does not provide tax advice.

This paper was prepared to support the marketing of Green Harvest Asset Management's investment products, as well as to explain its tax-loss harvesting strategies. Nothing in this white paper should be construed as tax advice, a solicitation or offer, or recommendation, to buy or sell any security.

Although GHAM does not employ a Certified Public Accountant on its staff, we have, and continue to work with outside accounting firms and outside tax counsel that provide ongoing guidance and updates on all relevant tax law.

Federal, state and local tax laws are subject to change. GHAM is not responsible for providing clients updates on any changes in tax laws, rules or statutes.

Reasons to harvest capital losses, sources of capital gains and the suggestion that mutual funds distribute capital gains are for example purposes only and not meant to be tax, estate planning or investment advice in any form or for any specific client.

All estimates of strategy performance, after tax alpha, after tax alpha opportunities and other performance figures are derived from data provided from multiple internal and third-party sources. All estimates were created with the benefit of hindsight and may not be achieved in a live account. The data received by GHAM is unaudited and its reliability and accuracy is not guaranteed.

The availability of after tax alpha is highly dependent upon the initial date and time of investment as well as market direction and security volatility during the investment period. Tax loss harvesting outcomes may vary greatly for clients who invest on different days, weeks, months and all other time periods.

There is no guarantee that the tax consequences described as part of its tax-loss harvesting service will be achieved or that Green Harvest Asset Management 's tax-loss harvesting service, or any of its products and/or services, will result in any particular tax consequence. The tax consequences of the tax-loss harvesting service and other strategies that Green Harvest Asset Management may pursue are complex and uncertain and may be challenged by the IRS. The information with regard to this service was not prepared to be used, and it cannot be used, by any investor to avoid penalties or interest.

The effectiveness of the tax-loss harvesting strategy to reduce the tax liability of the client will depend on the client's entire tax and investment profile, including purchases and dispositions in a client's (or client's spouse's) accounts outside of Green Harvest Asset Management and type of investments (e.g., taxable or nontaxable) or holding period (e.g., short- term or long-term). Except as set forth above, Green Harvest Asset Management will monitor only a client's (or client's spouse's) Green Harvest Asset Management accounts to determine if there are unrealized losses for purposes of determining whether to harvest such losses. Transactions outside of Green Harvest Asset Management accounts may affect whether a loss is successfully harvested and, if so, whether that loss is usable by the client in the most efficient manner.

When Green Harvest Asset Management says it replaces investments with "similar" investments as part of the tax-loss harvesting strategy, it is a reference to investments that are expected, but are not guaranteed, to perform similarly and that might lower an investor's tax bill while maintaining a similar expected risk and return on the investor's portfolio. Expected returns and risk characteristics are no guarantee of actual performance.

Prospective investors should confer with their personal tax advisors regarding the tax consequences of investing with Green Harvest Asset Management and engaging in these tax strategies, based on their particular circumstances. Investors and their personal tax advisors are responsible for how the transactions conducted in an account are reported to the IRS or any other taxing authority on the investor's personal tax returns. Green Harvest Asset Management assumes no responsibility for the tax consequences to any investor of any transaction.

ETF Fee and Performance Disclosure

An ETF typically includes embedded expenses that may reduce its net asset value, and therefore directly affect its performance and indirectly affect a Client's portfolio performance or an index benchmark comparison. These expenses may include management fees, custodian fees, and legal and accounting fees. ETF expenses may change from time to time at the sole discretion of the ETF issuer. Green Harvest Asset Management discloses each ETF's current information, including expenses, on the Site or App. ETF tracking error and expenses may vary.

Furthermore, ETF performance may not exactly match the performance of the index or market benchmark that the ETF is designed to track because 1) the ETF incurs expenses and transaction costs not incurred by any applicable index or market benchmark; 2) certain securities comprising the index or market benchmark tracked by the ETF may, from time to time, temporarily be unavailable; and 3) supply and demand in the market for either the ETF and/or for the securities held by the ETF may cause the ETF shares to trade at a premium or discount to the actual net asset value of the securities owned by the ETF. Clients should be aware that in some limited instances it may be difficult or impossible to trade the Clients' securities. This liquidity risk may be caused by numerous factors, including but not limited to: 1) extreme market volatility, 2) a decision by exchange participants to withhold some or all of their quoted market bids, 3) exchange technical issues or exchange closure, 4) delisted or halted securities, and/or 5) a position across Client accounts that is large relative to the average daily trading volume of the security.