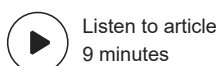


How to Use This Year's Market Tumble to Reduce Your Tax Bill

By Karen Hube Updated November 13, 2022 / Original November 10, 2022



Illustration by Liam Eisenberg



This year's market mayhem could shave your tax bill for years to come.

With just weeks to go, 2022 is poised for steep negative annual returns in both stocks and bonds, a correlated collapse that has occurred only twice since 1926—in 1931 and 1969. So far, stocks are down by 22% and bonds by 15%, and adding to this year's drubbing is a more-than 50% decline in the values of major cryptocurrencies.

But there is some light in this gloom. Market declines have created a bumper crop for year-end tax-loss harvesting, and there are other, lesser-known tax-savings strategies whose benefits are pronounced, thanks to low asset values and high inflation.

"You really could save a fortune in taxes if you just take advantage of freebies in the tax code at a time like this," says accountant Ed Slott in Rockville Centre, N.Y. "It doesn't necessarily involve doing a lot of fancy stuff."

For many investors, putting stock losses to work to minimize taxes is an annual practice. Even in bull markets, there are opportunities as volatile holdings wobble to the downside. What's remarkable about this year isn't just the magnitude of losses in stocks, but the once-in-a-generation opportunity to capitalize on deep losses in fixed income and an opportunity for many new digital-asset investors to do so in cryptocurrencies.

Investors who properly harness losses could enjoy benefits not just on their 2022 tax returns, but also on future returns, says Charles Zhang, a financial advisor in Portage, Mich. He recently unearthed depressed investments for a total \$640,000 loss for a client, "who probably won't have to pay taxes on capital gains for this year and even the next couple of years."

Investors can use realized losses to offset realized capital gains, thereby canceling any taxes owed on the gains. If losses exceed gains—or you don't have any realized gains—you can use them to offset up to \$3,000 of ordinary annual income. Excess losses can be used in future years until they are all gone. Tax losses don't expire until you do.

"With the size of declines we're seeing, investors who lock them in are virtually guaranteeing some tax-free gains in the future," says Jason Romano, a partner at Moss Adams.

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Say you realized a \$27,000 gain when selling an energy stock exchange-traded fund this year and a \$100,000 loss in Bitcoin [BTCUSD +1.55%](#). You

could use \$27,000 of the loss to offset your entire gain and pay no capital-gains taxes and use another \$3,000 to reduce your taxable income. The remaining \$70,000 of unused losses can be used in your lifetime to offset a capital gain. Or you can use it to offset up to \$3,000 of yearly ordinary income until it is used up.

The ability to pair losses and gains from different asset classes is creating stunning opportunities for folks who sold real estate this year after the long run-up in property prices, says Michael Chasnoff, CEO of Truepoint Wealth Counsel in Cincinnati.

Widening Brackets

Inflation adjustments expanded tax brackets dramatically between 2022 and 2023.

Singles

Tax Rate	2023	2022
10%	\$0 - \$11,000	\$0 - \$10,275
12%	\$11,001 - \$44,725	\$10,276 - \$41,775
22%	\$44,726 - \$95,375	\$41,776 - \$89,075
24%	\$95,376 - \$182,100	\$89,076 - \$170,050
32%	\$182,101 - \$231,250	\$170,051 - \$215,950
35%	\$231,251 - \$578,125	\$215,951 - \$539,900
37%	\$578,126 or more	\$539,901 or more

Married Filing Jointly

Tax Rate	2023	2022
10%	\$0 - \$22,000	\$0 - \$20,550
12%	\$22,001 - \$89,450	\$20,551 - \$83,550
22%	\$89,451 - \$190,750	\$83,551 - \$178,150
24%	\$190,751 - \$364,200	\$178,151 - \$340,100
32%	\$364,201 - \$462,500	\$340,101 - \$431,900
35%	\$462,501 - \$693,750	\$431,901 - 647,850
37%	\$693,751 or more	\$647,851 or more

Heads of Household

Tax Rate	2023	2022
10%	\$0 - \$15,700	\$0 - \$14,650
12%	\$15,701 - \$59,850	\$14,651 - \$55,900
22%	\$59,851 - \$95,350	\$55,901 - \$89,050
24%	\$95,351 - 182,100	\$89,051 - \$170,050
32%	\$182,101 - \$231,250	\$170,051 - \$215,950
35%	\$231,251 - 578,100	\$215,951 - \$539,900
37%	\$578,101 or more	\$539,901 or more

When retirees Don Mackenzie and Pam Carey-Mackenzie of Naples, Fla., both formerly in sales at Procter & Gamble, prepared to sell their local rental property that had about doubled in value, they worried the gain would trigger an enormous 2022 tax bill.

By their closing date in October, Naples property prices were still around all-time highs, but stock and bond values were down by double digits. “The timing of the trends worked out really well,” Mackenzie says. The couple sold off their Vanguard Mid-Cap Growth [VOT + 1.58%](#) ETF (ticker: VOT) to create a \$165,000 loss and used it to offset some of their \$250,000 property-sale gain, saving more than \$30,000 in taxes.

Harnessing a tax benefit is just half of an effective loss-harvesting strategy: the other is promptly reinvesting proceeds from the sale so you don’t miss out on a market rebound.

The Internal Revenue Service doesn’t want you bouncing in and out of the same stock, bond, or mutual fund as a tax-avoidance strategy, so it enforces the wash-sale rule, which prohibits buying a security either 30 days before or 30 days after you sell it. Such transactions can’t be used to offset gains.

If you like your asset allocation, your goal should be to find a similar replacement investment, says Josh England, partner and tax attorney at AAFCPAs, an accounting firm in Westborough, Mass. “You can sell [Home Depot \[HD\]](#) and buy Lowe’s [LOW], or buy a mutual fund or ETF that tracks your original investment’s sector.”

Replacement investments can’t be “substantially identical” to the original investment, IRS rules say, but guidance for trading funds is murky. Mackenzie and Carey-Mackenzie reinvested in the iShares Russell Mid-Cap Growth [IWP + 1.48%](#) ETF (IWP), which should satisfy the wash-rule while giving them exposure to nearly the same slice of the market.

As you consider a fund swap, avoid buying into a fund before its capital-gains distribution, which go to shareholders at year end. You don’t want to own a fund for a few weeks and get hit with the tax bill for the entire year.

“A mutual fund may appear to have losses, but that doesn’t mean it isn’t going to distribute a taxable gain,” says Scott Brown Jr., managing director at Silvercrest Asset

Management. Taxable distributions can be large in years like this when funds must sell investments to meet big redemptions.

Funds issue estimates of distributions in mid-November. Actively managed funds usually have the largest realized gains due to higher portfolio turnover. Passive index funds and ETFs typically pay out much less, if at all, making them good replacements.

Swaps sometimes mean parting with a favorite investment. Sarat Sethi, a managing partner at Douglas C. Lane & Associates, will double up on exposure of a stock that he doesn't want to part with, then sell half the holding after 30 days to realize a loss without letting go of his investment.

"I bought [Morgan Stanley \[MS\]](#) around \$100, and it dropped to \$80, so I doubled up, and I'm waiting to sell," Sethi says. "I have more exposure than I want but only for 31 days. As a long-term investor, I can handle that."

If you have less conviction about your holdings, this is an optimal environment for selling losers and buying better prospects.

Evercore ISI recommended tax-swap pairs for individual stocks in late October. The key characteristic of go-to stocks is that their 2023 earnings estimates have been revised upward, says Julian Emanuel, chief equity and quantitative strategist.

Among the recommended swaps are [JPMorgan Chase \(JPM\)](#) for [Bank of America \(BAC\)](#), [Alphabet \(GOOGL\)](#) for [Meta Platforms **META + 1.03%**](#) (META), [Ford Motor **F + 2.28%**](#) (F) for [General Motors \(GM\)](#), and [American Airlines Group \(AAL\)](#) for [Delta Air Lines \(DAL\)](#).

Advisors are also using loss harvesting to do housekeeping in bond portfolios. "People usually shy away from harvesting losses on individual bonds, because if you hold on to maturity, you're going to realize your full investment," says Jesse Little, senior director of advice for Wells Fargo Wealth and Investment Management.

But this year is unlike any other. Bond losses are the deepest on record. With long bonds yielding less than shorter maturities—you currently earn more on a six-month Treasury than on a 10-year Treasury (4.42% versus 4.15%)—"it's a good opportunity to review your duration strategy," Little says.

Concerned that the bond bloodbath isn't over, some investors are selling bond mutual funds for a loss but not replicating the exposure.

"When it makes sense for my clients, I'm selling out of bond managers I love, taking the loss, and moving into short-term Treasuries," says Debra Brede, founder of GW & Wade's DK Brede Investment Management. "I'll look at going back into the funds once the Fed stops raising rates."

In contrast, tax-loss harvesting in crypto is less constrained, because the wash-sale rule doesn't apply. You can sell Bitcoin and buy it back soon after, but use care, says Matt Metras, an enrolled agent at MDM Financial Services. The IRS frowns on moves purely for tax benefits, so wait for prices to fluctuate before rebuying, he says. "This could be just hours if there's a big swing in values, or days."

This tax loophole is in lawmakers' crosshairs, so enjoy it while you can. "There was an attempt by Congress to change that at the beginning of the year," says Erik Weinapple, an accountant at Moss Adams. "That hasn't gone anywhere, so far."

Email: editors@barrons.com
