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**Ken Berry, JD** • May. 18, 2014

For many farmers, harvest time comes at the end of the summer. The same thing is true for your clients who are active traders in the stock market. But you must caution them that the tax landscape has changed in recent years.

Traditionally, upper-income investors look to "harvest" capital losses by selling securities towards later in the year to offset capital gains realized earlier in the year. Those losses can offset capital gains plus up to $3,000 of highly taxed ordinary income. Furthermore, any excess loss can be carried over, giving you a head-start on next year's tax planning.

But it's not always in a client's best interests to harvest capital losses under the current tax rules. Consider that the maximum tax rate on net long-term capital is now 0% for taxpayers in the two lowest ordinary income tax brackets (the 10% and 15% rates), 15% for most other investors and 20% for those in the top ordinary income tax bracket. Even if an upper-income investor is hit with the 3.8% surtax on a long-term gain, the combined top tax rate is still only 23.4% — significantly lower than the top 39.6% rate on ordinary income.

As a result, every client needs to assess his or her personal tax position before the leaves begin to fall. Depending on the circumstances, it may be advisable to realize capital gains that absorb prior losses, especially if the client will benefit from a favorable long-term capital gains rate. Conversely, when it suits the client's needs, the traditional approach of harvesting capital losses to offset gains may still be recommended. Here are several rules of thumb to help guide the way:

- If you have capital losses, realize short-term capital gains to absorb the losses. Any



- If you must pay the 20% maximum tax rate on long-term capital gain, you might realize capital losses to offset the gains, especially if you expect to pay the 15% rate next year.

- If you're showing a short-term capital loss carryover from 2013, don't realize long-term capital gains because the tax benefit will be wasted. Instead, you might postpone long-term gains until next year or realize short-term gains, or both.

Finally, remind clients that they should not "let the tax tail wag the dog." In other words, it's important to weigh all the relevant factors, not just the tax ramifications, when you make investment decisions.

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