LESSON · TAX & WITHDRAWALS

Tax-Loss Harvesting in Retirement

A down market year feels purely bad — but in a taxable account, it's also an opportunity to turn losses into a real tax advantage without changing your long-term strategy.

Read time: 8 minutes **Level:** Intermediate **Includes:** Knowledge check

A down year in the market feels purely bad — but inside a taxable brokerage account, it also creates an opportunity: selling an investment at a loss to offset gains (or even ordinary income) elsewhere on your tax return. This is tax-loss harvesting, and it's one of the few strategies that genuinely turns a market decline into a tax advantage, without requiring you to time the market or change your long-term allocation.

The mechanics

When you sell an investment in a taxable account for less than you paid, that's a capital loss. Capital losses first offset capital gains realized elsewhere that year, dollar for dollar. If losses exceed gains, up to $3,000 of the excess can offset ordinary income each year, and anything beyond that carries forward indefinitely to future tax years.

Worked example

During a market downturn, someone sells a fund position down $12,000 from its purchase price and immediately reinvests the proceeds into a similar (but not identical) fund to stay invested in the market. That same year, they also have $7,000 of capital gains from rebalancing elsewhere in the portfolio. The $12,000 loss offsets the $7,000 gain entirely, plus $3,000 against ordinary income, leaving $2,000 of loss to carry forward and offset gains in future years — all while their overall market exposure never actually changed.

The wash-sale rule: the trap that undoes the strategy

Buying back the same (or a "substantially identical") investment within 30 days disqualifies the loss

The IRS wash-sale rule disallows the loss if you buy the same security, or one considered "substantially identical," within 30 days before or after the sale — including in an IRA or a spouse's account. This is why tax-loss harvesting typically involves swapping into a *similar but not identical* fund (e.g., one S&P 500 index fund for a different S&P 500-tracking fund from another provider) rather than simply selling and rebuying the same holding, and why it requires tracking purchases across all accounts, not just the one being sold from.

Why this matters more in retirement, not less

Tax-loss harvesting is often framed as an accumulation-phase strategy, but it's arguably just as relevant in retirement: retirees are actively drawing down taxable accounts (see the Withdrawal Sequencing lesson), which means realized gains are already a regular occurrence, giving harvested losses more opportunities to offset something. It also interacts with the "bracket-filling" approach from that lesson — in a year when you're deliberately recognizing more ordinary income (a Roth conversion, for instance), a harvested loss can help offset the sting.

Harvesting losses vs. harvesting gains

The flip side, "gain harvesting," is worth knowing too: in a year with unusually low income, deliberately realizing capital gains up to the top of the 0% long-term capital gains bracket costs nothing in federal tax and resets the cost basis higher, reducing future taxable gains. Retirees with a low-income year (a gap year before Social Security or RMDs) are well positioned to use this, and it's a useful complement to loss harvesting rather than a competing idea — harvest losses in down years, harvest gains in low-income years.

A caution on overdoing it

Tax-loss harvesting adds real value, but it's a secondary consideration to the underlying investment strategy — swapping funds purely to harvest a small loss, especially if it introduces tracking error or higher costs in the replacement fund, can cost more in complexity than it saves in tax. It works best as a disciplined, occasional response to genuine market declines, not a constant trading activity.

Using tax-loss harvesting effectively

- [ ] Only applies to taxable brokerage accounts — IRAs and 401(k)s have no capital gains/losses to harvest.
- [ ] Swap into a similar, not identical, fund to stay invested and avoid the wash-sale rule.
- [ ] Track purchases across all accounts, including a spouse's, to avoid an inadvertent wash sale.
- [ ] Remember losses offset gains first, then up to $3,000 of ordinary income per year, with the rest carried forward.
- [ ] In low-income years, consider the opposite move — harvesting gains at the 0% rate — rather than only ever harvesting losses.

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KNOWLEDGE CHECK

Test what you just learned

Answer four quick questions to test what you just learned.

1. What do capital losses offset first?

- A. Ordinary income, up to any amount
- B. Capital gains realized elsewhere that year, dollar for dollar
- C. Only losses from the exact same investment

2. What does the wash-sale rule prohibit?

- A. Selling any investment at a loss
- B. Claiming a loss if you buy the same or a substantially identical security within 30 days before or after the sale
- C. Harvesting more than $3,000 of losses per year

3. How much excess capital loss (after offsetting gains) can offset ordinary income each year?

- A. Unlimited
- B. Up to $3,000 per year, with the rest carried forward
- C. None — losses can only offset capital gains

4. What is 'gain harvesting'?

- A. Selling losing investments to generate losses
- B. Deliberately realizing capital gains in a low-income year, often at the 0% rate, to reset cost basis higher
- C. A penalty for selling too many investments in one year

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