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Tax-Loss Harvesting Kit: Turn Losses Into Tax Savings

Tax-loss harvesting is not a trick for bad investments. It is a disciplined way to turn market declines in a taxable account into future tax savings without abandoning your allocation. The work is operational: know which lots are down, decide whether the loss is big enough to matter, swap into a replacement fund that keeps you invested, avoid wash sales across every related account, and carry the loss forward correctly on Schedule D. The investors who benefit most are the ones who treat October through December as review season, but the process can work any time volatility creates temporary drawdowns. This guide turns the kit into a repeatable annual system.

1. Foundation

Tax-loss harvesting only matters in taxable brokerage accounts, because losses inside an IRA, 401(k), HSA, or 529 do not create deductible capital losses. In a taxable account, a realized capital loss first offsets realized capital gains of the same year. If losses exceed gains, up to 3,000 dollars of net capital loss can reduce ordinary income on the federal return each year, and unused losses carry forward indefinitely. That carryforward is why a loss harvested in a rough market year can still help you five years later after a business sale, a concentrated-stock unwind, or a year of large mutual fund distributions.

The busiest season is October through December because by then you can see the year's realized gains, year-end fund distributions, bonus income, and likely tax bracket. That timing is practical, not magical. If markets fall sharply in March or June, it can still make sense to harvest then rather than waiting for year-end. The real calendar discipline is this: set at least three review dates, usually early October, after Thanksgiving, and mid-December. Also stop automatic dividend reinvestment on any holding that might be harvested. Reinvested dividends can buy replacement shares inside the 30-day wash-sale window and quietly ruin an otherwise valid loss.

A good harvest decision is based on economics, not the emotional pain of seeing red numbers. Look at position size, percentage loss, dollar loss, short-term versus long-term holding period, your current marginal federal and state tax rates, and how likely the holding is to snap back before you can re-enter. A 12 percent loss on a 40,000 dollar ETF position can produce a meaningful tax asset. A 4 percent loss on a 1,800 dollar holding usually is not worth the paperwork unless it helps clean up a messy portfolio. Short-term losses are often more valuable than long-term losses because they can offset short-term gains taxed at ordinary income rates.

The operational edge is having a replacement roster before you need it. For every fund you own, list a backup that delivers similar exposure without being substantially identical. A total U.S. market fund needs a preapproved substitute. An international developed-markets ETF needs a substitute. Your bond fund needs a substitute. Once that roster exists, harvesting becomes mechanical: sell the tax lot, buy the replacement the same day, note the blocked repurchase date, and record the realized loss for Schedule D and your state return. The less improvisation you do on trade day, the less likely you are to miss market exposure or trigger a wash sale.

2. Step-by-Step System

1

Build a lot-level harvest dashboard

Start by exporting every taxable position with tax-lot detail, not just the account summary page. You need purchase date, cost basis method, number of shares, unrealized gain or loss, holding period, and any scheduled dividends in the next 31 days. If your broker defaults to average cost for mutual funds, verify that you can still identify specific lots before you trade. Then sort the dashboard three ways: biggest dollar losses, biggest percentage losses, and short-term losses. Those views answer different questions. Dollar losses show tax impact, percentage losses show how deep the drawdown is, and short-term losses show where the tax value may be highest. Finally, flag any lot that sits in a position also held in a spouse account, an IRA, an HSA, or through an automatic purchase plan. Cross-account overlap is where many otherwise careful investors create wash sales.

2

Decide whether each loss is worth harvesting

Not every decline deserves a trade. A practical screen is to ask four questions. First, is the dollar loss large enough to matter after spreads, commissions, and your time? Second, what tax rate will likely apply to the gains you are offsetting: long-term capital gains, short-term gains, or ordinary income through the 3,000 dollar annual limit? Third, do you have a replacement fund that keeps your target exposure intact? Fourth, how likely is a fast rebound in the next month? If you sell a volatile holding and sit in cash, you may save taxes and still lose economically by missing a sharp recovery. As a rule, the best harvest candidates are diversified funds or broad ETFs with meaningful losses, clear substitutes, and no need to own that exact security during the next 31 days.

3

Use a prebuilt replacement fund roster

Your goal after a harvest is to stay invested in roughly the same market, not to place a tactical bet. Build pairs before you need them. Many investors use VTI with SCHB or ITOT, VXUS with IXUS or VEU depending on desired coverage, and BND with AGG or SCHZ. The point is not that one pair is universally correct; the point is that you define acceptable substitutes in advance and understand the differences. Compare index provider, expense ratio, number of holdings, and sector or maturity profile. A replacement that drifts from your original exposure can accidentally change risk. Keep the roster in the guide and update it any time you add a new fund to the portfolio, because the worst time to research substitutes is while the market is moving fast.

4

Execute cleanly and avoid wash sales everywhere

On trade day, turn off dividend reinvestment and scheduled purchases for the security being sold, then sell the intended lots and buy the replacement fund as soon as the proceeds are available. The wash-sale rule is broader than one account. Buying substantially identical shares 30 days before or after the sale in a spouse taxable account or an IRA can disallow the loss. IRA wash sales are especially painful because the disallowed loss does not get added to IRA basis the way it can in a taxable account. Keep a written blocked-until date for each harvested symbol. If you want back into the original fund, wait until day 31 and then swap back intentionally instead of relying on memory.

5

Measure the real tax benefit after reinvestment

A harvested loss is a tax asset, not free money, so measure it honestly. Estimate federal benefit by multiplying the realized loss by the expected tax rate on the gains or ordinary income it will offset. Then add any state benefit if your state taxes capital gains and allows the loss. Subtract trading costs, bid-ask spread friction, and any incremental expense-ratio difference in the replacement fund. Also remember that harvesting does not eliminate tax forever; it often shifts basis downward, which can raise future gains if the replacement appreciates. That is still useful because deferring tax has value and future gains may be realized in a lower bracket, offset by future losses, or donated away through appreciated shares. Write down both the immediate tax estimate and the future-basis tradeoff.

6

Track carryforwards and close the loop on Schedule D

After the trade, save confirmations, the 1099-B download, and your lot notes in one folder. Update the guide with realized short-term losses, realized long-term losses, blocked repurchase dates, and the replacement fund used. When tax season arrives, compare your records with the broker's 1099-B and confirm that the net capital loss flows correctly onto Schedule D. If the total loss exceeds the amount used this year, record the carryforward separately so it is not forgotten next October. Also check your state treatment. Some states follow the federal carryforward rules closely, while others require different tracking or offer no state income-tax benefit at all. A harvest that looked modest this year can become valuable later only if you keep the record alive.

3. Key Worksheets & Checklists

Use these worksheets while the market is open only after you have already done the thinking. The first page gives you the numbers that drive the trade, the checklist keeps wash-sale prevention visible, and the tracker preserves the information you will need months later at tax time.

1. Harvest Decision Worksheet

Primary objective	Realize losses that create meaningful federal and state tax savings while preserving portfolio exposure.
Review window	Set review dates for early October, late November, and mid-December, plus ad hoc reviews after sharp drawdowns.
Best harvest candidates	List lots with large dollar losses, short-term losses, or positions you already planned to replace.
Replacement roster	Write the approved substitute for every fund you hold before you enter any orders.
Blocked repurchase date	Record the date when you can buy the original holding again without wash-sale risk.

2. Execution Checklist

- Confirm the position is in a taxable account and not sheltered inside an IRA or retirement plan.
- Check all related accounts for recent purchases, automatic investments, and dividend reinvestment settings.
- Select specific lots rather than guessing from the account-level loss number.
- Buy the replacement fund immediately so market exposure stays close to target.
- Estimate federal benefit, state benefit, and the effect of any basis reset before calling the trade a win.
- Save confirmations and update the carryforward log for Schedule D and the state return.

3. Carryforward and Re-entry Tracker

Window	Action	Evidence Complete
Before trade	Export tax lots, confirm replacement fund, and disable dividend reinvestment	Screenshot or spreadsheet saved with lot detail and blocked dates
Trade day	Sell intended lots and buy substitute fund	Broker confirmations show both sides of the swap
Day 31+	Decide whether to keep the substitute or rotate back to the original fund	Written note explains why you stayed or switched back
Tax filing season	Match realized losses to 1099-B and Schedule D, then record carryforward	Federal and state carryforward amounts stored for next year

4. Common Mistakes

Treating every red position as harvestable

A tiny loss on a tiny position is often just churn. Focus on losses large enough to move taxes or improve the portfolio.

Forgetting spouse, IRA, or DRIP purchases

Many wash sales come from an automatic dividend or a purchase in another account rather than from the main trade itself.

Sitting in cash instead of swapping immediately

The tax benefit can be outweighed if you miss a fast rebound because you turned a harvest into a market-timing bet.

Losing the carryforward record

A harvested loss is only useful later if you can prove it and remember to apply it on future returns.

5. Next Steps

Set your next three harvest review dates now, build the substitute-fund roster for every taxable holding, and keep one running carryforward log with federal and state notes. If you ever need to explain a trade six months later, your file should show the lot sold, the replacement bought, the blocked repurchase date, and the expected tax value.

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