YOUR MONEY

Harvest your losses before the year ends

Reduce tax liability by offsetting your capital losses against gains

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PROFITS OR LOSSES in your stock portfolio remain notional until the said profit/loss are actually booked, i.e., when the shares are sold, and money is realised in the bank account. While the income accrues continuously, for calculating your taxes only the net income earned (income that has actually been booked) between April 1 to March 31 is taxed under the Income-Tax Act.

This is the genesis of tax-loss harvesting, a strategy to minimise tax liability by selling investments that have declined in value just before the year end and utilising the losses to offset earlier gains.

Tax harvesting

This can be explained through an example: If an individual earns ₹10 lakh in short-term capital gains (STCG) on sale of listed shares this year, he must pay 15% of this amount as taxes, which amounts to ₹1.5 lakh. Additionally, if the individual holds stocks with an unrealised loss of ₹6 lakh, they can sell these stocks to reduce their net STCG to ₹4 lakh.

Accordingly, instead of paying taxes of ₹1.5 lakh, he would now have to pay ₹60,000 (i.e. 15% of ₹4 lakh) in taxes, resulting in overall tax savings. Further, if the investor wants to maintain his position on that stock, he can buy the shares which are now trading at a lower cost due to fall in prices.

Tax-loss harvesting allows for portfolio optimisation by enabling investors to rebalance portfolios without incurring significant tax consequences and an opportunity to diversify the portfolio. The market corrections that we are seeing for the past few days, may be due to several factors such as perceived overvaluation, pressure due to stress test triggers, etc. However, tax harvesting may also be a contributing factor.

How to do it

First, identify the loss-making investments by regularly monitoring the portfolio. After analysing the market, sell loss-making investments and book the capital loss. After selling, invest the funds realised by reinvesting in a similar asset.

Claim the losses while filing the ITR and complete the process of tax loss harvesting. The I-T Act allows you to carry forward capital losses for eight consecutive years; the process of tax harvesting helps precipitate the benefit of the loss in the same year. Also, while long-term capital losses (losses arising from sale of shares held for more than 12 months) can be adjusted against LTCG only, short-term capital losses can be adjusted against STCG as well as long term gains.

Long-term capital losses can be adjusted against long-term capital gains only. But short-term capital losses can be adjusted against short-term capital gains as well as long-term gains

In conclusion, tax loss harvesting is a smart way of reducing your tax liability and enhancing post-tax returns on your equity investments. However, it is not a one-size-fits-all solution and requires careful planning and execution and after considering the transaction cost (including brokerage, etc) associated with buying/selling. Considering that the financial year end is fast approaching, investors should review their existing portfolio position and evaluate the possibility of harvesting their tax losses.

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