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Harvesting Opportunities in Fixed Income

By: Holly Swan | July 19, 2023

Despite the Fed's recent pause to rate hikes, today's rising rate environment has us thinking about something we haven't thought about in years—tax-loss harvesting from fixed income portfolios. This opportunity is particularly relevant in the case of older trusts with large allocations to fixed income as well as hefty built-in capital gain within their equities.

Trustees have a fiduciary obligation to satisfy both the interests of the trust's income beneficiaries during the term of the trust, and the interests of the remainder beneficiaries at the trust's termination. While The Prudent Investor Act and Uniform Principal and Income Act have made balancing the interest of income beneficiaries and remainder beneficiaries easier, many older irrevocable trusts still utilize fixed income to generate funds for income beneficiaries. These same older trusts are more likely to hold highly appreciated stock that has been growing for the remainder beneficiaries—and therein lies the opportunity.

In today's rising rate environment, there may be an opportunity to harvest losses across the yield curve and utilize those losses to offset equity gains, while also improving the income stream available to current beneficiaries.

Here are a few questions you can ask to illustrate the current tax planning opportunities for the trustee:

1. Given the current rate environment, have you considered taking this opportunity to re-balance the portfolio?

Due to the declining value of older bonds, those trusts that aim to achieve a 50/50 balance of income and growth may find that they are now under-allocated to income. Re-balancing now could present opportunities.

2. We typically discuss tax-loss harvesting within the equity portfolio to offset our annual gains. Are you aware that we can also harvest losses from bonds, including municipal bonds?

Advisors and trustees who haven't experienced rising rate environments may not be aware that losses can be harvested from bonds in the same way they are harvested from equities.

3. In addition to year-end loss harvesting, are you familiar with systematically harvesting losses from fixed income portfolios?

Trustees who are taking advantage of systematic tax-loss harvesting of equities through a separately managed account may want to consider if applying a similar approach to fixed income makes sense.

Bottom line: Since many trustees have never experienced a rising rate environment such as today's, you can make them aware of the planning opportunities that may be available to them.

situation.

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