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Negative tax implications

Wash sales with multiple SMA managers

As many investors embrace Separately Managed Accounts (SMAs) for their flexibility, customization and access to professional management, a hidden challenge exists: the risk of unintended wash sales.

When multiple managers operate independently within an investor's portfolio, one may sell a stock at a loss while another may repurchase the same security shortly after, inadvertently triggering the wash sale rule. **This undermines the key tax benefits of selling at a loss and could actually lead to unexpected tax liabilities.**

Engaging a professional portfolio manager dramatically reduces this risk while creating a highly integrated tax-efficient investment solution for clients.

Understanding the Wash Sale Rule

The wash sale rule prevents taxpayers from claiming a tax-deductible loss on a security sale if they repurchase a “substantially identical” security within 30 days before or after the sale.

If an investor sells a security at a loss and then repurchases the same security (or a substantially identical one) within the 61-day period, the loss is disallowed for tax purposes. That disallowed loss is instead added to the cost basis of the repurchased security, effectively deferring any tax benefits.

In a single-manager scenario, this rule is straightforward to manage. However, when multiple managers operate independently within the same household’s portfolio, the risk of unintended wash sales increases dramatically.

The Value of Professional Portfolio Management

Engaging a single professional portfolio manager who oversees and personalizes the total portfolio can provide invaluable expertise and oversight, alleviating the challenges of tax loss harvesting.

1. Holistic View

A dedicated portfolio manager can monitor all investments across various accounts, ensuring that tax loss harvesting is executed efficiently and strategically within the client’s goals.

2. Enhanced Coordination

With a single manager coordinating all trading activities, they can time buys and sells to ensure that losses are harvested without conflicting trades occurring elsewhere.

3. Comprehensive Tax Strategy

Professional managers can integrate tax loss harvesting into a broader investment strategy, considering all aspects of an investor’s financial situation for optimal tax efficiency.

4. Ongoing Monitoring and Adjustments

A professional manager provides continuous oversight, adjusting strategies in response to ever-changing markets and personal client circumstances.

The Problem: Multiple Managers, No Coordination

In traditional SMA platforms, clients often allocate capital across different specialist managers to gain diversification across styles, asset classes or sectors. Most of these managers operate separately, focusing solely on their specific portfolios and strategy mandates. Without visibility on each other's strategies, the managers may be engaging in conflicting activities that could lead to inefficiencies in a portfolio.

For example, if Manager A sells a stock at a loss to realign his portfolio, while Manager B sees the lower price of the stock as a bargain and decides to purchase it for her portfolio, these collective actions have inadvertently triggered a wash sale for the end client. The disallowed loss results in a missed opportunity for tax savings across the entire portfolio.

In addition to the immediate tax implications that could arise, a lack of coordination across investment strategies may lead to added complexity for the investor. Having to keep track of all the transactions and associated tax triggers across numerous managers may create additional stress and potential for errors. An investor may miss critical harvesting opportunities or fail to adhere to IRS regulations while relying on fragmented advice from multiple sources.

Conclusion

In summary, understanding and adhering to tax regulations like wash sale rules is crucial for maximizing the benefits of tax loss harvesting. Multi-manager SMA structures have been widely embraced for their diversification benefits, but without coordination, they may expose investors to costly inefficiencies. By working with a professional portfolio manager who oversees the entire portfolio, investors can navigate the complexities of tax strategies more effectively, ensuring compliance while optimizing tax outcomes.

To learn more, contact your Senior Investment Consultant or Portfolio Manager. You can also visit us at www.rbcrochdale.com, or email us at citynationalrochdale@cnr.com

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