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RESEARCH · 06 | TAX MANAGEMENT

# Fit the harvest to the client, not the client to the harvest

A client selling a business next year and a retiree with no other gains need different harvesting. Here are the choices that change the outcome, and how to set them for each client.


| AUTHOR | CATEGORY | PUBLISHED | READ TIME |
|---|---|---|---|
| AdvisorXLS Research | Tax Management | November 27, 2026 | 4 min read |


Most harvesting programs run one process for every account. Your clients are not one client. One expects a large gain next year from the sale of a business. Another is retired, draws income, and has no other gains at all. The same harvesting gives them very different results.

When we built our harvest engine, we put every choice that changes the result in front of the advisor. There are 67 settings in nine groups. Most advisors use a few of them. Here are the ones that matter most, and the clients they matter for.

## Start with where the losses will go

A harvested loss saves tax only when it offsets a gain. Tell the engine about your client's life outside the account:

- **Gains elsewhere.** A concentrated stock sale, a fund distribution, a property sale. The more gains outside the account, the more each harvested loss is worth.
- **Losses already carried forward.** These use up gains first, so new losses may wait longer.
- **A loss goal.** For a client with a known sale coming, you can set how much loss you want banked by a date.

For a client with no gains anywhere, harvesting mostly builds a carryforward, used at $3,000 a year against ordinary income. You may decide to harvest less often or only on deeper losses, to keep the account closer to the model.

## Decide what happens to the winners

The most important single choice is whether the account may sell a gain to stay close to the model.

**Keep the winners.** The account never sells a gain to rebalance. Losses are harvested and winning positions are left alone. This keeps realized gains low, but the account drifts from the model as winners grow.

**Allow gains inside a band.** The account sells a gain only when a position drifts outside a band you set. On one model we tested, keeping every winner caused 87% of the shortfall against the unharvested model, because the account drifted too far from a strong model. Allowing gains inside a 10% band did better after tax in all five test periods.

Neither choice is right for every client. A client with a low tolerance for tax bills may prefer to keep the winners. A client who chose the model for its returns may want to stay closer to it.

## Choose where the cash waits

After a loss sale, the account cannot buy the same security back for 31 days. You choose what the money does meanwhile:

- Wait in cash for the same name, and buy it back on day 31.
- Go into a broad index fund, then return to the name.
- Go to other names in the model, such as the largest 25.

Each choice changes how closely the account tracks the model in that month, and what it costs to trade.

## Think about income

Harvesting changes the dividends an account pays. On one model over five years, the harvested account received 19% less in dividends than the model itself. The likely causes are cash that waits 31 days and the different mix of names the harvested account holds. For a client who lives on the portfolio's income, check the dividend figure in the results, not only the tax alpha.

## Know the structure of the account

For a long/short model, apply "keep the winners" to the long side only. On the short side, the same rule keeps winning shorts open, and the account can become heavily net short. In our tests, applying the rule to the longs only did better on every long/short model.

## Look at the account kept and the account sold

Part of every harvest is a deferral. The tax comes back when the client sells the low-basis shares. Your client may hold them for life, so heirs receive a step-up in basis, or give them to charity. In those cases much of the tax may never be paid. A client who will sell in a few years should see the result with the account sold. We show both, so you can show the client the right one.

## How AdvisorXLS lets you fit the harvest

- **Every setting is visible.** All 67 settings print on one page, so you and compliance can see exactly what ran.
- **Client inputs at the top.** Tax bracket, state, filing status, outside gains, carryforwards, withdrawals, contributions and who pays the tax.

- **Results for this client.** Tax saved, dividends paid, drift from the model, and the account kept and sold.
- **The same engine in every account.** A ticker change, such as Facebook to Meta, is not treated as a sale.

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