



Tax mitigation strategies when rebalancing your investment portfolio

Large stock market gains in recent years, coupled with some significant volatility in 2026, have left many investors with portfolios that are out of balance with their desired asset allocation. If you haven't rebalanced recently, it may be time to do so. But you also must consider the tax implications. Careful planning can minimize the tax cost of rebalancing.

What does rebalancing mean?

When you built your investment portfolio, you took several factors into account, such as your performance goals, risk tolerance and age, to arrive at an allocation across asset classes (such as money market funds, stocks and bonds) and subcategories (such as small-cap vs. mid-cap vs. large-cap U.S. stocks and U.S. Treasury vs. municipal bonds). When one asset class (or subcategory) outperforms, it will become a larger portion of your portfolio than your original asset allocation. This situation can potentially increase your risk and cause your portfolio to no longer align with your goals.

To keep your asset allocation in alignment, monitor your portfolio regularly and rebalance it as needed. Rebalancing involves selling some investments in classes that have become overweighted, usually appreciated stocks and mutual fund shares. You then reinvest the proceeds in other asset classes to help achieve your desired

allocation. But the gain you recognize from selling appreciated investments will be currently taxable — unless the investments are held in tax-advantaged retirement accounts, such as 401(k)s and IRAs.

Taxable brokerage accounts

When you file your tax return, your recognized capital gains for the year are netted against your recognized capital losses. If your gains in your taxable accounts exceed your losses, you have a net capital gain.

If a net capital gain is from investments held for more than a year, it will be taxed at the federal long-term gains rate. Most individuals will pay 15%, but, depending on your income, the rate could be 0% or 20%. Also depending on your income, you may owe the 3.8% net investment income tax (NIIT) on all or part of your net long-term gain. Depending on your state, you might owe state income tax, too.

If you have a net capital gain from investments held for one year or less, it will be taxed at the short-term gains rate. This is your ordinary federal income tax rate, which may be as high as 37%. You may also owe the NIIT on all or part of your net short-term gain. And, again, you might owe state income tax.

If losses in your taxable accounts for the year exceed your gains, you have a net capital loss. You can deduct the loss against up to \$3,000 of ordinary income (\$1,500 if you're married and file separately). Any remaining net capital loss is carried over to next year.

Tax-advantaged retirement accounts

If you sell assets held in a tax-advantaged retirement account, the resulting gains and losses affect your account balance. But they have no *tax* impact until you start taking withdrawals.

If it's a non-Roth account, the taxable portion of withdrawals (generally any amount attributable to appreciation or to contributions that were pretax or deductible) will be taxed at your ordinary federal income tax rate. Depending on your state, you may also owe state income tax.

If it's a Roth account, qualified withdrawals will generally be income-tax-free for federal purposes. This includes withdrawals attributable to appreciation.

Tax-smart strategies

If you have both taxable and tax-advantaged accounts, consider them together when rebalancing your portfolio. For example, let's say your overall portfolio across brokerage and retirement accounts has become overweighted in large-cap U.S. stocks. You can save taxes for the current year if you sell some of this appreciated stock from a retirement account because the gain won't be taxed.

Sometimes selling appreciated assets in a taxable brokerage account will be necessary to achieve rebalancing goals. In this case, look to see if there are also assets in that account (or another taxable account) that you can sell at a loss. The recognized loss can offset some or all of your capital gains on the appreciated assets you sell. Remember that selling assets at a loss in your tax-advantaged retirement account *won't* provide a current-year tax loss.

If you need to sell appreciated assets in a brokerage account and you won't be able to recognize enough losses to offset your gains, try to sell assets you've held more than one year. That way, the gain will be taxed at your lower long-term gains rate.

Rebalancing involves not only selling assets in classes that have become overweighted but also using the proceeds to buy assets in classes that have become underweighted. As you invest in new assets, consider which assets make more sense to hold in taxable vs. tax-advantaged accounts.

It generally makes sense to hold the investments you think will generate the highest long-term returns in a Roth account, because you can eventually take the resulting income and gains out free of federal income taxes. And if you do a lot of short-term trading that would generate high-taxed short-term gains in a taxable brokerage firm account, it makes sense to do the trading in a tax-advantaged retirement account.

Look beyond current tax consequences

Despite the significant impact taxes can have, don't make investment decisions — including those related to rebalancing your portfolio — based primarily on current-year tax consequences. You should also consider investment goals, time horizon, risk tolerance, investment-specific factors, fees and the *long-term* tax consequences. If you have questions or would like more information about investment portfolio rebalancing, contact us.