

Understanding the Fine Points of Capital Gains and Losses

Article Highlights:

- What is a Capital Asset?
- Long-Term Capital Gains Rates
- Capital Loss Limitations
- Asset Basis
- Net Investment Income Tax
- Home Sales
- Wash Sales

There is a category of income resulting from the sale of capital assets that receives special treatment for tax purposes.

A capital asset is defined to include property of any kind, whether held for business or personal use. Capital assets include all kinds of property, tangible and intangible; examples include land, buildings, plants and machinery, vehicles, furniture, jewelry, goodwill, tenancy rights, patents, trademarks, stocks and securities, mutual funds and homes.

Capital Gains - Generally, capital gains receive special tax rates if you have owned the capital asset for over a year, referred to as long-term capital gains. These special rates are 0%, 15% and 20% and are based on your regular tax bracket.

Thus:

- To the extent your regular tax bracket is less than 25%, the capital gains tax is zero.
- To the extent your regular tax bracket is 25% but less than 39.6%, the capital gains tax is 15%.
- To the extent your regular tax bracket is 39.6% or greater, the capital gains tax is 20%.

However, if the capital asset was held less than a year and a day, referred to as short-term capital gains, the gains are taxed at regular tax rates.

Capital Losses - For capital assets used personally, such as your car, home, jewelry, household items, etc., no losses are allowed. Business and investment losses are allowed and can offset gains but can only produce a maximum net loss for the year of \$3,000 (\$1,500 if filing as married separate). Any losses not allowed because of the annual net loss limit are carried forward to the next year.

Gains and Losses - These are determined by subtracting the capital asset's basis from the proceeds from sale, net of selling expenses. The basis of an asset is generally what you paid for it, but there are exceptions.

- Gift - If the asset was a gift, your basis will be the giver's basis at the time of the gift.
- Inherited - If you inherit an asset, your basis generally is the fair market value of the asset on the date of the decedent's death.
- Business - The basis of a business asset is its "adjusted basis," which is the cost adjusted for depreciation, improvements and casualty losses. In addition, there may be an element of ordinary income as a result of recaptured depreciation or reduction of basis due to cancellation of debt.
- Investments - Your original basis of shares of stock will need to be adjusted

for events such as stock splits, spin-offs and dividend reinvestments.

- Personal Use – Even the basis of personal use property may be adjusted because of improvements, casualty losses and cancellation of debt.

Other Issues:

- Net Investment Income – The Affordable Care Act included an additional tax on net investment income for higher-income taxpayers. This 3.8% tax applies to net investment income of individuals with modified adjusted gross incomes in excess of:

\$200,000 for unmarried taxpayers,

\$250,000 for married taxpayers filing jointly,

\$125,000 for married taxpayers filing separately.

- Home Sale Exclusion – Where you have a gain from a primary residence you used and owned for 2 of the 5 years preceding the sale, married couples filing jointly can generally exclude \$500,000 of the gain, and others can exclude \$250,000. There are numerous special rules associated with home sales; call for additional information.
- Wash Sales – To prevent taxpayers from selling a stock or security to produce a tax loss and then immediately buying it back, the tax code includes wash sale rules that prevent the loss from being claimed if the stock is repurchased 30 days before or after the sale resulting in the loss.

There are numerous other issues not covered in this article that can come into play depending upon your particular circumstances. If you are anticipating the sale of an asset that will result in a substantial gain or loss, you are encouraged to contact this office prior to the transaction to ensure you get the maximum benefits of the tax laws.