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Individual Capital Gains and Losses

Understanding short-term and long-term capital gains and losses, their respective holding periods, tax rates, brackets, and timing can be very helpful in your tax planning, especially at the end of the year.

Determining Holding Period:

Capital gains and losses are classified as long-term or short-term. If you hold the asset for more than one year before you dispose of it, your capital gain or loss is long-term. If you hold it one year or less, your capital gain or loss is short-term. To determine how long you held the asset, count from the day after the day you acquired the asset up to and including the day you disposed of the asset. If you do not have a capital loss carryover (discussed later) it could make sense to delay the sale of a particular security to create a long term capital gain (thus receiving preferential tax treatment).

Determining Tax Rates and Brackets:

If you have a long term net capital gain, this may be taxed at a lower tax rate than your ordinary income tax rates. For 2020, the capital gains tax rates will be as follows:

The 0% capital gains rate applies to adjusted net capital gain of up to:

- Joint returns and surviving spouses-$80,000 (up from $78,750 for 2019)
- Single filers and married taxpayers filing separately-$40,00 (up from $39,375 for 2019)
- Heads of household-$53,600 (up from $52,750 for 2019)
- Estates and trusts- $2,650 (same as for 2019)

The 15% capital gains tax rate applies to adjusted net capital gain over the amount subject to the 0% rate, and up to:

- Joint returns and surviving spouses-$496, 600 (up from $488,850 for 2019)
- Married Taxpayers filing separately-$248,300 (up from $244,425 for 2019)
- Heads of household- $469,050 (up from $461,700 for 2019)
- Single filers-$441,450 (up from $434,550 for 2019)
- Estates and trusts-$13,150(up from $12,950 for 2019)

The 20% capital gains tax rate applies to adjust net capital gain over the above 15%-maximum amounts.

There are a few other exceptions where capital gains may be taxed at rates greater than 15%:

1. The taxable part of the gain from selling section 1202 qualified small business stock is taxed at a maximum 28% rate.

2. Net capital gains from selling collectibles (like coins, gold/silver, including popular ETF, GLD, or art) are taxed at a maximum 28% rate.

3. The portion of any unrecaptured section 1250 gain from selling section 1250 real property is taxed at a maximum 25% rate.

A 3.8% tax on Net Investment Income applies to taxpayers with modified adjusted gross income (MAGI) that exceeds $250,000 for joint returns and surviving spouses, $200,000 for single taxpayers and heads of household, or $125,000 for married taxpayers filing separately. Net Investment Income includes but is not limited to gains from the sale of stocks, bonds, and mutual funds as well as capital gain distributions from mutual funds. After the 3.8% tax is factored in, the top rate on capital gain is 23.8%.

Timing of Mutual Funds:

If you invest in mutual funds and wait until after the distribution record date to buy a fund, you will be able to avoid recognizing taxes on that distribution (could be ordinary income or capital gains). These distributions are taxed as ordinary income or capital gains in the year received and immediately reduce the net asset value (NAV) of the fund. Since the purchase price of a mutual fund is its NAV (plus, perhaps, a broker's commission), if you wait to buy after the distribution record date, you will not get the dividend, however you will be able to buy the shares at the reduced NAV and thus have a lower basis than had they bought before the record date. This lower basis results in a higher capital gain or lower capital loss on disposition in addition to avoiding all taxation on the distribution amount.

For similar reasons, when it is time to sell mutual fund shares, you may want to sell before the distribution record date.

Capital Loss Carry Forward:

If you have a capital loss carry forward, you can recognize capital gains in future years

up to the amount of your capital loss carry forward, without increasing any future year's tax liability.

Generally waiting to convert a short-term to a long-term capital gain would be a waste of time if a capital loss carry forward offsets that gain.

To the extent that your capital gains in the future don't offset your unused capital loss carry forward, you can deduct the unused loss carry-forward up to $3,000 per year.

Please note that while New York also allows capital loss carry forwards, New Jersey does not.

Year End Tax Planning and Savings:

1. Review your portfolio with your broker or wealth advisor before the end of each year.

2. Determine the amount of long-term and short-term capital gains that have been realized during the year.

3. Ask your advisor if there is any opportunity for 'tax-loss' harvesting (realizing losses to offset gains during the year).

4. Any gains realized will be netted against carry forward losses available.

5. If the investment objective allows, try to spread capital gains over several years; this should help to avoid a jump to a higher tax bracket or the elimination of deductions.

Example of Tax Savings:

Facts:

1. Married couple under 65 years of age.

2. Receives qualified dividends of $20,000.

3. **Creates a long-term capital gain from the sale of securities of $80,000.**

4. Takes the standard deduction of $26,100.

5. Adjusted gross income would be $106,100.

6. Taxable income would be $80,000.

Under these facts, there would be **no federal income tax due.**

Conclusion:

Depending upon your filing status the amount of long-term capital gains that would be exempt from taxable income will change (married filing jointly or qualifying widow (er) - $80,000; single or married filing separately- $40,000 and $53,600 if head of

household).

However, even if you have other income, such as social security, pension or unemployment, that was included with the long-term capital gains, the overall effective federal tax rate could be below 10%.

If you have any questions about how these regulations apply to your particular situation, please contact our office so we can assist you.

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