Capital Gains Taxes – Details and Opportunities

It has been a national pastime to complain about taxes. In fact, 45% of Americans feel that their taxes are too high, even though only 56% of Americans pay any federal income tax. It is not my intention to convince you that taxes are too high or too low. However, I have noticed that many taxes are not well understood. Today, I hope to shed some light on the mechanics of the capital gains tax. It is tough to make tax topics simple, fun and interesting, but here it goes.

Capital gains taxes do not apply to qualified retirement accounts (401k, IRAs):

First, just to be clear, capital gains taxes only relate to gains on investments that have been realized (sold) in taxable accounts. These accounts are typically titled as individual accounts, joint tenant, community property and trust accounts. IRA's or 401k's are not taxable accounts since they are tax-deferred, and capitals gains taxes do not apply.

Low income taxpayers do not pay any capitals gains taxes:

Many people are unaware that there is no tax on long-term capital gains for taxpayers in the 12% tax bracket or below. A long-term capital gain means that you held the asset for at least a year before selling it. If you held it for less than a year then it is a short-term capital gain and taxed as ordinary income.

Long-Term Capital Gains Rate	SINGLE Filers (taxable income)	MARRIED filing Jointly	Head of Household	MARRIED Filing Separately
0%	\$0 - \$39,375	\$0 – 78,750	\$0 - \$52,750	\$0 - \$39,375
15%	\$39,376 - \$434,550	\$78,751 - \$488,850	\$52,751 - \$461,700	\$39,376 - \$244,425
20%	Over \$434,550	Over \$488,850	Over \$461,700	Over \$244,425

In 2019 a married couple, filing jointly, can have up to $78,750 in taxable income, and any of that income that came from long-term capital gains, that is selling the investment for more than you bought it for, will be tax-free at the federal level. Unfortunately, some states also tax capital gains at the state level. For example, California taxes capital gains at the same rate as ordinary income in addition to what you pay to the Feds (but at least the weather is nice).

Graduated tax brackets mean the same taxpayer can be taxed at different rates:

Capital gains tax brackets are graduated similar to the way ordinary income tax brackets work. Therefore, if you have $500,000 of ordinary income, some of it would be taxed at 10%, 12%, 22%, 24%, 32%, 35%, and 37%. If all the $500,000 of income was long-term capital gains, the 0% capital gains rate would apply to some of the income, then the 15% rate, and then the max rate of 20%.

The three long-term capital gains tax brackets, 0%, 15%, and 20%, are pretty straightforward. However, most families have a combination of ordinary income as well as capital gains. This means that there are multiple types of income, each with their own tax brackets! This is resolved by applying ordinary income to fill the bottom tax brackets first, and then adding the long-term capital gains on top. The tax deductions and exemptions are applied to the ordinary income first, and only apply against long-term capital gains once ordinary income has been reduced to zero.

This is the most favorable sequence possible as it ensures ordinary income, which is always taxed at a higher rate than capital gains, fills the lowest brackets. Then the long-term capital gains, with their preferential tax rates, fill the higher brackets. Thank you, Internal Revenue Code! Now, that's not something I find myself saying very often.

Capital gains tax planning opportunity:

The planning opportunity here is to use up the 0% capital gains bracket. Some retirees find that their taxable income is below $78,750 after deductions and exemptions. Even higher income families sometimes have a year or two when income is lower than normal (e.g. immediately after retirement before starting social security or pensions). If this is the case, it can pay to realize capital gains to the fill up the 0% bracket. Suppose you bought a stock for $20,000 and now it is worth $30,000. You can sell it, realize the $10,000 gain and not owe any taxes. You can even buy the stock back immediately if you still want to own it. There is **no wash sale rule** for realizing gains, only losses. In this case you just increased your cost basis from $20,000 to $30,000, which is a good thing. Feel free to email back with any questions.

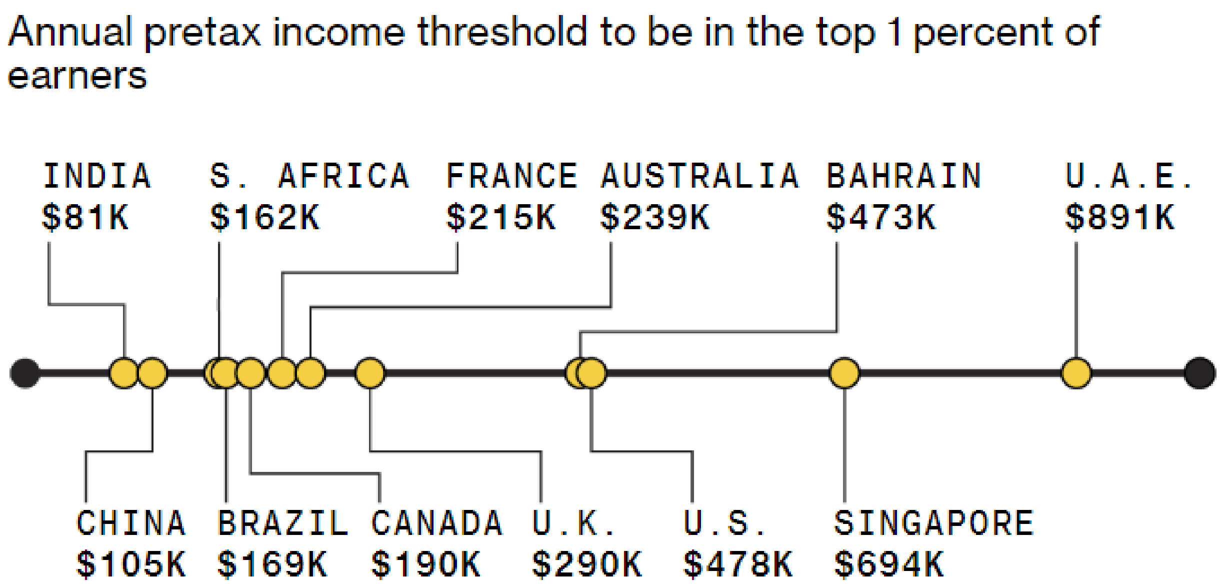
P.S. I did not forget about the 3.8% Medicare surtax. I just chose to ignore it for simplicity in the article. However, in 2013, we added a 3.8% surtax to all "unearned" income for taxpayers above $200,000 in Adjusted Gross Income (AGI) if you are single or $250,000 if married filing jointly. The 3.8% is added to the capital gains rate to get the full tax on the gain above the 200/250k threshold. This 3.8% Medicare surtax was part of the Affordable Care Act.

- Jeremy Kiser, Senior Wealth Advisor

What it takes to be in the top 1% around the world

Income inequality has garnered increasing attention from economists, politicians, and journalists since the 2007-2009 financial crisis. No group of people have been more scrutinized than those with income in the top one percent of the population. Yet that term can describe a wide variety of earners, depending on where they live.

Income standards vary widely around the world. You might need the combined incomes of eleven "One Percenters" in India to equal one such person in the oil-rich United Arab Emirates.



But check out how taxes and expenses vary also. See the full article from Bloomberg, [HERE].