VISION FINANCIAL GROUP CPAs LLP

ACCOUNTANTS & CONSULTANTS
1131 Campus Drive West · Morganville, New Jersey 07751
Phone (732) 536-5595 · Fax (732) 536-5592 · Web: www.vfgcpas.com

NEW CAPITAL GAINS TAXES

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Dear Client:

Year-end is a good time to engage in planning to save taxes by carefully structuring your capital gains and losses.

Let's consider some possibilities if you have losses to date. For example, suppose you lost money in the stock market in 2013 and have other investment assets that have appreciated in value. You should consider the extent to which you should sell appreciated assets (if you think their value has peaked) and thereby offset gains with pre-existing losses.

Long-term capital losses offset long-term capital gains before they offset short-term capital gains. Similarly, short-term capital losses offset short-term capital gains before they offset long-term capital gains. Remember you may use up to $3,000 of total capital losses in excess of total capital gains as a deduction against ordinary income in computing your adjusted gross income or AGI.

Individuals are subject to tax at a rate as high as 39.6% on short-term capital gains and ordinary income. But for most individuals long-term capital gains on most types of investment assets are taxed at a maximum rate of 15%. However, that 15% rate is (1) zero % to the extent the gain would otherwise be taxed at a rate below 25% if it were ordinary income and (2) 20% to the extent that the gain would be taxed at a 39.6% rate if it were ordinary income.

All of this means that you should try to avoid having long-term capital losses offset long-term capital gains since those losses will be more valuable if they are used to offset short-term capital gains or up to $3,000 per year of ordinary income. To do this requires making sure that the long-term capital losses are not taken in the same year as the long-term capital gains are taken. However, this is not just a tax issue, you also need to consider investment factors. You wouldn't want to defer recognizing gain until the following year if there's too much risk that the property's value will decline before it can be sold. Similarly, you wouldn't want to risk increasing a loss on property that you expect will continue to decline in value by deferring its sale until the following year.

To the extent that taking long-term capital losses in a different year than long-term capital gains is consistent with good investment planning, you should take steps to prevent those losses from offsetting those gains.

If you have yet to realize net capital losses for 2013, but expect to realize net capital losses in 2014 well in excess of the $3,000 ceiling, you should consider shifting some of the excess losses into 2013. That way the losses can offset 2013 gains and up to $3,000 of any excess loss will become deductible against ordinary income in 2013.

For the reasons outlined above, paper losses or gains on stocks may be worth recognizing this year in some situations. But suppose the stock is also an attractive investment worth holding for the long term. There is no way to precisely preserve a stock investment position while at the same time gaining the benefit of the tax loss, because the so-called “wash sale” rule precludes recognition of loss where substantially identical securities are bought and sold within a 61-day period (30 days before or 30 days after the date of sale). Thus, you can't sell stock to establish a tax loss and simply buy it back the next day.

However, you can substantially preserve an investment position while realizing a tax loss by using one of these techniques:

... Sell the original holding and then buy the same securities at least 31 days later. The risk is upward price movement.

... Buy more of the same stocks or bonds, then sell the original holding at least 31 days later. The risk here is downward price movement.

... Sell the original holding and buy similar securities in different companies in the same line of business. This approach trades on the prospects of the industry as a whole, rather than the particular stock held.

... For mutual fund shares, sell the original holding and buy shares in another mutual fund that uses a similar investment strategy.

As we have shown, careful handling of your capital gains and losses can save you substantial amounts of tax. Please contact us so that we can help you to realize maximum tax savings from these and other year-end planning strategies.

Very truly yours,

Jacob Ansel, CPA
Vision Financial Group CPAs LLP