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Introduction to Capital Gains

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Translating tax matters to prospects takes time, and techniques. First, the PGO must have a solid understanding of tax basics. Second, the PGO must explain tax strategies in a simple manner, gather further information about the prospect's property; and then clarify how property type, holding period, and gain or loss will effect both current and future gift arrangements.

One successful technique to explain the effect of taxes on gains and losses is to illustrate it using a lineup of nine one-dollar bills and two fifty-cent pieces. Assume a prospect in the 25% or higher tax bracket and the ten-dollars represent a gain on stocks or bonds. If the gain is short-term remove $2.50 or assume the gain is long-term and remove $1.50.

For many years property was simply classified as either short-term or long-term. Short-term was property held for a year or less while long-term was property was held for more than one year. Once the length of the holding period is established gain or loss in the fair market value of the property is computed. Thus, the prospect could have property held short-term with either a gain or loss and property held long-term with either a gain or loss. Four options to consider when a PGO is describing a gift situation.

Tax law changes in 2001 created a new five year holding period but it effects only taxpayers in the 10% or 15% tax bracket (joint returns with income of less than $58,100 or a single person with income of less than $29,050). This type of property is commonly called "super-gain" property and in 2004 "super-gain" properties is taxed at a maximum rate of 5%.

Property holding period is important because it effects the taxability of the gain. All tax rates should be adjusted to include the impact of any state and local taxes.

Lets look at some examples. Property held short-term and sold with a gain is added to other income and taxed at the donor's highest ordinary income tax rate. Property held short-term and sold at a loss is used first to offset short-term gains and once short-term gains are exhausted the donor may deduct on their Federal return a maximum loss of $3,000 in any tax year.

Property held long-term and sold with a gain is taxed at the Federal rate of 10% if the

donor is in the 10% or 15% bracket, and 15% for all other tax payers. If the property is "super-gain" property, the capital gains tax is 5% for 10% and 15% tax payers.

A special Federal tax rate of 28% exist for the sale of collectibles and a 25% tax rate applies to the recapture of depreciation on the sale of investment real estate.

Gift planners should be aware that gifts of mutual fund shares may contain both short-term and long-term gains and losses if distributions have been reinvested.

The IRS has helpful information on the reporting and taxation of gains and losses at: www.irs.gov/publications/p17/ch17.html#d0e43615