



# Capital Gains Tax Overview

When it comes to your investments, you may spend time choosing the best strategies and considering the tax consequences on those investments.

In this overview, we'll look at how your investments are taxed and strategies to help minimize the taxes you pay on those earnings.

## What are Capital Gains?

Capital gains and losses arise from the sale of a capital asset, and the applicable tax rate depends on how long the capital asset was held as well as your income. Generally speaking, long-term capital gains/losses are from the sale of capital assets held for more than a year, while short-term capital gains/losses are from capital assets held for a year or less. When the capital asset is sold for more than what was invested in it, the difference is a capital gain, which is subject to taxes.

## Taxes on Capital Gains 2024

Long-term capital gains generally qualify for a tax rate of 0%, 15%, or 20%. Under the Tax Cuts and Jobs Act of 2017, long-term capital gains tax rates are applied to income levels that differ from regular income tax brackets, as shown in the table below. Short-term capital gains are still taxed at your ordinary income tax rate.

Long-term Capital Gains Tax Rate	Income: Single Filer	Income: Married Filing Jointly
0%	Up to \$47,025	Up to \$94,050
15%	\$47,026 - \$518,900	\$94,051 - \$583,750
20%	Over \$518,901	Over \$583,751

### 3.8% Net Investment Income Tax Triggers

Those at the higher end of the income spectrum will need to account for a surtax in their capital gains income. The Health Care and Education Reconciliation Act of 2010 brought with it a 3.8% Medicare surtax on net investment income for taxpayers with modified adjusted gross income (MAGI) over a certain threshold. Net investment income includes interest; dividends; capital gains (including gains from investment real estate); rental and royalty income; income from financial instrument or commodity trading; and income from businesses that generally do not require active involvement from the taxpayer.

The statutory threshold amount for a tax year depends on your filing status, and these amounts are not indexed for inflation.

Filing Status	Threshold
Married Filing Jointly, Qualifying Widow(er)	\$250,000
Single, Head of Household	\$200,000
Married Filing Separately	\$125,000

If your MAGI is above the applicable threshold, the 3.8% tax will be applied to the lesser of your total net investment income or the amount by which your MAGI exceeds the threshold.

Take, for example, a single filer whose MAGI is \$240,000, of which \$180,000 is wages and \$60,000 is net investment income. With MAGI \$40,000 over the surtax threshold and net investment income of \$60,000, he'll pay the 3.8% surtax on \$40,000, which is the lesser of the two, resulting in a net investment income tax of \$1,520.

### Capital Gains Taxes – Examples

Frequent changes in your investment holdings can result in tax payments on capital gains – especially in tax-inefficient asset classes like REITS, commodities, bonds, and small/mid cap funds.<sup>1</sup> In the examples below, we illustrate the impact of both long-term and short-term capital gain taxes on a hypothetical stock. Assume for these examples that the sale of stock is the only investment income. We also show the impact across several income tax brackets for a married couple filing jointly. As you can see, capital gain taxes can add up quickly.

Long-term Example (Married Couple)	MAGI: \$150,000 15% Capital Gains Rate	MAGI: \$300,000 15% Capital Gains Rate	MAGI: \$600,000 20% Capital Gains Rate
Purchase 500 shares at \$100 each	\$50,000	\$50,000	\$50,000
Sell 500 shares at \$200 each more than a year later	\$100,000	\$100,000	\$100,000
Net investment income	\$50,000	\$50,000	\$50,000
Taxes owed on capital gains	\$7,500	\$7,500	\$10,000
Net investment income tax owed	\$0	\$1,900 (3.8% on \$50,000)	\$1,900 (3.8% on \$50,000)
<b>Total capital gains tax obligation</b>	<b>\$7,500</b>	<b>\$9,400</b>	<b>\$11,900</b>

<sup>1</sup> Generally, tax-inefficient asset classes are asset classes such as alternatives, bonds, real estate, and utilities, as well as other funds that may generate ordinary income, dividends, or short-term capital gains when they are purchased outside of a tax-deferred investment vehicle.

Short-term Example (Married Couple)	MAGI: \$150,000 22% Marginal Tax Rate	MAGI: \$300,000 24% Marginal Tax Rate	MAGI: \$500,000 35% Marginal Tax Rate
Purchase 500 shares at \$100 each	\$50,000	\$50,000	\$50,000
Sell 500 shares at \$200 each less than a year later	\$100,000	\$100,000	\$100,000
Net investment income	\$50,000	\$50,000	\$50,000
Taxes owed on capital gains	\$11,000	\$12,000	\$17,500
Net investment income tax owed	\$0	\$1,900 (3.8% on \$50,000)	\$1,900 (3.8% on \$50,000)
Total capital gains tax obligation	\$11,000	\$13,900	\$19,400

## Strategies to Help Avoid Capital Gain Taxes

There are a number of strategies to consider when seeking to control the loss in your portfolio caused by the taxation of capital gains. Below are four popular options to optimize your investment growth:

- 1 **Long-term investing** — Holding assets for the long term ensures you pay only the tax rates applicable to long-term capital gains tax, which is less than the rates for short-term capital gains. Keep in mind that many factors impact your investment decisions and there are any number of reasons you may want to sell earlier than you plan.
- 2 **Using capital losses to offset gains (tax-loss harvesting)** — This strategy requires losses in order to offset your gains. For example, if you are invested equally in two stocks, and one company's stock rises by 20% and the other company falls by 10%, you can subtract the loss from the gain, reducing the amount of capital gain on which you pay tax. Keep in mind that there is a cap on the amount of capital loss you are able to use against your capital gain, and the losses needed for this approach are real economic losses to you.
- 3 **Retirement plans** — There are numerous types of qualified retirement plans like the 401(k), 403(b), IRA, and Roth IRA where your investment can grow tax deferred. Most of these plans don't require participants to pay income taxes until funds are withdrawn from the plan, typically at retirement when many investors may find themselves in a lower tax bracket than during their working years.
- 4 **Annuities** — Similar to qualified retirement plans, annuities grow without being subject to capital gain taxes and aren't taxed until funds are withdrawn.<sup>2</sup> The main differences are in how the invested dollars are taxed prior to investing and how much you can invest. In qualified plans, you invest pre-tax dollars and annual contributions are capped. In a non-qualified annuity, you use after-tax dollars and are not subject to a contribution maximum as qualified retirement accounts are. Consider a non-qualified annuity once your qualified plans are maxed out or when you have a windfall to invest for additional retirement savings.

## The Bottom Line

Capital gains are a result of investments that have performed well, but taxes can eat away at their compounding power. As a sophisticated investor, you have a range of strategies to help you mitigate such losses — from buy and hold, tax-loss harvesting, maxing out your qualified retirement plans, and contributing to tax-deferred annuities.

<sup>2</sup> Withdrawals from an annuity are taxable as ordinary income and, if made before age 59½, may be subject to a 10% IRS penalty tax. Investing in an annuity through a tax-qualified contract, such as an IRA, offers no additional tax benefit.

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