Managing Capital Gains and Losses

What you need to understand before selling an investment

Capital gains and capital losses

A capital gain or loss results from the sale of a capital asset. Examples of capital assets are stocks, bonds, mutual funds, and real estate. The amount of the capital gain or loss equals the net sales proceeds minus the adjusted cost basis.

Capital gains do not include ordinary income, such as interest or dividend income. Although qualified dividends are taxed at long-term capital gains rates under current tax law, you cannot use capital losses to directly offset qualified dividends.

How you manage your capital gains and losses can play a major role in determining your after-tax return. To get the greatest benefit from current tax law, there's important information you need to understand.

Holding periods

Your holding period and taxable income (discussed below) determine your capital gains tax rate. Assets you hold long-term—longer than one year—receive a preferential rate. Assets held short-term are those held for one year or less. To determine if you held property longer than one year, start counting on the date following the day you acquired the property.

For example, if you purchased an investment on Feb. 4, begin counting on Feb. 5. The short-term holding period would end on Feb. 4 of the next year. To establish a long-term holding period, you would have to sell the asset on or after Feb. 5 of the next year. (Note that dates of acquisition and disposition are determined by the trade date, not the settlement date. Exceptions may apply to short sales.)

Special holding-period rules for assets acquired by gift or inheritance

Your holding period for an appreciated asset received as a gift includes the length of time you held the asset plus the time the donor held it. Any property you inherit related to a death occurring in a year other than 2010 has an automatic long-term holding period—no matter how long you or the deceased held the asset.

Long-term capital gains rates*

Generally, long-term capital gains fall into one of three tax brackets: 0%, 15%, or 20%. The thresholds for determining which bracket applies to a long-term capital gain are illustrated in the federal tax rate summary that follows below. The 0% long-term capital gains rate only applies to the amount of gain below the threshold of $80,000 (married filing jointly) or $40,000 (single) for 2020. While long-term capital gains may be eligible for 0% rates for lower income individuals, the gain itself is still considered income, potentially impacting certain deductions, tax credits, and the taxation of Social Security.

**Stated rates are for federal income tax purposes only. Consult your tax advisor for state income tax rates.*

The following example shows the amount of gain taxed at the 0% rate for a married couple with $85,000 taxable income; $70,000 from wages and $15,000 from long-term capital gains. Although their total taxable income exceeds the $80,000 limit, they pay no tax on $10,000 of capital gains. The excess $5,000 in capital gains would be taxed at 15%.

Taxable income	=	$85,000
Maximum threshold for 0% rate	=	$80,000
Amount exceeding threshold	=	$5,000 (15% long-term capital gain rate applies)
Amount of gain under threshold	=	$10,000 (0% long-term capital gain rate applies)
Total gain	=	$15,000

Capital gains and losses and dividends

	Long-term capital gain rate (held longer than one year)		
Filing Status	**0%**	**15%**	**20%**
Married filing jointly and surviving spouse	$0–$80,000	$80,001–$496,600	Over $496,600
Single	$0–$40,000	$40,001–$441,450	Over $441,450
Head of household	$0–$53,600	$53,601–$469,050	Over $469,050
Married filing separately	$0–$40,000	$40,001–$248,300	Over $248,300
Trusts and estates	$0–$2,650	$2,651–$13,150	Over $13,150

Exceptions to these rates include gains from sales of collectibles and certain depreciable property. Capital gains on those items may be taxed at a higher capital gains rate. For more information, consult your tax advisor.

Short-term capital gains rates

Like ordinary income, short-term capital gains are taxed at an individual's marginal tax rate, which can currently be as high as 37%.

Think about taxes all year

Although many investors wait until year-end or the approach of the April 15 tax-filing deadline to begin thinking about taxes, it may be wiser to periodically assess your tax situation—especially those issues surrounding your portfolio—throughout the year. Talk with your Financial Advisor and tax advisor regularly to review how well your investments are helping you work toward your goals in a tax-efficient manner.

Offsetting capital gains and losses

Capital losses you incur may be tax-deductible; however, there are limitations on the deductible amount in any given year. Here are the steps to follow to deduct a capital loss:

1. Offset short-term capital gains against short-term capital losses to determine the net short-term capital gain or loss.
2. Offset long-term capital gains against long-term capital losses to determine the net long-term capital gain or loss.
3. Combine the net short-term result with the net long-term result if one result is a net gain and the other a net loss.
4. If a net capital loss remains after completing steps 1 through 3, you may use it to offset up to $3,000 in ordinary income in the current tax year.
5. If there's still a remaining capital loss, you may carry it forward to offset future years' capital gains and/or ordinary income (in accordance with steps 1 through 4).

For example, an investor has a:

- $6,000 short-term gain
- $4,000 short-term loss
- $5,000 long-term gain
- $12,000 long-term loss

He or she should:

1. Calculate the net short-term capital gain or loss:

Short-term gain:	$6,000
Short-term loss:	(4,000)
Net short-term capital gain:	$2,000

2. Calculate the net long-term capital gain or loss:

Long-term gain:	$5,000
Long-term loss:	(12,000)
Net long-term capital loss:	($7,000)

3. Calculate the net capital loss:

Net long-term capital loss:	($7,000)
Net short-term capital gain:	2,000
Net long-term capital loss:	($5,000)

4. Use $3,000 of the net long-term capital loss to offset ordinary income in the current year.*
5. Carry over the remaining $2,000 long-term capital loss to offset future years' capital gains and/or ordinary income.

**When calculating the Medicare surtax, the $3,000 capital loss cannot offset dividend income.*

You can count on us

Your Financial Advisor can work with you and your tax advisor to help manage your capital gains and losses whenever you sell an investment.

Capital loss carryover

Losses carried over to future years retain their long-term or short-term character. For example, if a taxpayer reported a net short-term loss carryover from a prior year, then in the current year that loss would first be applied against short-term gains.

Unused net capital losses can be carried over until they are fully used or until the taxpayer's death. Carryover losses may be used on a deceased individual's final income tax return in the same manner as described above. Surviving spouses can carry forward only half of a joint loss, if applicable. Any remaining losses cannot be passed on to the deceased's spouse or heirs.

Watch out for wash sales

When you sell stocks at a loss, the IRS lets you offset the loss against capital gains or take up to $3,000 of your capital losses against your taxable income. The exception to this is a "wash sale." If you buy the same stock 30 days before or after the sale, the IRS will disallow the loss. This prevents you from selling the stock, including the loss on your return and then buying the stock back immediately to capture any future gains.

If the wash sale rule applies, the disallowed loss in the current year is added to the cost basis of the new security purchased within the wash sale window. When you sell that stock, the price is adjusted with the previous loss. The date of the new purchase also changes to include the holding period of the original shares.

Schedule D and Form 8949

Many transactions previously reported on Schedule D are reported on Form 8949. Form 8949 segregates short-term transactions from long-term transactions. Capital transactions must be further separated on Form 8949 based on the following categories:

- Transactions reported on Form 1099-B with cost basis reported to the IRS.
- Transactions reported on Form 1099-B but cost basis is not reported to the IRS.
- Transactions not reported to you on Form 1099-B.
- For additional information on Form 8949, you should consult your tax advisor.

Medicare surtax

Higher income taxpayers may be subject to an additional Medicare tax of 3.8% on net investment income. The tax affects taxpayers with modified adjusted gross income in excess of $200,000 for single individuals and $250,000 for married couples filing jointly. This surtax is in addition to any capital gain or ordinary income taxes that apply.

Wells Fargo Advisors is not a tax or legal advisor. While this information is not intended to replace your discussions with your tax advisor, it may help you to comprehend the tax implications of your investments and plan efficiently going forward.