Humberto Cruz

TAX BREAK VALID REST OF THE YEAR

By ***Humberto Cruz***
June 27, 2010
The Savings Game

Q: I have a question concerning your recent column about the 0 percent tax rate on long-term capital gains. What advantage is there in selling for a long-term gain, then buying back the same security?

A: This reader and many others with a similar question were referring to a 0 percent federal income tax rate for long-term capital gains available to many taxpayers.

This 0 percent rate remains a surprisingly little known provision of the Jobs and Growth Tax Relief Reconciliation Act of 2003. That's probably because this provision didn't become effective until 2008. It's set to expire after Dec. 31, 2010, along with other so-called Bush tax cuts.

Until then, if you sell a security you've held more than a year at a gain, and your total taxable income for the year, including the gain from the sale, does not push you beyond the 15 percent tax bracket, there's no tax to pay on the gain.

Therefore, I suggested the strategy of selling a security for a tax-free gain, then buying it back.

Say you paid $10,000 to buy shares of a stock or mutual fund years ago, and the shares are worth $20,000 now. Your taxable income for 2010 is low enough that even if you sell the shares for a $10,000 gain, you won't go over the 15 percent tax bracket. For 2010, single taxpayers with taxable income up to $34,000 and joint filers with taxable income up to $68,000 won't go over the 15 percent bracket.

You sell your shares for $20,000 and buy them back. With stock, you may incur commissions and other trading costs, such as the bid-ask spread. Between the time you sell and buy back, the price of the stock or fund may have gone up.

But even if the sell-and-buy-back transaction sets you back a few dollars, you will have permanently shielded your $10,000 gain from taxation. The point: Next time you sell, you will be taxed only on any increase in value above the $20,000 repurchase price, not the original $10,000.

I don't know what capital-gains taxes will be in the future but they could well be higher. Even if Congress does nothing, rates in 2011 will automatically revert to what they were before 2003. That means a taxpayer in the 15 percent bracket will pay a 10 percent tax on long-term capital gains (or 8 percent for "super long" gains on securities held more than five years, said John W. Roth, senior tax analyst for tax publisher CCH, a Wolters Kluwer business). Even at 8 percent, that's an $800 tax on what could have been a tax-free $10,000 capital gain in 2010.

In addition, the maximum capital gains tax rate would go back from the current 15 percent to 20 percent in 2011. That's another argument for selling and buying back now, because the longer you defer realizing gains, the higher those gains may grow, pushing you into a higher tax bracket.

Send questions or comments to Humberto Cruz at AskHumberto@aol.com.