Harvesting Capital Gains and Losses

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The first step in your year-end planning for capital gains and losses is to run tax projections to determine your projected 2014 income and thus, your 2014 tax bracket. Your projected tax bracket will determine how you handle year-end planning moves for your securities portfolio. If you determine that you are in the 15% or lower tax bracket, you will want to do capital gains harvesting. On the other hand, if you determine that you are in the 25% or higher tax bracket, you will want to engage in capital loss harvesting. So, the key to handling your year-end securities moves is going to be based on your tax bracket. The advice for someone in the 15% tax bracket is exactly the opposite of the advice for someone in the 25% or higher tax bracket and vice versa. Here are the tax brackets for 2014 and the projected tax brackets for 2015:

Chart 1: Single Taxpayers

2014		2015	
If taxable income is between:	**Tax Rate**	**If taxable income is between (estimated):**	**Tax Rate**
$0 and $9,075	10%	$0 and $9,225	10%
$9,076 and $36,900	$907.50 + 15% of excess over $9,075	$9,226 and $37,450	$922.50 + 15% of excess over $9,225
$36,901 and $89,350	$5,081.25 + 25% of excess over $36,900	$37,451 and $90,750	$5,156.25 + 25% of the excess over $37,450
$89,351 and $186,350	$18,193.75 + 28% of excess over $89,350	$90,751 and $189,300	$18,481.25 + 28% of the excess over $90,750
$186,351 and $405,100	$45,353.75 + 33% of excess over $186,350	$189,301 and $411,500	$46,075.25 + 33% of the excess over $189,300
$405,101 and $406,750	$117,541.25 + 35% of excess over $405,100	$411,501 and $413,200	$119,401.25 + 35% of the excess over $411,500
$406,751 and above	$118,118.75 + 39.6% of excess over $406,750	$413,201 and above	$119,996.25 + 39.6% of excess over $413,200

Source: Bloomberg BNA

Chart 2: Married Taxpayers			
2014		**2015**	
If taxable income is between:	**Tax Rate**	**If taxable income is between (estimated):**	**Tax Rate**
$0 and $18,150	10%	$0 and $18,450	10%
$18,151 and $73,800	$1,815 + 15% of excess over $18,150	$18,451 and $74,900	$1,845 + 15% of excess over $18,450
$73,801 and $148,850	$10,162.50 + 25% of excess over $73,800	$74,901 and $151,200	$10,312.50 + 25% of the excess over $74,900
$148,851 and $226,850	$28,925 + 28% of excess over $148,850	$151,201 and $230,450	$29,387.50 + 28% of the excess over $151,200
$226,851 and $405,100	$50,765 + 33% of excess over $226,850	$230,451 and $411,500	$51,577.50 + 33% of the excess over $230,450
$405,101 and $457,600	$109,587.50 + 35% of excess over $405,100	$411,501 and $464,850	$111,324 + 35% of the excess over $411,550
$457,601 and above	$127,962.50 + 39.6% of excess over $407,600	$464,851 and above	$129,996.50 + 39.6% of the excess over $464,850
Source: Bloomberg BNA			

Looking at your investment portfolio can reveal a number of different tax saving opportunities. Start by reviewing the various sales you have realized so far this year on stocks, bonds, and other investments. Then review what's left and determine whether these investments have an unrealized gain or loss. (***Unrealized*** means you still own the investment and haven't yet sold it, versus ***realized***, which means you've actually sold the investment itself.)

You must know the tax basis of your investments, which is usually the cost of the investment when you originally bought it. However, some investments allow you to reinvest your dividends and/or capital gains. This means you are actually buying more shares and therefore the basis of this investment is determined by your original cost plus all these reinvestments. Unfortunately, many taxpayers and other advisors aren't aware of the amount for reinvested shares when they sell their investment because they didn't keep track of the cost basis, especially for stocks purchased many years ago. We can help you calculate the cost basis using a number of different techniques.

Capital Gain Harvesting

If you are in the 10% or 15% tax bracket, the tax rate for long-term capital gains is zero percent! In order to qualify for this tax break, your 2014 taxable income cannot exceed $36,900 for singles and $73,800 for married joint filers.

Please note that the 0% tax rate only applies until your taxable income exceeds the current 15% tax bracket. For example, let us assume that a married couple with a taxable income of $60,000 sells an investment for a long-term capital gain of $40,000. The first $13,800 of long-term capital gain is tax-free, but once their taxable income passes the $73,800 limit, the remaining capital gain of $26,200 is taxed at the 15% tax rate.

If you are eligible for the 0% capital gains tax rate, it might be appropriate to sell some appreciated stocks to take advantage of this tax strategy. Sell just enough so your gain pushes your income to the top of the 15% tax bracket, then buy new shares in the same company. The new shares will have a higher cost basis than the shares you sold. The capital gains tax you pay when you eventually sell these shares in the future is based on the gain above this new higher basis. This allows you to take advantage of the 0% tax rate now, so when the 0% tax rate goes away you won't have to pay as much taxes on the appreciation that occurred when you first bought the stock. Please also note that you do not have to wait 30 days before you can buy the stock back when there is a gain, which is referred to as "gains-harvesting." You have to wait 30 days only if there is a loss.

If your income makes you ineligible for the 0% capital gains tax rate, but you have adult children in the 0% bracket, you could give appreciated stock to them. Your adult child in a lower bracket will pay a lot less in capital gains tax than if you sold the stock yourself.

It is also important to look at the possibility of selling some of the shares of a stock at different times and different prices. You may be able to reduce a gain or increase a deductible loss if you identify the particular shares to be sold at the time of the transaction.

But be careful—you can't "go back in time" if you subsequently discover you would have fared better had you identified different shares before you made a particular sale. If you don't specify which shares you are selling at the time of the sale, the tax law treats the shares you acquired first as the first ones sold. In other words, it uses a **FIFO** (First-In, First-Out) method. This may not produce the optimal result that you had wished for.

Capital Loss Harvesting

If your capital gains are larger than your losses, you might want to do some "loss harvesting." This means selling certain investments that will generate a loss—converting them from unrealized losses to realized losses. You can use an unlimited amount of capital losses to offset capital gains. However, you are limited to only $3,000 of net capital losses that can offset other income, such as interest, dividends and wages. Any remaining unused capital losses can be carried forward into future years indefinitely.

Please note that if you sell an investment with a loss and then buy it right back, the IRS disallows the deduction. The "wash sale" rule says you have to wait at least 30 days before buying back the same security in order to be able to claim the original loss as a deduction. However, you can buy a *similar* security to immediately replace the one you sold—perhaps a stock in the same sector. This strategy allows you to maintain your general market position while utilizing a tax break.

If you own an investment that you believe is worthless, sell it to someone other than a related party for a minimal amount, say $1, to show that it is, in fact, worthless. The IRS often disallows a loss of 100% because they will usually argue that the investment has to have at least *some* value.

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