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43.4% Capital Gain Tax? 10 Things To Know

Most income is ordinary, including pay for services, interest, business profits, dividends, money for winning the lottery, and most other payments. But for generations, there's been a big tax break for long-term capital gains, those held over a year. Assuming you get past one year, if you sell your house, car, crypto stockpile, Amazon AMZN +0.6% stock or other assets, it's long-term capital gain. Up to now, the tax rate on capital gain has been zero, 15% or 20%, depending on your income. In some cases you must add the 3.8% Obamacare tax, but at worst, your total tax bill is 23.8%. In contrast, ordinary wage income can face tax of 40.8% once you include payroll tax. But change is in the wind. Here are 10 things to know.

1. The 23.8% rate may go to 43.4% for some. That rate hike amounts to a staggering 82% increase in the old rate. If you add state income taxes, like California's current 13.3% rate, the government gets most of your gain. The current long term capital gain tax is graduated. You pay 0% on income up to $40,000, 15% over $40,000 up to $441,450, and 20% on income over $441,451. But those thresholds may change.

2. The 43.4% rate is supposed to hit only those earning $1M or more. One big debate is who should face this stratospheric rate hike. But if you bought a house 30 years ago that is now worth over a million, you could be impacted.

3. It might already be too late to sell. A natural reaction to a looming 82% tax rate hike is to sell quickly before the new law takes effect. But the proposal was specifically designed to prevent this. As proposed, the rate hike *is already in effect* for sales after April 28, 2021. It might not pass of course, or it might pass in a different version or with a different effective date. But for right now, it is hard to decide what to do. Do you sell now, figuring you are stuck with the new higher rates? Or do you wait to see? If you wait, might you miss the chance to sell under the old rates? What if you wait until September and the tax hike passes, but with an August effective date? There's no easy answer.

4. With capital gain, you can offset losses. You can use your capital losses to offset capital gains. Even if you don't have existing losses, you can time asset says to trigger losses with your gains, to help offset them.

5. You can subtract your basis, but can you prove it? Capital gain tax applies to your gain not to your sales proceeds, so your adjusted tax basis can be subtracted. Your basis is your original investment, as adjusted by things like remodeling costs, expenses related to the investment, etc. Keep your receipts, which can be relevant for decades with assets like a house. The IRS always wants receipts, and if you can't establish your basis, you could face tax on it all.

6. Timing ordinary income is tough, but capital gain allows timing. Normally, you can decide when to sell an asset and under what terms. In contrast, with ordinary income the constructive receipt doctrine says "don't pay me until January" doesn't work with IRS. In essence, it means that you can't time your

income in most cases. However, if you are settling a lawsuit, you can refuse to sign a settlement agreement unless it states that the defendant will pay you in installments. Even though it may *sound* as if you could have gotten the money sooner, there is no constructive receipt because you conditioned your signature on receiving payment in the fashion you wanted.

7. Keep track of other tax breaks. A house sale is taxable, but the primary home sale exemption may also apply, excluding from tax up to $500,000 for some home sales. And there are other benefits being quietly left alone. A good example is qualified small business stock, a darling of silicon valley that allows up to $10M of gain on certain stock sales to escape tax entirely.

8. Taxes on death are coming too. The most pervasive change of all impacts massive capital gain tax increases on death. President Biden's tax plans reflect a massive change in how income and estate taxes interact, amounting to a big tax increase that will transform *income* taxes on death. Under present law, inherited property receives a full fair market value tax basis on death. The step-up in basis provides tax benefits for everyone passing down appreciated assets, including real estate, stock, family companies and more. For generations, assets held at death have received a stepped-up basis to market value when you die. Small businesses count on this. President Biden would end the step up in basis, subject only to an exemption of $1 million plus $250,000 of gain on a home. Beyond that, everything would be taxed.

9. The Biden plan cuts deep on many more people for much higher *income* taxes once you die. After the Democratic National Convention, Mr. Biden pledged 'no new taxes' on incomes under $400,000 and on mom & pop businesses, but this tax increase on death could hit everyone, including people making less than $400,000. There appears to be no reliable estimate

for how many people are holding highly appreciated assets that are counting on a step up in basis on death to avoid income taxes.

10.Some things are hard to justify. There are debates about which tax increases are fair, over the high rate proposals and tax on death. But some parts of current capital gain tax law have been called abusive. A good example is the capital gain treatment that some private equity fund managers get. But no matter your income, people care about capital gain. Even so, the basic idea long ensconced in the tax law is that everyone gets a break on selling assets compared with regular income could be on the chopping block.

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