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New Capital Gain Tax Reporting For 2011 Tax Returns

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This may seem like a sleeper development, not a dramatic turn of events. After all, it's just a new form to report the same old thing, gains or losses from stock investments, real estate or what have you. But ***anything*** that impacts ***this most fundamental line*** in the tax law should make you sit up and take notice.

Plus, this is from the IRS—the Oracle itself, giving you a New Way to Report Capital Gains and Losses.

Schedule D is so Last Year! You were used to reporting capital gains and losses on Schedule D. Now, in most cases, use new Form 8949 to report capital gain and loss transactions. Schedule D—the form traditionally used to show individual transactions—still exists. But now it is a summary sheet reporting total sales price, basis and other adjustments for all transactions and for figuring the tax.

For securities both bought and sold in 2011, the Form 1099-B issued by the broker normally shows your basis. The information on this form will help you correctly fill out Form 8949. See the instructions for Form 8949 and Schedule D for details.

Why Do You Care? A professor once told me tax lawyers spend a third of their time trying to convert ordinary income into capital gain. He may be right, but he may have underestimated it. The line between capital gain and ordinary income has always been important.

Throughout much of the history of our tax law, there's been a decidedly lower rate on capital gain. See Historical Capital Gains and Taxes. Today, this 15% rate is a full 20 percentage points below the ordinary income rate. The capital gain classification is also important to basis. The corollary to capital gain treatment is generally basis recovery even before one has gain.

Then too, there are capital losses. Individuals often find themselves trapped with large accumulated capital losses from which they can benefit only at a painfully slow pace. Some taxpayers argue for capital gain treatment not because they are trying to claim the 15% rate, but to soak up accumulated losses that might otherwise languish until the next ice age!

For entities, it's mixed. S corporation shareholders benefit from the flow-through of these items on their Schedules K-1. Ditto for limited liability companies and partnerships. C corporations do not receive a tax rate preference, but even they can care about this distinction.

Thus, the distinction between capital and ordinary remains vital, not just for planners and those handling tax controversies, but for lawmakers, too. See Capital Gains Tax Rates Benefiting Wealthy Feed Growing Gap Between Rich and Poor. One needs to look no further than the carried interest debate. See Tax Gift To The Rich. Should private equity and hedge fund titans pay 15% while most of us pay 35% tax?

Ultimately, that's the same issue raised by Warren Buffett who notes his own tax rate vs. his secretary's. See Buffett's Tax Buffet Is No Smorgasbord. If you can plan and orchestrate your tax life carefully, who wouldn't pay 15%?

For more, see:

Capital Gain: Three-Year or Six-Year Statute of Limitations?

Tax Credit Sale Favorably Taxed

Buffett Tax Goes Korean

Choice of Entity Poses Tax, Liability Issues

IRS Tax Topics – Topic 409 Capital Gains and Losses

IRS: Ten Important Facts About Capital Gains and Losses

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