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Week 3 Homework

Capital Gains tax is a tax that is made when you sell a non-inventory asset that was purchased at a lower price. The most common thing that this can take place on would be the sale of a house. Although in this economy we are seeing more and more people that are losing money when they go to sell their homes because of how bad things are. These taxes are charged by the sate in which the transaction is completed.

In the United States, aside from some restrictions or exceptions, the individuals or corporations will pay income tax on the net total of their capital gains. They also have to figure in if it is a short term or long term gain. If it is short term then they are taxed at a higher rate or the ordinary income tax rate. When they are looking at weather it is a long term or short-term gain they are looking at how long the individual or corporation has owned the asset in question. For a short-term gain the asset has been held for less than a year. For the long-term gains the asset has been held for more than a year. However, there are some tax brackets where there is no tax due on such gains.

In 2003 there was a rate reduction on the long-term taxes from 20% to 15% for the individuals that fell into the higher of the tax brackets. And it went from 10% to 5% for the individuals who are in the lowest two brackets. This law has been extended several times and is now set to go till the end of 2012. President Bush help the individuals in the lower two tax brackets out even more by take the 5% down to 0%. These things constantly have to change because of how hard off so many of the individuals are. We have so many American’s struggling just to make ends meat in todays world it is not even funny.

The United States have taken it one step further and no matter if you live outside of the United States if you are a U.S. Citizen you have to report any type of capital gain you may have had in order to insure that you are taxed properly when that time comes. There are many countries that have with a they call “Tax Havens” but the United states do not allow their individuals to participate in those options even if they live out of the country. I think this is a good thing because then it will help get the taxes from the individuals who need to pay them. We have so many people in todays world that are hiding money in off shore accounts so they don’t have to pay tax on them it is truly hurting the economy. This is my opinion only. If the US citizens fail to report any income from those accounts then they can be charged with Tax Evasion, which can carry some pretty hefty fines.

There are a few ways in which and individual or corporation and defer and/or reduce capital gains tax.

1. Tax Loss Harvesting – Realized tax losses can carry forward forever and can be applied to offset capital gains months or years in the future. Discretionary Overlay managers have developed new trading methodologies that have evolved tax loss harvesting into a year-round strategy, as apposed to year-end, which is standard to most financial advisors, and is paramount in reducing the capital gains tax burden on affluent investors.
2. Charitable trust can defer and reduce capital gains by giving equity to a charity.
3. Installment Sale – Defer capital gains by taking payments from a buyer over a period of years. No protection from buyer default.
4. Deferred sales trust – allows the seller of property to defer capital gains tax due at the time of sale over a period of time.
5. 1031 Exchange – Defer tax by exchanging for “like kind” property – however, generally available only for real estate and tangible property, both of which must be business-related. Pay capital gains when they are realized (i.e. when subsequently sold).
6. Roth IRA – Transactions inside an account (including capital gains, dividends, and interest) do not incur a current tax liability.
7. Structured sale annuity (aka Ensured Installment Sale) – Defer and reduce capital gains tax while gaining safety and a stream of guaranteed income.
8. Self directed installment sale (SDIS) allows for the deferral of capital gains taxes while removing the risks from the buyer default under a traditional installment sale. (Wikipedia)

There are a few ones that are not for use in the United States. The main one is the Private Annuity Trust, which is no longer allowed. And for Canada residents only there is the utilization of a Tax-Free Savings Account.

A lot of this tax is reported on individuals or companies year-end taxes. They will need to fill out the form 1040 Schedule D. The IRS or any local tax expert will be able to help you fill out any forms that you may need help with. The IRS also list some very important facts about Capital gains so that you know if you need to pay taxes on them or not. They are as follows:

1. Almost everything you own and use for personal purposes, pleasure or investment is a capital asset.
2. When you sell a capital asset, the difference between the amount you sell it for and your basis ins a capital gain or a capital loss.
3. You must report all capital gains.
4. You may deduct capital losses only on investment property, not on property held for personal use.
5. Capital gains and losses are classified as long-term or short-term, depending on how long you hold the property.
6. If you have long-term gains in excess of your long-term losses, you have a net capital gain to the extent your net long-term capital gain is more than your net long-term loss if any.
7. If your total net capital loss is more than the yearly limit on capital loss deductions, you can carry over the unused part to the next year and treat it as if you incurred it in that next year.

There is a lot to know when it comes to capital gain taxes. I would always suggest contacting a tax professional or doing your research on the IRS website because it has a lot of valuable information.