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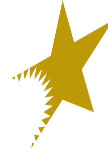

EXPECT THE BEST

Year-End Planning For Capital Gains

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by Paul L. Schnier
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As we approach the end of the year, it is time to think about some tax planning strategies that can reduce your tax bill for 2010. This planning goes hand-in-hand with stock market investment strategies, such as when to realize a gain and when to take a loss. Since 2010 was a good year for the markets compared to 2009 and the disaster that was 2008, people may be in the mood to take some profits and/or trigger some losses in order to offset these gains. Tax planning strategies should be kept in mind in either event.

First, with respect to capital gains, one needs to consider when to recognize these gains. Personal tax rates will not differ materially between 2010 and 2011, so the rate of tax one will pay on a capital gain is not affected. However, by deferring the sale from the latter part of December until the early part of January (a matter of a few trading days) the tax is deferred for a full year. In the current low-interest rate environment, that may not be very exciting. The opportunity to do something more meaningful with the deferred taxes, however, can be enticing.

Those who unfortunately have accumulated capital losses from previous years need not concern themselves with the deferral since these capital losses can be carried forward to the current year and beyond so as to offset any capital gains. The ability to carry forward capital losses is indefinite but, when considering when to trigger gains, if triggering the gain will not have a tax effect, why not do it now and make better use of the money?

A very interesting way of tax planning for capital gains involves charitable donations. Typically, people look at the end of the year as a time to fulfill pledges made to various charities during the year. Selling off stocks is a common way of funding these pledges. A more creative way of paying these pledges is donating the stocks themselves to the charities.

As an example, let's assume someone wants to fund a pledge of $1,000 and holds a stock that will yield a capital gain of $1,000. If that person sells the stock, he will have a tax cost of $230 (at the top marginal rate) and when he donates the $1,000 to the charity he will have a charitable donation tax credit of roughly $400. The net tax recovery from this transaction is $170.

On the other hand, the person could choose to donate the stock to the charity directly. Assuming the stock is listed on an exchange, the charity will issue a donation receipt for the trading price of the stock on the date of donation. However, the benefit is that no capital gain is triggered when a stock is donated to a charity. The net tax benefit of the donation is therefore $400 (as opposed to $170), a considerable improvement. (Many charities have rules as to what sorts of donations they will accept but most will accept donations of publicly-traded securities.)

Another way of managing the tax on capital gains is by triggering losses at the same time to offset these gains. We are not suggesting that losses be triggered solely to offset gains; however, in cases where investors would be selling the stock in any event, selling the losers at the same time as selling the winners will offset the gains.

So-called "loss trading" is often undertaken when a stock has gone down and the investor wants to trigger the loss but still believes in the stock and wants to hold onto it for future appreciation, so he might sell the stock and then immediately buy it back at the lower price. The superficial loss rules will deny this loss where, at any time in the period that begins 30 days before the sale and ends 30 days after the sale, the same or identical stock is held by the individual or a party affiliated with the individual. Affiliated parties include spouses and corporations controlled by them, so selling the losing stock to your spouse or selling the losing stock in the market and having your spouse immediately reacquire the same stock will not work. However, children are not affiliated parties, so this strategy will work with adult children. The easiest solution, of course, is to wait out the 30-day period before re-acquiring the stock. As we well know, however, market forces can intervene.

So, the end of the year is always a good time for investors to consolidate their gains and take their losses. Tax planning should form an integral part of this process but, as always, careful planning is required to seize upon the opportunities and avoid the traps. ■