Sale or Exchange Requirements

Realization sales casualty or theft corporate

- bankruptcy (worthless security)
- Recognition
- • realized gains must be recognized unless congress defers/excludes the gain from income

EXAMPLE

Brendan purchased a Ferrari 10 years ago for $80,000. He used the car for personal purposes and sold it earlier this year. Because the model he purchased was a limited edition, he was able to sell the car for $90,000 even though he used it for over 10 years. Brendan's gain is calculated as follows:

Amount Realized	$90,000
Less: Adjusted Basis	- $80,000
Equals: Gain or (Loss)	$10,000

- the realized gain of $10,000 must be recognized on his income tax return this year

Disallowed Losses

Losses on sale or conversion of personal assets losses on gift or sale

of property to a related party wash sales purchase and sale within 30

days results in 61 day window unrecognized loss added to basis of

- replacement securities
-
- **Losses on related party transactions**

Maxine Purchased triton stock three years ago for 30 a share. the stock is currently valued at $25 years a share. Maxine Decides to gift her shares of Triton to her son, Justin. Justin immediately sells the shares of stock for $26 the $5 loss that occurred during Maxine's holding period will never be recognized (disallowed loss). Justin has an economic gain of $1 per share and no taxable gain (double basis rule)

Wash sales

Michael reviews his portfolio and decides to sell 100 shares of Bear stock on November 1st for $20,000 to offset some of his annual gains. Michael purchased the stock two years ago for $30,000. Michael subsequently reads an investor report that indicates Bear stock has a new patent for a potentially high revenue product.

On November 20th, Michael purchases 100 shares of Bear stock for
$15,000. Michael will not be able to recognize the $10,000 loss on the original sale due to the wash sale transaction (sale and purchase within 30 days). The loss will be added to his new basis.
• ($15,000 + $10,000 = $25,000 new basis)

Special Holding Period Rules

Property received from a decedent • death is

long term

Gifts

- FMV>basis on date of gift add holding
    - period of donor and donee
- FMV<basis on date of gift gains basis
    - used on sale ad holding period of donor
        - and donee loss basis used on sale
    - holding period starts on date of gift
        - Related Party sale transaction

HP begins on date of sale

Nonbusiness bad debts always

short term

Non-taxable exchange

HP of replacement assets includes HP of original asset

Taxation of capital gains & losses

capital gains and losses must be separated from other types of gains and losses for two

- reason long term capital gains may be taxed at lower rate than ordinary gains net
- capital losses or only deductible up to $3,000 per year

Determining Net capital gains

noncorporate taxpayers capital gains and losses must be netted by

holding period short erm capital gains and losses are netted

- long term capital gains and losses are then netted
-
- if possible, long term gains or losses are then netted with short term gains or losses

If the result is a loss • the net capital loss deduction is limited to a maximum deduction

of $3,000 per year

- unused losses retain their character (as to short or long term) an dare carried forward indefinitely

Net capital losses can generally only offset capital gains may not be used as

- deduction against other sources of income up to $3,000 of net capital
- losses can offset other income up to $50,000 (single; $100,000 MFJ) of
- losses on section 1244 stock offset other income

EXAMPLE

	Short-Term	Long-Term
Gains	$15,000	$3,000
Losses	<$10,000>	<$5,000>
	$5,000 NSTCG	<$2,000> NLTCL
	↓	
Result: Net $3,000 NSTCG		
	NSTCG	$5,000
	NLTCL	(2,000)
	NSTCG	$3,000

Capital Gains Tax rate

General Rule:

Long term gains generate lower tax rates than ordinary income tax rates

- 0%
- 15%
- 20%
- 25% for unrecaptured section 1250 depreciation
- 28% for collectibles

long term losses are limited

- 3,000 max per year

Exceptions collectibles - 28% unrecaptured

- section 1250 gain - 25%
- The effective rate may be more than the max rate
- capital gains increase taxpayers AGI increases AGI
- may lead to phaseouts

3.8% Medicare tax (NIIT)

applies to the lesser of:

1. net investment income
2. MAGI threshold amount (not indexed)
    a. MFJ - $250,000
    b. MFS - $125,000
    c. Single - $200,000

Net investment income includes portfolio income from passive activities, gains on disposition of property, but does not include distributions from qualified plans or IRAs therefore capital gains for those above the threshold amount may be taxed at 18.8% or 23.8% instead of 15% or 20%