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TAXLOGIC

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We provide a prompt, professional, personal one-on-one tax preparation service from the comfort of your home. We are competitively priced and offer a lot of additional information from our web site – http://www.taxlogic.com

Capital Gains

Almost everything you own and use for personal purposes or investments is a capital asset. When you sell a capital asset, the difference between the amount you sell it for and your basis, which is usually what you paid for it, is a capital gain or a capital loss. You have a capital gain if you sell your asset for more than your basis. You have a capital loss if you sell your asset for less than your basis.

Capital gains and losses are classified as long-term or short-term, depending on how long you hold the property before you sell it. If you hold it more than a year, your capital gain or loss is long term. You must report capital gains or losses on Schedule D of form 1040.

If your capital losses exceed your capital gains, the excess is subtracted from other income on your tax return up to an annual limit of $3,000.

In an earlier newsletter we explained the **Lower Capital Gain Tax Rates** - that applies to the new "qualified 5-year gain" for assets held for more than 5 years. For 2001, the 10% capital gain rate will be lowered to 8% for qualified 5-year gain. If you want more information on this election please ask at http://www.taxlogic.com.

You pay tax on capital gains just as you pay tax on other types of income. However, if you have a net gain, a lower maximum tax rate may apply. The term "net capital gain" means the amount by which your net long-term capital gain for the year is more than any net short-term capital loss. The highest tax rate on a net capital gain is generally 20%. There are 3 exceptions:

Exception 1. The taxable part of a gain from qualified small business stock is taxed at a maximum 28% rate.

Exception 2. Net capital gains from selling collectibles, such as coins or art, are taxed at a maximum 28% rate.

Exception 3. The part of any net capital gain from selling Section 1250 real property that is due to prior depreciation is taxed at a maximum 25% rate.

Capital Gain Rates (maximum for non-corporate taxpayers)

After 12/31/97:

Adjusted net Capital Gain

Assets held more than 12 months	20%
For those in the 15% bracket	10%

Beginning in 2001:

For those in the 15% bracket for 5 year gain 8%
(holding period can begin before 12/31/00)

Frequently asked questions on Capital Gains or losses are as follows:

Can I us a long-term capital loss carried over from a prior year to offset a short-term capital gain?

A loss carryover maintains its character as long-term or short-tem and must first be used against gains, if any, in its own category, but then offset net gains from the other category. The result on Form 1040, Schedule D, Capital Gains and Losses, of netting the net short-term gain or loss against the net long-term gain or loss will apply your loss carryover against your short-term gain.

Can I use a long-term capital loss to offset a short-term capital gain before using it to offset a long-term gain?

No. Long-term capital gains and losses must first be combined to arrive at net long-term gain or loss before the result can be netted against the net short-term gain or loss. If you follow the Schedule D, Parts 1 and 2 line-by-line, the form will perform the netting for you in this order.

How do I determine my gain or loss on the proceeds reported on Form 1099-B from a short sale entered into last year if I have not yet bought the stock to deliver back to my broker?

If you did not hold substantially identical stock at the time you entered into the short sale, you cannot determine your gain or loss until you purchase the stock that you are going to deliver to close the short sale. You still need to report the gross proceeds on Schedule D so that the total of lines 3 and 1, column (d), reconciles with all of your Forms 1099-B.

I buy and sell stocks as a day trader using an online brokerage firm. Can I treat this as a business and report my gains and losses on Schedule C?

A business is generally an activity carried on for a livelihood in good faith to make a profit. Rather than defined in the tax code, exactly what activities are considered business activities has long been the subject of court cases. The facts and circumstances of each case determine whether or not an activity is a trade or business. Basically, if your day trading activity goal is to profit from short-term swings in the market rather than from long-term capital appreciation of investments, and is expected to be your primary income for meeting your personal living expenses, i.e. you do not have another regular job, your trading activity might be a business. If your trading activity is a business, your trading expenses would be reported on Schedule C, instead of Schedule A. Your gains or losses, however, would be reported on Schedule D, unless you file an election to change your method of accounting.

If your trading activity is a business and you elect to change to the mark-to-market method of accounting, you would report both your gains or losses on Part II of Form 4797, Sale of Business Property. A change in you method of accounting requires the consent of the commissioner and cannot be revoked without the consent of the Secretary.

It is almost the end of the year, but it is not too late to offset some of your capital gains. One last tip is that if you give appreciated property to a qualified organization, the amount of your charitable contribution is generally the fair market value of the property at the time of the contribution. We would be happy to give you more information on the Capital Gains and Losses and help you to understand the financial issues that affect you at out site http://www.taxlogic.com.