



Investing Tax Smart

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First and foremost, before investing in stocks, mutual funds, property, collectibles, or any asset, you have to keep in mind the tax treatment of capital gains and losses. The federal capital gains tax likely isn't going away anytime soon, despite regular attempts in Congress to abolish it. Your investment strategy needs to recognize this and structure your investments so you minimize taxes.

This guide will help you understand the complex federal taxation of capital gains and losses. It also gives you the details needed to understand the immediate and long-term impact that the new, flat 15 percent dividends tax rate will have on your portfolio. Working in conjunction with the net capital gains rate of 15 percent, the new dividend rate is applicable even if you find yourself otherwise in the highest income tax bracket.

Finally, recently-lowered general income tax rates also have a significant impact on what "investment mix" is now most advisable for maximizing your after-tax returns.

What Are Capital Gains?

Capital gains and losses come about from the sale or exchange of capital assets. A "sale" or "exchange" is the transfer of a capital asset for money or other property. A capital gain is the transfer of property for a profit. If you lose money when you sell an asset, that's a capital loss.

Capital gains are taxed at different rates depending on how long you have owned the asset. If you hold onto a capital asset for more than 12 months, then usually any gain you get from its sale will be taxed at a maximum rate of 15 percent (5 percent for individuals in the 10 or 15 percent tax bracket). Short term gain is taxed at the same rates as your ordinary income.

Caution. Some long-term gain, such as gain from the sale of collectibles, is subject to an even higher maximum tax rate, 28 percent.

Capital losses

To determine the deductibility of capital losses, all capital gains and losses (without distinction between long-term and short-term) incurred during the year must be totaled. You can deduct net capital losses, but this

deduction is limited to \$3,000 each year for individuals (\$1,500, one-half of the limit for a joint return if you are married and file separately). Nevertheless, this deduction can be valuable since it allows the first \$3,000 of your net capital losses to offset any other income that you may have for the year, even “ordinary income” such as wages or dividends that would otherwise be taxed at a higher rate.

Example. In 2006, Janet had \$30,000 of ordinary income, a net short-term capital loss of \$500 and a net long-term capital loss of \$300. Janet’s total capital loss deduction is \$800.

If your net capital losses exceed \$3,000, you can deduct \$3,000 against current income, and can carry over the excess loss to the following year. The amount carried over can be deducted in the following year (up to the \$3,000 limit.)

Capital Assets

Almost everything you own and use for personal purposes or investment is a capital asset. The following are examples of capital assets:

- Stocks and bonds;
- A home owned and occupied by you and your family;
- Household furnishings;
- A car used for pleasure or commuting;
- A coin or stamp collection; and
- Gems and jewelry.

Noncapital assets may include:

- An inventoriable asset;
- Property held primarily for customers in the ordinary course of your trade or business;
- Depreciable business property;

	Property Held 12 Months Or Less You'll be taxed at your	Property Held Over 12 Months You will be taxed at
Post 12-31-97 Sales	ordinary Income tax rate.	15% if you are in a high tax bracket or 5% if you are in the 10% or 15% tax bracket.
Post 12-31-00 Sales	You'll be taxed at your ordinary Income tax rate.	(Same as above)
Post 12-31-05 Sales	You'll be taxed at your ordinary Income tax rate.	(Same as above)
Post 12-31-07 Sales	You'll be taxed at your ordinary Income tax rate.	15% if you are in a high tax bracket; 0% if you are in the 10% or 15% rate.

- Real property used in your trade or business;
- A copyright, a literary, musical or artistic composition, a letter or memorandum held by the person who created it; and
- Any hedging transaction that is clearly identified as a hedging transaction by the end of the day on which it was acquired.

Just because you have an asset does not necessarily mean that you have a capital asset.

Basis

The amount of your capital gain is the difference between your basis in the asset and the amount realized from its sale. Basis is generally how much you paid for the asset. Basis can change over the course of time you own the asset. For example, if stock splits, basis also splits. The amount realized is generally the price (less selling expenses) for which you sell the asset.

6 Capital Gains Tax Rates

Your capital gains tax rate depends on how long you held the property that you sold and when you first acquired it. Most people think that 15 percent is the automatic capital gains tax rate. It isn't. There are four capital gains tax rates. The low is five percent and the high is 28 percent.

You can use the chart at the bottom of the previous page to compare capital gains tax rates.

Netting procedure

Under one of the basic netting procedures, your short-term capital losses (losses from property you held for 12 months or less) are applied first against your short-term gains. If you have a net short-term loss at this point, it would be applied against your net long-term gain. If you had a net short-term gain after you netted against long-term losses, then your short-term gain would be taxed at your ordinary income tax rate. The netting process lets you offset your net long-term capital loss against any net short-term capital gain.

Lower tax rates for long-term capital gains

The Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) lowered the maximum tax rates that are generally applied to long-term capital gains.

- A 15-percent maximum tax rate replaces the 20-percent rate that existed under prior law but only temporarily through 2008;
- A 5-percent rate replaces the 10-percent rate likewise for individuals in the 10-percent or 15-percent tax brackets; and

- A zero percent rate replaces the 5-percent rate for tax years beginning after December 31, 2007.

Caution. JGTRRA did *not* bring about an overall reduction in maximum long-term capital gains rates. Left unchanged are:

- The 28-percent rate imposed on long-term gain from collectibles and net gain from small business stock;
- The maximum rate of unrecaptured Section 1250 gain (defined as gain attributable to excess depreciation on real estate) remains at 25 percent;
- The holding period for property as more than 12 months to be classified as “long-term;” and
- The \$3,000 per year limit on using net capital losses to reduce ordinary income.

Permanent rate reduction?

In order to keep within its budget in passing JGTRRA’03, Congress made the reduced maximum 15 percent rate effective only for capital gains on sales taking place through 2008. As that date nears, Congress is under intense pressure to extend the date or even make it permanent. Consult with your tax advisor for the latest news from Washington on this development.

Bottom-line tax liability

Although your capital gains and dividends are taxed at lower rates than your “ordinary” (other) income, they may impact your bottom-line tax liability so as to lower their initial benefit to you. The reason is that capital gains and dividends are added to income in computing adjusted gross income.

Example. You have \$100,000 in salary, \$100,000 in long-term capital gain income and \$40,000 in dividend income. That’s \$240,000 in adjusted gross income (AGI) on which the 7.5 percent medical deduction floor, 10 percent casualty deduction floor, and 2 percent miscellaneous itemized deduction floor are computed, as well as any qualification for tax benefits that carry an AGI limit such as the education credits or the ability to make a Roth IRA rollover.

What’s my holding period?

To determine how long you have held an asset, the holding period starts the day after you acquired the property. The same day of each following month is the start of a new month, disregarding the number of days in the previous month.

Example. If you acquire property on February 1, 2006, the holding period starts on February 2, 2006. On March 3, 2006, you will have held onto the property for one month. The date you dispose of the asset is part of the holding period.

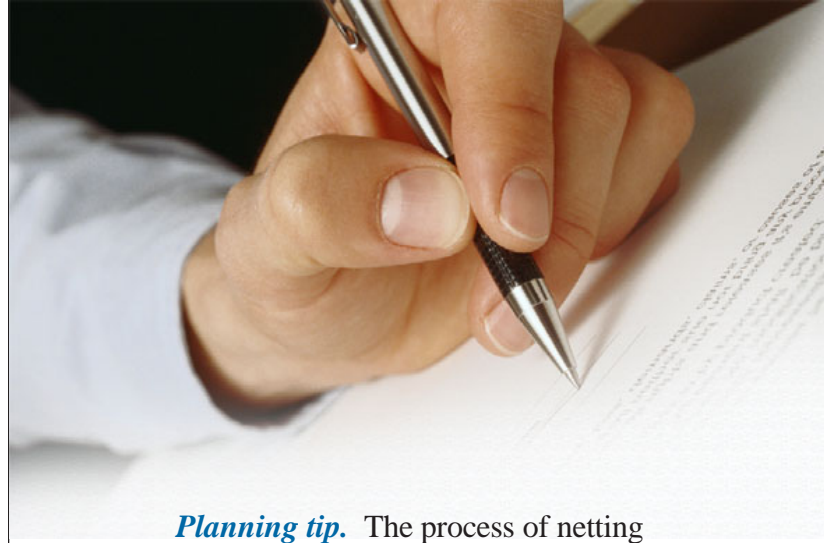
Generally, for publicly traded securities, the holding period starts the day after the “trade date” on which you purchased the securities and ends on the “trade date” on which you sell them. A capital asset must be held “more than 12 months” for realized gain to be classified as long-term capital gain.

Example. On November 2, 2005, John purchased 100 shares of Gizmo Inc. for \$5000. On May 8, 2006, John sold the 100 shares for \$20,000. John will compute his tax on his \$15,000 capital gain by using his ordinary income tax rate. The ordinary income rates apply because he did not hold the stock more than 12 months.

Gifts. The holding period for gifts of stocks and other investments starts when the person making the gift acquired the property. His or her holding period is then added to the time you hold the asset before selling it.

Example. Ann purchased 1000 shares of ABC Co. stock on October 20, 2005. She gives the shares to her adult daughter, Elizabeth, on May 8, 2006. Elizabeth’s holding period for the asset started on October 21, 2005 which was when her mother’s holding period started. Elizabeth will have held the shares for at least five years on October 21, 2009.

Inherited Property. If stock or other property is inherited, any gain or loss from the property is considered to be long-term.



Planning tip. The process of netting capital gains can become extremely complex. This especially is true if you also have gains taxed at the maximum 25 percent or 28 percent rates, or if you have net capital loss carryforwards. Consult your tax advisor before making any major adjustments, for tax reasons, to your investment portfolio. Also, while income taxes are an important part of investment decisions, they should not be the sole determining factor of whether you buy or sell a capital asset. Your ultimate decision needs to be based on the potential the asset has for growth and how this potential compares against the growth potential of other assets.

Offsetting Gains And Losses

In order for you to effectively plan your investment transactions, you have to understand how, under the tax law, you must net or “offset” the various types of capital gains and losses that you experience. The totals for short-term capital gains and losses and the totals for long-term capital gains and losses must be figured separately.

Dividends

Dividend taxes before 2003 could be high. Corporate dividends paid to

individuals have long been taxed at ordinary income tax rates. Before the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), the top rate for dividends was 38.6 percent for high-income couples (over \$311,950) and 27 percent for middle-income joint filers (from \$47,450-\$114,650).

Tax rates on dividend income reduced to 15 and 5 percent. The top federal tax rate for dividends received by an individual, estate or trust is reduced by JGTRRA to 15 percent (5 percent for those whose incomes fall in the 10- or 15-percent rate brackets). These are the same rates applicable to capital gains. The reduced rates apply to eligible dividends received from January 1, 2003, through December 31, 2008. A zero-percent rate applies to taxpayers in the 10- or 15-percent brackets for 2008 only. The reduced rates for dividends will expire in 2009 (unless extended by Congress).

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Caution. Although dividend income shares the same 15/5 percent tax rate applicable to net capital gains, net capital losses are *not* allowed to directly reduce the amount of dividend income that will be taxed.

Eligible dividends. The reduced tax rates apply to dividends received during the tax year from a:

- Domestic corporation or
- Qualified foreign corporation.

Corporate stock dividends passed through to investors by a mutual fund or other regulated investment company, partnership, real estate investment trust, or held by a common trust fund are also eligible for the reduced rate assuming the distribution would otherwise be classified as qualified dividend income.

Dividends ineligible for the reduced tax rate. The reduced dividend rate does not apply to dividends paid by:

- Stock owned for less than 61 days in the 121-day period surrounding the ex-dividend date;
- Stock purchased with borrowed funds if the dividend was included in investment income in claiming an interest deduction;
- Stock with respect to which related payments must be made with respect to substantially similar or related property (through a short sale or otherwise);
- Specified organizations including credit unions, mutual insurance companies, farmers' cooperatives, or certain employer securities owned by an employee stock ownership plan (ESOP).

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Caution. A large number of investors currently receiving “preferred dividends” on “preferred stock” may be ineligible for the reduced dividend tax rate. The most popular preferred equity, hybrid preferred stock, is actually reported as debt by the corporate issuer and pays interest that is deducted by the corporation. Payments on these preferred instruments (hybrid preferred shares) are technically not dividends and are thus ineligible for the reduced dividend rate.

Caution. Investments in tax-deferred retirement vehicles such as regular IRAs, 401(k)s and deferred annuities receive no benefit from the rate reduction. Distributions from these accounts will be taxed at ordinary income tax rates even if the funds represent dividends paid on stocks held in the account.

Dividends paid by foreign corporations. Dividends received from qualified foreign corporations are eligible for the reduced tax rate. Any foreign corporation stock that is traded on an established U.S. securities market is considered qualified. Any corporation incorporated in a U.S. possession is also considered qualified.

Gifts: A Means Of Shifting Capital Gains Tax

Most gifts are not subject to the gift tax. For example, there is usually no tax if you make a gift to your spouse or if your estate goes to your spouse at your death. If you make a gift to someone else, the gift tax does not apply until the value of the gifts you give that person is

more than the annual exclusion for the year (\$12,000 for 2006).

In addition, you can get large tax savings by making gifts of stock or mutual funds.

Example #1. Jane owned 100 shares of Yawl Inc. for two years. Her basis is \$2,000 and the stock’s current fair market value is \$10,000. She is in the 35.0 percent tax bracket. Her son is getting married and she sells the stock to give him a \$10,000 cash wedding gift. If she sells the stock at the current fair market value, the tax on her \$8,000 gain would be \$1,200 ($\$8,000 \times 15\%$).

Example #2. Instead of selling the stock, Jane gives the shares to her son as a wedding gift. Her son is in the 15 percent tax bracket, and sells the stock three weeks later for \$10,000. Since the stock was a gift, his basis equals his mother’s basis; that is, \$2,000. He recognizes gain of \$8,000. Because he is in the 15 percent tax bracket, the capital gains tax on the \$8,000 gain would be \$400 ($\$8,000 \times 5\%$). Because Jane made a gift of the stock rather than selling it and then giving her son a gift of the proceeds, the tax savings was \$800.

“Kiddie tax” impact

For children over 13 years of age, and therefore no longer subject to the “kiddie tax,” (which taxes the child at the parents’ tax rate), the difference between 5 and 15 percent capital gain can potentially be maximized for a considerable “college or first-house fund” using this gifting technique.

Even allowing for some interest income and summer job earnings, about \$22,000 each year in capital gains can be sheltered using the 5 percent rather than the 15 percent rate. That's a \$2,200 tax savings for every year this technique is used.

Example. Roslyn and Stanley give gifts of stock to their grandson, Zachary. In 2006, when Zachary turns 14 years old he begins to gradually sell the stock each year to help pay future college costs. Since Zachary is in either the 10 or 15 percent tax bracket in the year of sale, there would be a 5 percent maximum long-term capital gains rate.

Inherited Property

Traditionally, when you inherit investment property, gain from the sale of the asset is classified as long-term gain and taxed at the long-term capital gains rates.

Example. Alec inherits 100 shares of Surprise Inc. from his Uncle Brian. Alec's stock basis equals the fair market value of the shares at the date of his uncle's death (\$5,000). Two months later, Alec sells the shares for \$6,000. Although Alec only owned the stock for a few months, his \$1,000 gain is treated as long-term since he is considered to have held the shares over one year.

Other Special Considerations for Capital Gains

Even though it is important that you keep in mind the holding period for long-term capital gains, several other specialized rules also come into play about capital gains.



Planning tip. You can deduct your net capital losses on a dollar-for-dollar basis against net capital gains. Excess losses can offset up to \$3,000 of ordinary income (\$1,500 if you are married and filing separately). Losses that remain after the limit can be indefinitely carried forward.

Collectibles

If you hold certain “collectibles” for over 12 months, any gain is taxed at a maximum 28 percent. Gain would not be taxed as ordinary income unless you hold onto the asset for 12 months or less.

Example. “Collectibles” generally includes items such as works of art, antiques, rugs, gems, stamps, and coins.

Alternative minimum tax

If you have alternative minimum tax (AMT) liability, your AMT will be calculated using the same capital gains rates used to compute your regular income tax.

The Working Families Tax Relief Act of 2004 increased the amount of income that qualifies for the 5% rate on capital gains, thus decreasing the taxpayer's tentative minimum tax liability.

Mutual funds/ passthrough entities

The capital gains tax rate is applicable to long-term capital gains distributed by certain passthrough entities—for example, mutual funds, real estate investment trusts and S corporations. The entity must inform the taxpayer about the proper classification of distributions (short-term or long-term).

District of Columbia tax incentives

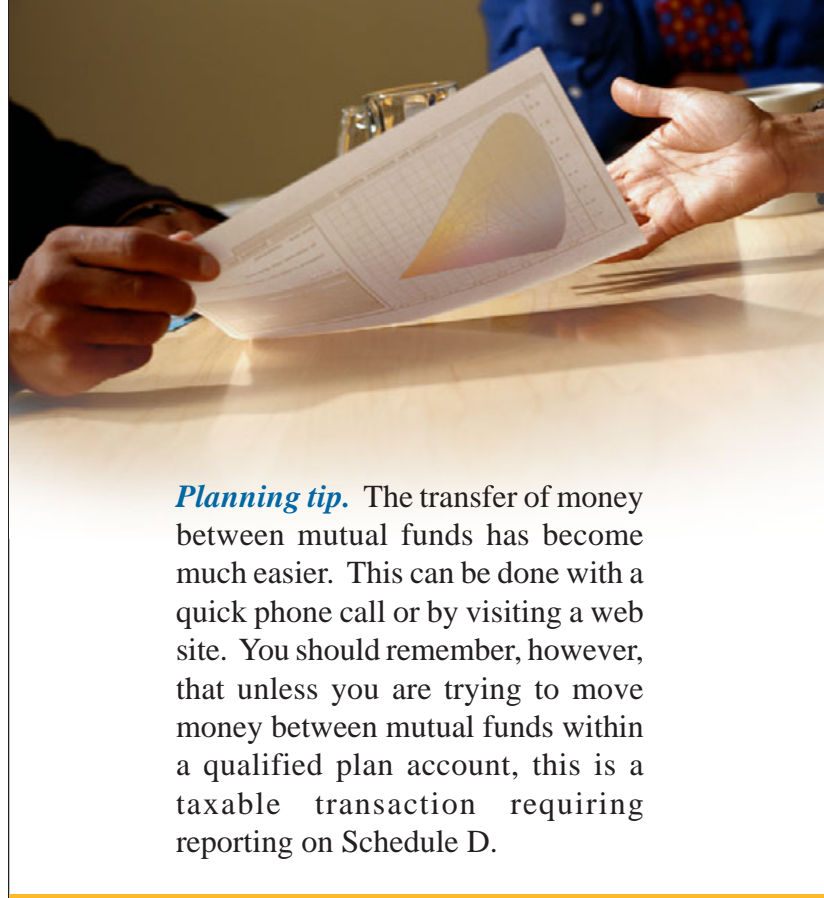
You are eligible for enhanced tax incentives for investing in businesses that are located within the District of Columbia Enterprise Zone. Included in these incentives is a zero capital gains rate for gain from specific “Zone assets,” held for over five years.

Small business stock

Individuals can elect to roll over capital gain from the sale of qualifying small business stock held for over six months if other small business stock is bought during the 60-day period starting on the date of sale.

Stock options

If you recognize gain from stock options, Uncle Sam wants some of it. The tax treatment depends on the type of stock option. Two common types are ISOs (incentive stock options) and NSOs (nonqualified stock options). Gain from the sale of ISOs is usually taxed as capital gain



Planning tip. The transfer of money between mutual funds has become much easier. This can be done with a quick phone call or by visiting a web site. You should remember, however, that unless you are trying to move money between mutual funds within a qualified plan account, this is a taxable transaction requiring reporting on Schedule D.

when you sell the stock. Gain from NSOs is calculated differently. The rules are very complex and it is wise to consult with a tax professional to minimize your tax liability.

Timing

In many cases, the change of a few days in the timing of when you acquire or sell an asset can have a dramatic difference in the way a transaction will be taxed.

Market economic factors should take precedence over tax considerations. However, you should not completely ignore tax considerations and you should consider tax minimization strategies. You should not hold onto an asset only because you don't

want to pay tax on any gain you may realize. On the flip side, you shouldn't sell an asset only to take a tax loss if you believe the asset will increase in value.

Capital gains are fertile areas for planning since you usually have much more control over when you realize income than you have over your salary or business income. You are the one who decides when to sell. However, be aware of the rules governing capital loss deductions.

Capital gains strategies

- You should sell capital gain property prior to the end of the year if you have already realized capital losses for the year, which are over any capital gains you have already realized plus \$3,000.
- If your gains exceed your losses, you should sell loss property to offset the gain.
- If your other allowable deductions are more than your income, you should avoid realizing any further capital losses during the year.

Wash Sales

You may want to recognize a loss on a security this year without having to abandon your investment. A technique to do this is called a "wash sale." This is a transaction whereby you sell the security and later reacquire the same security.

However, you cannot take a deduction for such a loss if you acquire securities that are substantially identical, within a 61-day period starting 30 days before, and ending 30 days after, the sale. As a result, if you need to use a wash sale, you can use the following techniques:

- Wait a minimum of 31 days prior to repurchasing the asset. However, the risk in using this technique is that you forego any gain on the stock that happens during the waiting period.
- "Double up." Buy a second lot equal to your original holding, wait 31 days, then sell the original lot. By doing this you will recognize the loss. This lets you maintain a continuing interest in the stock, but you would have to tie up more funds for at least 31 days to achieve this and risk is doubled.
- You could sell the stock and reinvest in another company's stock, in the same industry that has historically performed similarly. After 31 days have passed, you could reverse the process for restoring your original holding. In this way, you can minimize your risk during the waiting period.

Caution. If you sell stock at a loss but then buy the same stock within the 61-day period through your IRA, you will not be allowed to deduct the loss.

Small Business Investments

A valuable tax incentive is available to encourage people to invest in certain small businesses. This incentive lets investors exclude, from a qualified small business stock (QSBS) sale, 50 percent of the gain they realize. However, you must hold the stock for a minimum of five years and you must also make sure other requirements are met.

The 15 percent capital gains tax rate is inapplicable to the portion of the gain included in the taxpayer's income. Rather, the maximum tax rate stays at 28 percent. However, due to the 50 percent exclusion you, as an investor, have a total gain from a qualified investment that is subject to a maximum effective tax rate of 14 percent.

Small business investment companies

Another major tax advantage is available for investors in common stock or a specialized small business investment company's (SSBIC's) partnership interests. An SSBIC is licensed by the Small

Business Administration, with investments that are directed toward businesses that are owned by people who are socially or economically disadvantaged.

Investors who sell publicly traded stock and use the proceeds to buy an interest in an SSBIC can elect to have tax deferred on any gain. Gain is rolled over into the SSBIC. For SSBIC stock, the investor's basis fails to be reduced for purposes of calculating the gain that is eligible for the 50 percent exclusion now applicable to investments in certain small business stock.

Selling Your Home

The good news about gain from the sale of your home is that the tax rate is usually zero. You can exclude up to \$250,000 of gain that you realize from the sale if you are single. Married couples can exclude up to \$500,000.

Generally, your home must have been your principal residence for two of the past five years. Special rules make it easier to qualify for a partial exclusion if you have to sell your home because of a change in job, health or other special circumstances.

Individuals

To be eligible for this exclusion, you must have owned and occupied your home as a principal residence for a minimum of two years of the five year period ending on the sale date.

Married Couples

Married individuals may use the \$500,000 exclusion amount if:

- Either spouse meets the ownership test;
- Both spouses meet the use test;
- Neither spouse is ineligible for the exclusion due to a sale or exchange of a principal residence within the last two years; and
- The couple files a joint return for the year.

Different scenarios: Do one of these apply to you?

- If, after May 6, 1997, you have claimed depreciation deductions on a part of your principal residence—for example, with regard to a home office or at a time when the principal residence was used as a rental property—the amount of otherwise excludable gain is decreased by the amount of claimed depreciation. The amount of claimed depreciation is taxable.
- Special considerations may come into play if you are married and your spouse



Planning tip. Short temporary absences for vacations or seasonal absences are counted as periods of use. However, an absence for a whole year is not a short temporary absence.

dies and you jointly owned the house. You would get the \$500,000 exclusion if you sell your residence in the year of the spouse's death. However, if you wait until the following or a later year to sell, your exclusion is \$250,000.

- If your residence was purchased and jointly held after 1976, your basis in half of the residence (the half you are deemed to have received from your deceased spouse) is stepped-up to its fair market value.
- If a joint residence was bought prior to 1977 and jointly held, the Tax Court has determined that you can claim a fair market value step-up for the entire basis if your deceased spouse paid for the property. However,

if you paid for the house, no part of the property's value would be included in your deceased spouse's gross estate and no part of the home's basis would be stepped-up. With this situation, you might want to follow the IRS's position so that you would include half of the home's fair market value in the estate, then take a stepped-up basis regarding that amount.

Exceptions

The IRS has issued regulations on the subject of excluding gain, but with a reduced pro-rata maximum amount, when the seller does not satisfy one of the time-based rules. The tax law provides an exception to the two-year, all-or-nothing rules for use, ownership and claimed exclusion when the primary reason for the sale is health, change in place of employment, or other unforeseen circumstances.

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Caution. Unforeseen circumstances may include: death; divorce or legal separation; multiple births resulting from the same pregnancy; and condemnation, seizure or other involuntary conversion of the property.

“Section 1231” Gains In Business

If you operate a business, you will need to deal with a special type of capital gain called “Section 1231” gain, named after the Internal Revenue Code section that offers you a tax break. You may treat gains and losses from “Section 1231 property” as long-term capital gains and losses when your recognized gains in the current year exceed recognized losses, and as ordinary gains and losses when losses exceed gains. It's a “heads you win, tails IRS loses” tax break that Congress has given only to those in business.

Section 1231 property includes both depreciable and real property if held for more than one year and used in your business. It also includes other capital assets held in connection with a business or a transaction entered into for profit, but only when these capital assets are compulsorily or involuntarily converted. Compulsory or involuntary conversion gains and losses include gains and losses from casualty or theft only if there is a net recognized gain from casualty and theft gains and losses.

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Example. Julia owns four residential units and a restaurant. A kitchen fire destroys the restaurant's oven. The oven is Section 1231 property because it is depreciable property used in Julia's business and held in excess of one year. The original cost basis of the oven, \$20,000, is reduced by \$5,000 of depreciation deductions, leaving a tax basis of \$15,000. The oven is insured for \$22,000; therefore, Julia realizes a \$7,000 casualty gain. If this had been Julia's only taxable event for the year, the \$7,000 gain would be taxed at the 15 percent long-term capital gain rate.

During the same year, however, Julia sells a rental unit (purchased in 1998 for \$100,000) for \$95,000. Julia realizes a \$5,000 loss on the sale of the business property, which she had held for more than one year. This loss is netted with the casualty gain, resulting in a net gain of \$2,000 (\$7,000 - \$5,000). Therefore, both the casualty gain and the sale loss are treated as long-term capital gain. Unfortunately, however, the tax rules are complex. "Depreciation recapture rules" recharacterize as ordinary income the gain attributable to accelerated depreciation of the oven, superseding the Section 1231 capital gains characterization.

Bottom line. Consult your tax advisor to correctly time Section 1231 gains and losses to your best advantage.

Investor Expenses

The old adage, "You've got to spend money to make money" is recognized, at least in part, by the tax law.

Investment counsel fees, custodian fees, fees for clerical help, office rent, state and local transfer taxes, and similar expenses that you pay in connection with your taxable investments are deductible as itemized deductions on Schedule A of Form 1040. However, they are subject to a two-percent floor for all itemized deductions.

Caution. To the extent any expense is attributable to tax-exempt interest, however, it cannot be deducted. Unless an investment advisory fee contains an allocation, the IRS expects you to deduct only the portion of the fee pro-rata in relation to the income you earned.

Fortunately, the tax law does not require you to allocate expenses between those related to ordinary income and long-term capital gain or dividend income. Either generates a full itemized deduction that can be used against any type of income.

Travel expenses

Travel expenses related to the production or collection of income are deductible if you provide proof of the expenses and the necessity for incurring them. Deductions for travel expenses related to attending investment seminars, however, are specifically non-deductible. Travel expenses to attend stockholder meetings are permissible deductions only if travel is not for personal reasons and expenses are reasonable in relation to the value of your investment.

Interest expenses

If you take out a loan to carry taxable investment property, you are entitled to an itemized deduction for the interest you pay. The deduction is limited to your net investment income.

The investment interest deduction is not subject to the two-percent floor; you can start with deducting the first dollar of interest paid. Any disallowed interest over the net investment income limit can be carried over to a subsequent tax year.

Caution. Net capital gain from the disposition of investment property is not considered investment income. However, you may elect to treat all or any portion of such net capital gain as investment income by paying tax on the elected amounts at your ordinary income rates. This is usually not advisable.

Brokerage commissions

Brokerage commissions related to a particular stock purchase or sale are considered a cost of the sale itself. As such, any commissions paid to buy a stock are added to your tax basis in the shares, which will later determine the amount of taxable gain you have when the property is sold. Any commission on the sale of the shares is netted from the amount you will be considered to realize on that sale.

Conclusion

Taxes impact your investments when you acquire them and when you sell them. Many people plan the acquisition and disposition of their investments based on the tax consequences. To generate the most tax savings, you must rely on a tax professional to map out the best acquisition or disposition route for you. Careful planning will help to maximize your investment portfolio and minimize your tax liability.