

Capital Gains

Capital gain is the profit left after you sell a capital asset for more than its **adjusted basis**—the original cost plus improvements, reinvested dividends, commissions, and certain taxes. The concept appears simple, yet the tax code transforms it into a maze of holding-period thresholds, rate differentials, exceptions, surtaxes, and reporting regimes. Mastery of that maze determines how much of an investor's return the government ultimately keeps.

The Internal Revenue Code divides gains by time held. Sell after **one year and a day** and the profit is **long-term**; sell sooner and it is **short-term**—taxed like wages. Publication 550 devotes two chapters to this split because it underpins the preferential 0 %/15 %/20 % rate structure that Congress designed to reward long-horizon capital formation. [IRS](#) For 2025 a single filer can realise up to \$47,025 of long-term gains completely tax-free; above that threshold the marginal bill rises first to 15 %, then 20 %, and finally 23.8 % when the 3.8 % net-investment-income surtax clicks in at \$200 000 of modified AGI. Quick reference tables circulated each January summarise the brackets so investors and advisers can plan harvests rather than guess them. [Voya Presents](#)

Behind the rate grid sits the more subtle question of **basis**. A gain is only as large as the distance between proceeds and basis, so meticulous record-keeping shades every future tax bill. Brokerages now track cost by lot and report it on Form 1099-B, yet the taxpayer remains responsible when data gaps appear after transfers or corporate actions. Fidelity's cost-basis guide warns that switching between the default "average basis" method for mutual funds and the "specific-lot" method can alter

the taxable gain on identical sales—proof that basis strategy matters as much as security selection. [Fidelity](#)

Mutual-fund shareholders face a special twist: they can owe capital-gains tax even if they never sold a share. When a fund realises gains inside the portfolio, it must distribute them at year-end. Vanguard’s qualified short-term-gain notice for the 2024 tax year lists dozens of index and active funds, each with per-share amounts that flow straight onto Schedule D of the shareholder’s return. [Vanguard](#) Fidelity’s capital-gain Q&A explains that these distributions reset the fund’s internal basis, so future sales won’t double-tax the same appreciation—but the cash hit today is real, making embedded gain a hidden cost of buying funds late in the tax year. [Fidelity](#) Closed-end funds complicate matters further because distributions may mix long- and short-term gains with **return of capital**; Voya’s monthly notices break out the percentages so investors can distinguish taxable income from mere basis give-back.

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For direct stockholders, the wash-sale rule lurks. Sell a loser, buy back a “substantially identical” security within ± 30 days, and the IRS disallows the loss, forcing it onto the replacement shares’ basis. Schedule D instructions outline the mechanical adjustments, reminding traders that options on the same underlying can trigger the wash even if the stock itself is not repurchased. [IRS](#) The rule has no mirror for gains: one may realise and immediately repurchase a winner, a tactic called **gain harvesting**. Investors in the 0 % bracket use the move to step up basis at no tax cost, effectively insuring against future higher rates. Publication 550 confirms that the holding period starts anew after the buyback, a fact that influences future tax-lot planning. [IRS](#)

Real estate brings its own catalogue of exceptions. Publication 523 condenses hundreds of pages of law into a single headline: homeowners who meet **ownership and use tests** may exclude up to \$250 000 of gain (\$500 000 joint) on the sale of a **principal residence** every two years. [IRS](#) The exclusion morphs sequence risk for retirees: downsizers often unlock tax-free equity that later funds living expenses, shrinking the taxable withdrawal rate from portfolios. Investment property is different. Sell an apartment building and, without planning, the entire appreciation plus depreciation recapture becomes taxable. Section 1031 of the Code allows a **like-kind exchange**: roll proceeds into another qualifying property and defer the gain. Publication 544 walks through the tight timelines—45 days to identify, 180 days to close—and the boot rules that tax any cash pulled out. With forgiveness ending at death (thanks to the basis step-up), serial exchanges can defer capital-gains tax indefinitely.

Corporations sometimes return capital instead of earnings—tender offers, share redemptions, liquidations. These are capital-transaction events, not dividends, and shareholders compute gain against the portion of basis allocated to the redeemed shares. Voya's fund notices flag such cases, preventing brokers from mis-coding them as ordinary dividends. [individuals.voya.com](https://www.voya.com/individuals)

Collectibles—art, rare coins, vintage wine—attract a **28 % maximum rate** regardless of holding period. Qualified small-business stock under Section 1202 offers the opposite extreme: hold five years and exclude up to 100 % of gain, subject to per-issuer limits, fostering venture-capital investment. Publication 550 enumerates both divergences from standard

brackets, illustrating how Congress tweaks capital-gains policy to encourage or discourage specific asset classes. [IRS](#)

The capital-loss netting system offsets short-term gains against short-term losses and long-term against long-term before crossing buckets. An excess net loss up to \$3 000 offsets ordinary income and the unused balance carries forward indefinitely. Schedule D's worksheets guide taxpayers line by line; many discover large carry-forwards only when a new advisor reviews old returns. Recognising and deploying those dormant assets often finances future tax-free reallocations. [IRS](#)

High-income investors confront the **net-investment-income tax**. The 3.8 % surtax applies to the lesser of net-investment income (which includes capital gains) or the excess of modified AGI over \$200 000 (single) or \$250 000 (joint). Planning revolves around controlling AGI with Roth conversions in low-income years, deferring gain realisations, and using charitable strategies to drop below the thresholds. Quick reference guides flag the EIT triggers because overlooking them converts a headline 20 % long-term rate into an effective 23.8 %. [Voya Presents](#)

Cost basis methods influence both realised gain size and future flexibility. **Specific-lot identification** allows cherry-picking high-basis shares to reduce current tax without altering economic exposure; but it also lowers remaining basis, possibly inflating future tax. **FIFO** offers simplicity yet can backfire when oldest, cheapest lots leave large gains. Fidelity's fact sheet demonstrates how average-cost rules for mutual funds may suit passive investors but frustrate active gain-harvesters. [Fidelity](#)

Capital-gains taxation extends beyond federal borders. State regimes vary from zero (e.g., Texas) to near-double-digit

percentages (e.g., California, New York City combined). Residency tests, part-year rules, and community-property splits complicate multi-state households. Non-resident aliens face a gentler landscape: U.S. capital-gains tax generally doesn't apply to portfolio stocks unless tied to a U.S. trade or business, but real-property gains remain taxable and subject to FIRPTA withholding. Publication 544 underscores that foreign sellers must provide Form 8288-B or expect 15 % of gross proceeds withheld at closing.

Capital-gains planning intertwines with estate strategy. Death confers a basis step-up, wiping embedded appreciation for heirs—an incentive to gift **high-basis, low-growth** assets during life and hold **low-basis, high-growth** assets until death. Yet the future of the step-up remains a policy debate; advanced plans hedge by spreading appreciated assets between irrevocable trusts and taxable accounts to stay nimble.

From a behavioural lens, market euphoria tempts investors to ride gains, triggering surprise tax bills when they later rebalance. Conversely, bear-market despair breeds inertia, and losses that could offset gains expire unused. Setting calendar or value-trigger reminders to check unrealised positions neutralises emotion, converting capital-gains management from an after-thought into a quarterly habit.

Finally, capital gains anchor public finance. Federal receipts from capital-gains taxes swing with bull and bear cycles, influencing budget forecasts and, indirectly, fiscal policy. The Treasury's Monthly Statement tracks these flows; 2024's rally lifted receipts 17 % year-over-year, giving Congress room for debate on new incentives—or claw-backs.