Tax Tips You Can Use May 2007

Tax Free Capital Gains for 2008

By Kathleen Crawford, EA

Now that the 2006 tax filing season is in the past, it is time to look forward. That is actually difficult for tax preparers to do. Mostly, tax preparers live in the past. During tax season, I asked my clients about their expenses for "this year" meaning 2006. I planned their estimates for "next year" meaning 2007. It all got a little confusing, especially in April.

So, in a rare mood, I would like to talk about the future. There is a rare event that will take place in 2008, 2009 and 2010. It is the possibility of tax-free income. As our tax law now stands, for those three years the 5% tax bracket for long term capital gains will be reduced to zero percent. It will be a great gift to certain individuals.

For 2007, long term (LT) capital gains are taxed at one of two rates. The lower, 5% rate is charged for LT capital gain income that falls into the 10% and 15% brackets for ordinary income. The 15% rate is charged for LT capital gain income that falls within the 25% and higher ordinary income brackets. Confused? Welcome to tax law.

I can demonstrate how this all works with an example. I will use Jack and Jill, a married couple filing joint federal returns for 2006, 2007 and 2008. Let's assume there are no inflation adjustments, raises or other changes in any of the three years. For this example, the top of the 15% bracket for ordinary income is $61300 in all years. In 2006, Jack and Jill work for wages and have $25000 of net taxable income, so their tax bill is $2995. In 2007, they make the same wages, but sell some land that they owned for many years and make $35000 of profit on the sale. Since $60000 (25000 plus 35000) of net taxable income is still in the 15% bracket for ordinary income, their LT capital gains of $35000 is taxed at 5%. Their tax bill is $4745 total, due to $2995 of tax on the taxable income from wages and $1750 of tax on the sale of the land. In 2008, they still have the same net taxable income from wages of $25000, but they sell another piece of land that they owned for over a year and make another $35000 in profit. In 2008, their tax would be only $2995. Their total taxable income of $60000 is in the 15% bracket for ordinary income, so their long term capital gain on the property profit is taxed at 0%.

Congress can change the tax law at any time, but at this writing, taxpayers have a rare opportunity to lower their tax bill during 2008, 2009 and 2010. Taxpayers who have more than about $31000 of net taxable income per taxpayer ($62000 for a couple) from wages, interest, pensions, businesses, farms or rentals are already out of the game. However, if you have a lower taxable income in any of those three years because of lower wages, retirement, business losses or high deductions, it is wise to think about taking advantage of the 0% tax on long term capital gains in the low bracket.

As a last thought, just to make things interesting, all of the special lower rates on capital gains are due to expire in 2010, so long term capital gain rates will return to ordinary rates in 2011.

The fine print is that this article is for information only. Please call Kathy or a tax professional for questions about your individual tax situation. The Jacksonville Tax Lady can be reached at 541-899-7926 or at 610 North Fifth Street.