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Publication: Asheville Citizen-Times
Day: MONDAY
Section: W
Page: 6
Keyword: COLUMNS, INVESTING

Date: 03/07/2005
Edition: FINAL
Sectionname: WNC BUSINESS
Byline: WARREN W. WALL

A 0% capital gains tax could be in your future

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The most recent major tax law change was passed in May 2003. Within the new rules, several taxes phase out and then phase back in. For the older investor who is willing to set up a plan, one provision in particular could mean significant tax savings.

The tax act reduced the long-term capital gains rate to 15 percent for anyone in the 25 percent or higher bracket and down to 5 percent for taxpayers in the 10 percent to 15 percent brackets. These rates will remain effective through 2007.

In 2008, however, another change emerges when the capital gains tax falls to 0 percent for individuals in the 10 percent to 15 percent brackets. This presents some money-saving opportunities for you if you are considering giving assets to anyone in a lower tax bracket, such as children or grandchildren.

For example, suppose you own a mutual fund that you want to use to help your grandson when he starts college in 2008. If you are in a high tax bracket, you will have to pay 15 percent on any gains you realize on the fund's sale.

The IRS specifies that when you give an appreciated asset, the donee receives the gift at your cost basis. Therefore, any untaxed profit is passed on with the asset and taxed based on the donee's tax bracket when sold. So if your grandson sells any of the gifted shares between now and the end of 2007, he will have to pay at least 5 percent on the profits.

On the other hand, you could hold off giving him the fund until 2007 and have him keep the account for at least one year. As long as he liquidates the fund in 2008, he will have a good chance of avoiding the capital gains tax. However, based on present law, if he does not sell out until 2009, he could face a 10 percent capital gains tax.

Department: WNC BUSINESS
Docname: WALL ON THE STREET_0307
Pubdate: 03/07/2005
Typist: KATHLEEN DAVIS

Depth: 9.62
Docnumber: 956125
Source: STORY
Wordcount: 333

1-Edit

Author: KATHLEEN DAVIS
Status: Sent

Datatype: Text

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