How Can I Avoid Capital Gains Tax?

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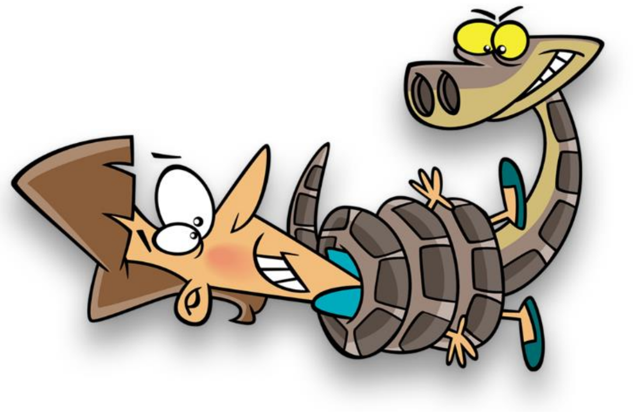
November 21, 2022



A primary focus at Exchange is to build tax-efficient financial plans and portfolios guiding our clients to their long-term goals. When assessing tax efficiency, we often must come up with strategies that avoid or minimize capital gains tax.

Capital gains taxes are a tax on profits (i.e. realized gains) from investments when they are sold. Some investors may manage their portfolio using only a tax minimization strategy, resulting in problems including overexposure to a single company stock and a reduced ability to rebalance their portfolio later in life. However, there are certain strategies that involve tax minimization, without trading one issue for another.

Gift to Children

For those who wish to support their children financially, gifting appreciated securities may be a wise decision. The date of purchase and cost basis carries over to the recipient of the gift. It is then up to that recipient to sell or hold the asset. At the time of sale, any realized gains will be taxable to the new owner at their rate. Therefore, if a parent facing the 20% federal capital gain tax were to gift securities to their child when a sale takes place, the child would be taxed at their lower (possibly 0%) rate. Also, note that any gift above $16,000 in 2022 could result in extra steps when filing taxes.

Gift to Charities

A similar option for those who are charitably inclined would be to gift appreciated securities to a qualified charitable organization designated by the IRS as a 501(c)(3). In applying this method, the grantor of the gift receives the current market value as a deduction, no gain is realized by the grantor, and any gain realized by the charitable organization is non-taxable. This method typically presents more benefits than donating cash. Depending on your income, there may be a limitation as to how much of the gift can be deducted. Combining gifts in one calendar year (i.e. bunching) or utilizing a Donor Advised Fund could potentially provide a greater benefit.

Monitor Taxable Income

The only method for paying no capital gains tax while also retaining ownership of an asset is to fall under certain income thresholds. Single filers with income under $40,400 and joint filers under $80,800 could end up paying a 0% tax on their gain. If income is lower in certain years, it may be advantageous to realize gains and repurchase the same security (if appropriate), effectively stepping up the basis at no cost. Similarly, if income is likely to be reduced in future years, deferring gains could make financial sense. Just be sure that tax avoidance isn't the only driver of your portfolio. Risk and investment thesis should also play a role in the decision to hold or sell an asset.

Step-Up in Basis

When an individual passes away, their assets will likely receive a step-up in basis. This allows the beneficiary to liquidate inherited assets without facing a capital gains tax they were not responsible for creating. For those later in life, holding onto low basis property could preserve substantial wealth from an estate. If following this strategy, consult with a financial professional to understand more about the risks related to holding large positions in individual securities. As always, the tax code is subject to change.

The Bottom Line

In the end, there isn't a lot we can do to legally avoid taxes. However, certain strategies can be used to manage them. Taxes alone should never dictate a decision, but it's important to always be aware of their financial impact. Keep your financial advisor and accountant in the loop on any taxable events so they can verify you're not paying the government more than their fair share. If you’re not sure what strategy works best, consider scheduling a discovery meeting with us. A financial professional can be instrumental in minimizing taxes while guiding you to your goals.