Money Monday: How to Get Preferential Tax Treatment

Today's Money Monday is the third in the growing wealth series. It is impossible to discuss growing wealth without a conversation about taxes. Because tax conversations are complicated and complex, it is virtually impossible for me to distill all the concepts in a few short paragraphs called Money Monday. To present the magnitude and scope of this endeavor, all you need to know is that the United States Tax Code has some Nine Thousand, Eight Hundred and Thirty -Four Sections (9,834). Today however, I will narrow our article as much as possible, to one section of the tax code known as capital gains and some basic concepts.

Historical Context

The concept and application of capital gains have been around since 1921. From inception, the United States Congress and the Internal Revenue Service decided that some forms of income should receive preferential treatment. This effectively means that some groups or classes of individuals will be treated better than others. While some will argue that capital gains is not discriminatory, a law does not have to be discriminatory on its face to be judged as such. All that needs to happen is that its impact can be discriminatory. In order to receive preferential tax treatment, you need to acquire and own assets in addition to not earning a living or making money from wages or ordinary income. Since a majority of this country's population is comprised of employees, who earn a living through wages the ability to grow or become wealthy is limited to a few individuals. Let's look at a few elements of this tax concept and wealth.

Capital Gains

The IRS will sometimes use terms, words or phrases while providing no definition. That’s normal, so welcome to capital gains. In order for you to become the beneficiary of a preferential tax treat you must have invested in a capital asset. What’s a capital asset? There is no IRS definition of a capital asset either, but instead, they define what a capital asset is not. For the purpose of basic understanding and building wealth, capital assets would be real property, stocks, bonds and other investment securities.

Next, understand that there are long term capital gains and short term capital gains.

Long term capital gains relate to assets you have purchased and possessed for more than twelve months.

Short term capital gains relate to assets acquired and retained for less than twelve months.

This knowledge is important because these gains are taxed or treated differently which is really the main point in growing wealth. Long term capital gains are either taxed at zero percent (0) , fifteen percent (15%) or twenty (20%).

Short term capital gains are taxed at rates ranging from ten percent (10%) through thirty seven percent (37%).

For example, if this year the only income you earned was $40,000 from the sale of some stocks you purchased more than twelve months ago, your capital gain taxes next year will be zero! If we were to contrast that with an employee, whose gross wages for this year will be $40,000, he or she would be in the twelve percent (12%) income tax bracket! This example clearly demonstrates the preferential treatment provided to certain groups and classes of individuals in society. Generally, If you are an employee, you’re starting off with a tax of at least ten percent (10%) on earned income from your job; and will not be afforded preferential tax treatment under the law.

Final note on this point is that to experience capital gain treatment the transaction must be “realized” by a taxable event. When explaining capital gains or losses you will hear terms like “ Realized and Recognized”. Suffice it to say that a realized taxable event, means the sale or other disposition of the asset. In other words once you sell the stock you have a realized taxable event.

What’s a Capital Asset :

As noted in order to obtain preferential tax treatment in growing wealth, you must invest or acquire a capital asset. But what is defined or listed as a capital asset is not always straightforward. Musical compositions or copyrights in musical works will receive capital gains treatment. Therefore if you are investing in these assets you are safe. However, patents, designs, inventions or what may be considered self created property are excluded from capital gains treatment. There is also the issue of passive income losses. Passive income is money earned from dividends, stocks, rental property and the like. Those losses may not be used against active income for preferential treatment. If you invest in the basic assets you can grow your wealth and receive preferential tax treatment.

Takeaways: In today’s economy it’s pretty easy to acquire, if not an entire capital asset such as a stock, you can acquire a piece or portion of one such as a fractional share. All you have to do then, is to hold on to it for at least twelve months or more and upon sale you will qualify for preferential tax treatment. Don’t let Uncle Sam reduce your wealth!

WHAT’S UP! Today’s What’s Up is about back to school tax breaks. One survey report stated that the average family spent $597 per child on back to school items in 2023. This month begins tax breaks on school supplies. Here is a summary by state:

- Alabama tax holiday is from July 19 through 21, 2024;
- Maryland from August 11 through 17, 2024;
- Virginia tax breaks are from August 2nd through 4th, 2024 and,
- New Jersey tax breaks are from August 24 through September 2nd, 2024.

And that’s what’s up!