How Capital Gains Are Taxed

In this overview, we’ll look at how your investments are taxed, and strategies to help minimize the taxes you pay on those earnings.

When it comes to your investments, you may spend considerable time choosing the best strategies, as well as the tax consequences on those investments.

What are Capital Gains?

Capital gains and losses arise from the sale of a capital asset, and the applicable tax rate depends on how long the capital asset was held as well as your income. Generally speaking, long-term capital gains/losses are from the sale of capital assets held for more than a year, while short-term capital gains/losses are from capital assets held for a year or less. When the capital asset is sold for more than what was invested in it, the difference is a capital gain, which is subject to taxes.

Taxes on Capital Gains

Long-term capital gains generally qualify for a tax rate of 0%, 15% or 20%. Under the Tax Cuts and Jobs Act of 2017, long-term capital gains tax rates are applied to income levels that differ from regular income tax brackets, as shown in the table below. Short-term capital gains are still taxed at your ordinary income tax rate.

Long-term Capital Gains Tax Rate	Income: Single Filer	Income: Married Filing Jointly
0%	Up to $41,675	Up to $83,350
15%	$41,676 - $459,750	$83,351 - $517,200

20%	Over $459,750	Over $517,200

3.8% Net Investment Income Tax Triggers

Those at the higher end of the income spectrum will need to account for a surtax in their capital gains income. The Health Care and Education Reconciliation Act of 2010 brought with it a 3.8% Medicare surtax on net investment income for taxpayers with modified adjusted gross income (MAGI) over a certain threshold. Net investment income includes: interest; dividends; capital gains (including gains from investment real estate); rental and royalty income; income from financial instrument or commodity trading; and income from businesses that generally do not require active involvement from the taxpayer.

The statutory threshold amount for a tax year depends on your filing status, and these amounts are not indexed for inflation:

Filing Status	Threshold
Married Filing Jointly, Qualifying Widow(er)	$250,000
Single, Head of Household	$200,000
Married Filing Separately	$125,000

If your MAGI is above the applicable threshold, the 3.8% tax will be applied to the lesser of your total net investment income or the amount by which your MAGI exceeds the threshold.

Take, for example, a single filer whose MAGI is $240,000, of which $180,000 is wages and $60,000 is net investment income. With MAGI $40,000 over the surtax threshold and net investment income of $60,000, he'll pay the 3.8% surtax on $40,000, which is the lesser of the two, resulting in a net investment income tax of $1,520.

Capital Gains Taxes – Examples

Frequent changes in your investment holdings can result in tax payments on capital gains – especially in tax-inefficient asset classes like REITS, commodities, bonds and small/mid cap funds.[1] In the examples below, we illustrate the impact of both long-term and short-term capital gain taxes on a hypothetical stock. Assume for these examples that the sale of stock is the only investment income. We also show the impact across several income tax brackets for a married couple filing jointly. As you can see, capital gains taxes can add up quickly.

Long-term Example (Married Couple)	**MAGI: $150,000 15% Capital Gains Rate**	**MAGI: $300,000 15% Capital Gains Rate**
Purchase 500 shares at $100 each	$50,000	$50,000
Sell 500 shares at $200 each more than a year later	$100,000	$100,000
Net investment income	$50,000	$50,000
Taxes owed on capital gains	$7,500	$7,500
Net Investment Income tax owed	$0	$1,900 (3.8% on $50,000)

Total Capital Gains Tax Obligation	$7,500	$9,400

Short-term Example (Married Couple)	**MAGI: $150,000 22% Marginal Tax Rate**	**MAGI: $300,000 24% Marginal Tax Rate**
Purchase 500 shares at $100 each	$50,000	$50,000
Sell 500 shares at $200 each less than a year later	$100,000	$100,000
Net investment income	$50,000	$50,000
Taxes owed on capital gains	$11,000	$12,000
Net Investment Income tax owed	$0	$1,900 (3.8% on $50,000)
Total Capital Gains Tax Obligation	$11,000	$13,900

Strategies to Help Avoid Capital Gains Taxes

There are a number of strategies to consider when seeking to control the loss in your portfolio caused by the taxation of capital gains. Below are four popular options to optimize your investment growth:

1. Long-term investing — Holding assets for the long term ensures you pay only the tax rates applicable to long-term capital gains tax, which are less than the rates for short-term capital gains. Keep in mind that many factors impact your investment decisions and there are any number of reasons you may want to sell earlier than you plan.

2. Using capital losses to offset gains (tax-loss harvesting) — This strategy requires losses in order to offset your gains. For example, if you are invested equally in two stocks, and one company's stock rises by 20% and the other company falls by 10%, you can subtract the loss from the gain, reducing the amount of capital gain on which you pay tax. Keep in mind that there is a cap on the amount of capital loss you are able to use against your capital gain, and the losses needed for this approach are real economic losses to you.

3. Retirement plans — There are numerous types of qualified retirement plans like the 401(k), 403(b), IRA, and Roth IRA, where your investment can grow tax deferred. Most of these plans don't require participants to pay income taxes until funds are withdrawn from the plan — typically at retirement, many investors may find themselves in a lower tax bracket than during their working years.

4. Annuities — Similar to qualified retirement plans, annuities grow without being subject to capital gain taxes, and aren't taxed until funds are withdrawn (annuity withdrawals are taxed at ordinary income tax rates, not at capital gains tax rates).[2] The main differences are in how the money paid into the annuity is taxed prior to being paid in and how much can be paid in. In qualified annuities, you pay in pre-tax dollars. In a non-qualified annuity, you use after-tax dollars. Consider a non-qualified annuity once your qualified plans are maxed out or when you have a windfall to use for additional retirement savings.

The Bottom Line

Capital gains are a result of investments that have performed well, but taxes can eat away at their compounding power. You have a range of strategies to help you mitigate such losses – from buy and hold, tax-loss harvesting, maxing out your qualified retirement plans, and contributing to tax-deferred annuities.

Download PDF Now

Back to Tax Center Home Tax Center

---

[1]Generally, tax-inefficient asset classes are asset classes such as alternatives, bonds, real estate and utilities, as well as other funds that may generate ordinary income, dividends or short-term capital gains when they are purchased outside of a tax-deferred investment vehicle.

[2]Withdrawals from an annuity are taxable as ordinary income and, if made before age 59½, may be subject to a 10% IRS penalty tax. Investing in an annuity through a tax-qualified contract, such as an IRA, offers no additional tax benefit.

Tax Topics

- SECURE Act Overview
- 2022 Quick Reference Tax Guide
- How Tax Deferral Works
- Tax-savings Strategies for 2022
- How the Tax Saver’s Credit Can Help
- When do I take a Required Minimum Distribution?

Related Products

- EliteDesigns® Variable Annuity
- EliteDesigns® II Variable Annuity
- SecureDesigns® Variable Annuity
- Variflex® Variable Annuity

Tax Management Strategies

- Fixed Period Annuity Option - EliteDesigns®
- Fixed Period Annuity Option - EliteDesigns® II

Neither Security Benefit nor its affiliates are fiduciaries and the information provided is not intended to be investment advice. This information is general in nature and intended for use with the general public. For additional information, including any specific advice or recommendations, please visit with your financial professional.

Annuities are issued by **Security Benefit Life Insurance Company** (SBL) in all states except New York. SBL is not licensed in and does not transact business in New York. Services are offered through Security Distributors, a subsidiary of SBL, which is wholly owned by Security Benefit Corporation ("Security Benefit").

Security Benefit, its affiliates and subsidiaries, and their respective employees and/or representatives do not provide tax, accounting or legal advice. Any statements contained herein concerning taxes are not intended as and should not be construed as tax advice, nor should they be used for the purpose of avoiding federal, state or local taxes and/or tax penalties. Please seek independent tax, accounting or legal advice.

SB-10005-13 | 2022/01/14