Ways to Defer or Pay No Capital Gains Tax on Stock Sales

By Anita Steburg, Esq., Contributor

Stocks are a popular investment vehicle. Stocks are purchased with the anticipation the value of the stock will increase. Selling appreciated stock can generate a large capital gain taxes. Perhaps you purchased shares of Microsoft many years ago, have acquired founders stock from a startup, or hold shares from employee stock options that have appreciated significantly. Generally stocks held more than one year have favorable long-term capital gain tax treatment but the total tax bill can still be significant.

The tax code is very complex and there are strategies which can be utilized to defer or pay no capital gain taxes. Each strategy is dependent upon your income, personal goals, financial goals and your risk aversion comfort level. There are legal ways to defer taxes using more sophisticated techniques in combination with consulting with your trusted tax advisor to keep you out of trouble. These are valid strategies and not tax dodges, loopholes or barred transactions that will result in an IRS criminal investigation at your doorstep.

Strategy One: Low Tax Bracket

For individuals in a low tax bracket, the long term capital gains rate is 0%. The eligibility for the 0% capital gains rate is not a perfect match with the income ceiling for the 12% income tax rate. The income for the 0% rate for 2020 are $40,000 for single filers and $80,000 for joint filers.

Before you begin coordinating complex acrobatics to shuffle your stock to someone else in a lower tax bracket to avoid capital gain taxes, you want to consult with a tax advisor to ensure you are complying with the rules. For example, the net gains from your stock counts against the income limit. Kiddie tax is triggered should the gifted stock be sold by a child under the age of 19. These are just two examples of how easily missteps can occur without the proper planning advice.

Strategy Two: Utilizing Tax Losses

Capital losses can be used to offset capital gains occurring in the same tax year. The capital gains and capital losses are offset by each other to determine if there is an aggregate capital gain or loss. This can also result in no capital gains at all and is a popular strategy. Only $3,000 of net capital losses can be deducted in any one year against ordinary income on your tax return and

the remaining balance can be carrier over to future years indefinitely. One trap for the unwary is to avoid wash sales which apply when you sell and then repurchase the same stock.

Strategy Three: Stock Donations

If you have a favorite charity you make donations, this strategy can be right up your alley. Instead of selling the appreciated stock and paying the capital gain taxes and then donating the proceeds to your favorite charity, you can donate the stock directly. This strategy avoids the capital gains tax completely. In many cases, it generates a tax deduction for the full market value of donated shares held more than one year and it results in a larger donation to your favorite charity.

If donations exceed your yearly standard deduction amount, then the stock donation also reduces your overall taxable income. You could donate the shares to a donor-advised fund if you are uncertain about your philanthropic goals for the stock. For larger donations, an estate planning attorney can advise you regarding charitable remainder trusts or private foundations.

Strategy Four: Qualified Small Business Stock

Private company shares held for at least five years that are considered qualified small business stock (QSB) may be eligible for an income exclusion of up to $10 million or 10 times the cost basis. This is separate from the approach of rolling over your capital gains by reinvesting them within 60 days of sale in another start up. For the stock to qualify, the company must not have gross assets valued over $50 million when it issued you the shares. This is a very complex area of tax law and successfully navigating the various statutes and regulatory regulations are key if you are adopting a QSB strategy. If you are considering this strategy, a tax attorney or advisor should be consulted.

Strategy Five: Qualified Opportunity Zones

Opportunity Zones encourage investment in distressed communities and areas that need funding and development. This is the "shiny new thing" of ways to defer and potentially pay no capital gain taxes. By investing unrealized capital gains within 180 days of a stock sale into an Opportunity Fund and holding it for at least 10 years, no capital gain taxes will be due on the profit from the fund investment.

For realized but untaxed short and long term capital gains from the stock sale, the tax on the capital gains is deferred until 2026 or earlier should the investment be sold. For capital gains placed in Opportunity Funds for at least five years until the end of 2026, the basis in the original

stock investment increases by 10%. This relatively new tax incentive is complex and faces potential legislative changes. Unresolved issues also remains on some aspects as reflected from interim and ongoing guidance from the Internal Revenue Service.

Strategy Six: Own Appreciated Stock At Your Death

When you own stock at your death, your tax basis in the stock receives a “stepped up” tax basis to the fair market value as of the date of your death. The stock escapes the capital gain taxes on the equity during your lifetime, regardless of the size of the estate. Thus, no taxable gain is recognized when the inherited shares get sold at no higher than the date of death price.

The above six strategies are legal ways which you can defer potential capital gain taxes from the liquidation of stocks. Before deciding on a strategy, it is always advisable to consult with a tax professional. The Internal Revenue Code is complex and many of these strategies involve employing more sophisticated and complex planning strategies.