

THE LAST BUSH TAX CUT
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It sounds like a pitch for a sham tax shelter: Sell stocks for a profit and pay no capital gains tax. But it's not. It's legal, and it's the last of the capital gains tax cuts President George W. Bush pushed through in 2003 to take effect.

Beginning Jan. 1, 2008, taxpayers whose income is low enough to keep them in the 10% or 15% ordinary income tax bracket, will pay a 0% tax rate on gains from the sale of stocks, funds and some other assets (such as a vacation home) they've held a year or more. Like the rest of Bush's tax cuts, the 0% rate expires at the end of 2010--and might disappear sooner if Democrats gain control of both ends of Pennsylvania Avenue in the November elections. So act this year. "For those who can use the 0% rate, there is a sense of urgency," says Clifford Caplan, a financial planner with Neponset Valley Financial Partners in Norwood, Mass. So who can get this freebie? Couples with taxable income--that's income after all exemptions and deductions--of up to \$65,100 for 2008 and singles with up to \$32,550 in taxable income will get the full benefit of the 0% rate.

That taxable income limit includes the capital gains themselves, warns Kaye Thomas, author of "Capital Gains, Minimal Taxes." So you can't pay a 0% rate on \$1 million in capital gains just because you have no other income. A couple with only capital gains would have the first \$65,100 of their gains taxed at 0% and the rest at 15%. Compared to last year's 5% capital gains tax rate for low-bracket taxpayers, that's a maximum tax cut of \$3,255--a lot more than the "stimulus" tax rebate Congress and Bush are talking about giving you.

Note that this break works best if your main (or only) source of income is from capital gains. That's because other income is counted first in the income limit. So a couple with \$55,100 in other taxable income (say from salary, or from pensions and Social Security) would get only their first \$10,000 in gains taxed at the 0% rate. Gains above that would be taxed at 15%.

If you want to take advantage of the 0% rate, start thinking of ways to reduce your income this year. A 50-something couple, for example, can cut their 2008 taxable income by \$41,000 if they both make the maximum contributions to their 401(k)s. Count in other deductions (mortgage interest, state and local taxes) and their standard exemptions, and a couple earning \$100,000-plus might easily take advantage of the 0% rate.

Retirees, too, can make good use of this break, particularly if they don't yet have to take required minimum distributions from their pre-tax IRAs. (Required distributions start after age 70 1/2.) A couple could put off taking any distributions from their IRAs and live instead on capital gains realized from their taxable accounts--gains "taxed" at 0%.

Adult children, who are out of college, but not yet earning much, may also be able to use the break. Well-off parents or grandparents can give these struggling 20-somethings appreciated stock to sell at the 0% rate, instead of the parents' or grandparents' 15% rate.

But watch out for gift tax limits; each parent can give \$12,000 a year in stock (cash or other gifts) to each child. Give more in a year, and you'll use up some of your lifetime exemption from gift and estate taxes.

Also, don't try this trick with younger kids. New "kiddie tax" rules provide that children are taxed at their parents' higher tax rate through age 18 or age 23, if they're full-time students.

What if you qualify for the 0% gains rate but don't want to sell your stock now? Maybe you don't need the cash. Or maybe you think that the stock will go higher? Not to worry, you can sell shares at a profit and buy back the same stock immediately, replacing your old holdings with new stock with a higher basis. (No, the "wash sale" rules, which make you wait 31 days to replace stocks, don't apply if you're selling for a gain.) "It's a great hedge against higher capital gains tax rates in the future, says Marc Soss, a tax lawyer in Tampa, Fla.

But don't sell that stock without thinking through all the financial consequences, warns Soss. For younger folks, increasing income by recognizing capital gains could hurt future eligibility for financial aid, say if grad school is in the picture. For older folks, the move could make previously non-taxed Social Security benefits taxable.