**8545. How is net capital gain taxed?**

 “*Net capital gain* is the excess of net long-term capital gain for the taxable year over net short-term capital loss for such year.[[1]](#footnote-1) However, net capital gain for any taxable year is reduced (but not below zero) by any amount the taxpayer takes into account under the investment income exception to the investment interest deduction.[[2]](#footnote-2)

If a taxpayer has net capital gain for any tax year, the IRC provides that the tax will not exceed the *sum* of the following six items:

(A) the tax computed at regular rates (without regard to the rules for capital gain) on the *greater* of (i) taxable income reduced by the net capital gain, or (ii) the *lesser* of (I) the amount of taxable income taxed at a rate below 25 percent, *or* (II) taxable income reduced by the adjusted net capital gain;

(B) 0 percent of the taxpayer’s adjusted net capital gain (or, if less, taxable income) that does not exceed the *excess* (if any) of (i) the amount of taxable income that would (without regard to this paragraph) be taxed at a rate below 25 percent *over* (ii) the taxable income reduced by the adjusted net capital gain;

(C) 15 percent of the lesser of (i) so much of the taxpayer’s adjusted net capital gain (or, if less, taxable income) as *exceeds* the amount on which a tax is determined under (B), above, or (ii) the *excess* of (I) the amount of taxable income which would be taxed at below 39.6 percent *over* (II) the sum of the amounts on which a tax is determined under (A) and (B), above;

(D) 20 percent of the taxpayer’s adjusted net capital gain (or, if less, taxable income) in *excess* of the sum of the amounts on which tax is determined under (B) and (C), above;

(E) 25 percent of the *excess* (if any) of (i) the unrecaptured IRC Section 1250 gain (or, if less, the net capital gain (determined without regard to qualified dividend income)), *over* (ii) the *excess* (if any) of (I) the sum of the amount on which tax is determined under (A) above, *plus* the net capital gain, *over* (II) taxable income (See Q 8546 for a discussion of unrecaptured IRC Section 1250 gain); *and*

(F) 28 percent of the amount of taxable income in *excess* of the sum of the amounts on which tax is determined under (A) through (D) above. See Q 8546 for a discussion of 28 percent gain.

For most long-term capital gains, this complicated formula generally results in a maximum capital gains rate on adjusted net capital gain for 2014 equal to: (i) 20 percent for individuals taxed at the 39.6 percent income tax rate, (ii) 15 percent for individuals taxed at the 25, 28, 33 or 35 percent income tax rates, and (iii) 0 percent for individuals taxed at the 15 percent or 10 percent income tax rates.

1. . IRC Sec. 1222(11). [↑](#footnote-ref-1)
2. . IRC Secs. 163(d)(4)(B)(iii), 1(h)(2). [↑](#footnote-ref-2)