

What is capital gains income? What are short- and long-term capital gains?

When a taxpayer sells a capital asset, such as stocks, a home, or business assets, the difference between the sale price and the asset's tax basis is either a capital gain or a loss. The "tax basis" is usually what the taxpayer invested in the asset, less any depreciation deductions claimed for business assets. Special basis rules apply to assets received as a gift or inheritance.

The gain or loss on an asset held for more than one year is considered "long term." If the taxpayer disposes of an asset after holding it for a year or less, the gain or loss is "short term."

How does the federal government tax capital gains income?

Four maximum federal income tax rates apply to most types of net long-term capital gains income in tax year 2019 (these rates include the additional 3.8 percent tax on net investment income or NII):

- 0 percent for taxpayers in the 10 percent or 15 percent bracket (under \$78,750 of federal taxable income (FTI) for married joint filers)
- 15 percent for taxpayers above the 15 percent bracket but below the threshold for the tax on NII (from \$78,750 of FTI to \$250,000 of modified adjusted gross income (MAGI) for married joint filers)
- 18.8 percent for taxpayers subject to the tax on NII but not in the top bracket on ordinary income (from \$250,000 of MAGI to \$488,850 of FTI for married joint filers)
- 23.8 percent for taxpayers in the top 37 percent bracket (\$488,850 of FTI or higher for married joint filers)

The net capital gain income that qualifies for the preferential rates is long-term capital gain after subtracting both long-term capital losses and net short-term capital losses (i.e., in excess of short-term capital gains). Short-term capital gains do not qualify for the preferential federal rates.

How does Minnesota tax capital gains income?

Minnesota includes all net capital gains income in taxable income and subjects it to the same tax rates as apply to other income: 5.35, 7.05, 7.85, and 9.85 percent. Minnesota recognizes the federal exclusions on the sale of the taxpayer's home and the sale of qualified small business stock.

Are there higher or lower federal rates for certain kinds of income?

Three exceptions to the maximum federal rates apply:

- **Qualified small business stock.** 50 percent to 100 percent of the gain on sale of qualified small business stock is exempt, depending on when the stock was acquired; a 31.8 percent maximum rate applies to any remaining gain
- **Collectibles.** The net capital gain from selling collectibles (such as coins or art) is subject to a maximum 31.8 percent rate
- **Section 1250 real property.** The part of any net capital gain on property for which the taxpayer claimed "additional depreciation" (Section 1250 real property) is taxed at a maximum 28.8 percent rate

How are gains from the sale of the taxpayer's main home taxed?

Taxpayers may exclude up to \$250,000 of gain on the sale of the home (\$500,000 for married joint filers), if they owned and used the homes as their principal residences for two out of the five years before the sales. There is no limit to the number of times a taxpayer may claim this exclusion.

Can capital losses reduce ordinary income?

Up to \$3,000 per year of capital losses can be deducted from ordinary income; losses over \$3,000 are carried forward to future tax years. Losses on personal use items, such as a home or car, are not deductible.

How do other states treat capital gains?

Nine states (Arkansas, Arizona, Hawaii, Montana, New Mexico, North Dakota, South Carolina, Vermont, and Wisconsin) exclude a portion of long-term capital gains income, provide a lower rate, or allow a credit. Massachusetts taxes short-term capital gains at a higher rate (12 percent) than long-term capital gains. Of the states that impose individual income tax, 31 states including Minnesota do not provide preferential treatment for capital gains income; some provide special treatment for capital gains income from certain types of assets.

What are the income levels, filing types, and ages of Minnesota residents who have capital gains income?

In tax year 2016, about 20 percent of all returns filed by Minnesota residents reported some capital gain or loss. Married taxpayers filing joint returns reported 79 percent of capital gains income. Filers with incomes over \$100,000 reported about 86 percent of capital gains income. Over 40 percent of taxpayers aged 65 and older reported some capital gains income in tax year 2016. The table shows the percent of gains by age of taxpayer.

Federal adjusted gross income	\$ of capital gains reported (millions)	% of all gains reported	% of income consisting of gains	Average gains per return
Returns with capital gains				
Less than \$50,000	\$649	8.4%	10.6%	\$2,834
\$50,000 to \$99,999	\$431	5.6%	3.5%	\$3,490
\$100,000 to \$500,000	\$2,208	28.7%	6.8%	\$14,561
Over \$500,000	\$4,413	57.3%	17.3%	\$234,437
All incomes	\$7,702	100.0%	10.1%	\$14,721
Taxpayer Age				
Less than 25	\$28	0.4%	6.5%	\$1,081
25 to 39	\$434	5.6%	4.8%	\$5,897
40 to 64	\$4,421	57.4%	9.5%	\$19,077
65 or older	\$2,818	36.6%	13.9%	\$14,692
All ages	\$7,702	100.0%	10.1%	\$14,721



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