

Managing capital gains and losses

What you need to understand before selling an investment

Capital gains and capital losses

A capital gain or loss results from the sale of a capital asset. Examples of capital assets are stocks, bonds, mutual funds and real estate. The amount of the capital gain or loss equals the net sales proceeds minus the adjusted cost basis.

Capital gains do not include ordinary income, such as interest or dividend income. Although qualified dividends are taxed at long-term capital gains rates under current tax law, you cannot use capital losses to directly offset qualified dividends.

How you manage your capital gains and losses can play a major role in determining your after-tax return. To get the greatest benefit from current tax law, there's important information you need to understand.

Holding periods

Your holding period and income tax bracket (discussed below) determine your capital gains tax rate. Assets you hold long-term – longer than one year – receive a preferential rate. Assets held short-term are those held for one year or less.

For example, if you purchased an investment on Feb. 3, the short-term holding period would end on Feb. 3 of the next year. To establish a long-term holding period, you would have to sell the asset on or after Feb. 4 of the next year. (Note that these dates are determined by the trade date, not the settlement date.)

Special holding-period rules for assets acquired by gift or inheritance

Your holding period for an appreciated asset received as a gift includes the length of time you held the asset plus the time the donor held it. Any property you inherit related to a death occurring in a year other than 2010 has an automatic long-term holding period – no matter how long you or the deceased held the asset. With the repeal of the estate tax in 2010, the holding period and cost basis rules for inherited assets have become much more complex. It is important to talk with your tax advisor on this issue.

Long-term capital gains rates*

Net long-term capital gains may be tax-free for those in the 10% or 15% tax brackets. These gains are taxed at a 15% rate for those in the 25% or higher tax brackets.

Exceptions to these rates include gains from sales of collectibles and certain depreciable property. Capital gains on those items may be taxed at a higher capital gains rate. For more information, consult your tax advisor.

Short-term capital gains rates

Like ordinary income, short-term capital gains are taxed at an individual's marginal tax rate, which can currently be as high as 35%.

*Stated rates are for federal income tax purposes only. Consult your tax advisor for state income tax rates.

Federal tax-rate summary

Ordinary income-tax bracket	Short-term capital gains rate	Long-term capital gains rate*
10%	10%	0%
15	15	0
25	25	15
28	28	15
33	33	15
35	35	15

These tax rates are temporary

Under current law, the existing tax rates will expire at the end of 2012 and revert to those in effect prior to the 2001 tax-reform legislation. For example, starting in 2013, long-term capital gains will increase to 10% or 20%, depending on your marginal tax bracket, instead of 0% or 15%. Short-term gains will continue to be taxed at the same rates as ordinary income; however, the 10% ordinary income tax bracket will disappear, and the rates for the remaining brackets will be higher (39.6% maximum). See “Special reduced rate for property held five years or longer” on page 4.

Sunset provisions' effects on long-term capital gains rates

	2011 and 2012	2013 and later
10%* and 15% brackets	0%*	10%*
25% and higher brackets	15	20

*The 10% ordinary income tax bracket will not exist starting in 2013.

Offsetting capital gains and losses

Capital losses you incur may be tax-deductible; however, there are limitations on the deductible amount in any given year. Here are the steps to follow to deduct a capital loss:

1. Offset long-term capital gains against long-term capital losses to determine the net long-term capital gain or loss.
2. Offset short-term capital gains against short-term capital losses to determine the net short-term capital gain or loss.
3. Offset the net short-term result against the net long-term result if one result is a net gain and the other a net loss.
4. If a net capital loss remains after completing steps 1 through 3, you may use it to offset up to \$3,000 in ordinary income in the current tax year.
5. If there's still a remaining capital loss, you may carry it forward to offset future years' capital gains and/or ordinary income (in accordance with steps 1 through 4).

*For gains within the tax bracket.

Think about taxes all year

Although many investors wait until year-end or the approach of the April 15th tax-filing deadline to begin thinking about taxes, it may be wiser to periodically assess your tax situation – especially those issues surrounding your portfolio – throughout the year. Talk with your Financial Advisor and tax advisor regularly to review how well your investments are helping you work toward your goals in a tax-efficient manner.

For example, an investor has a:

- \$5,000 long-term gain
- \$12,000 long-term loss
- \$6,000 short-term gain
- \$4,000 short-term loss

He or she should:

1. Calculate the net long-term capital gain or loss:

Long-term gain:	\$5,000
Long-term loss:	(12,000)
Net long-term capital loss:	<u>(\$7,000)</u>

2. Calculate the net short-term capital gain or loss:

Short-term gain:	\$6,000
Short-term loss:	(4,000)
Net short-term capital gain:	<u>\$2,000</u>

3. Calculate the net capital loss:

Net long-term capital loss:	(\$7,000)
Net short-term capital gain:	<u>2,000</u>
Net long-term capital loss:	<u>(\$5,000)</u>

4. Use \$3,000 of the net long-term capital loss to offset ordinary income in the current year.
5. Carry forward the remaining \$2,000 long-term capital loss to offset future years' capital gains and/or ordinary income.

Capital loss carryforwards

Losses carried forward to future years retain their long-term or short-term character when applied. For example, if a taxpayer reported a net short-term loss carryforward from a prior year, then in the current year that loss would first be applied against short-term gains.

Unused net capital losses can be carried forward until they are fully used or until the taxpayer's death. Carryforward losses may be used on a deceased individual's final income tax return in the same manner as described above. Any remaining losses cannot be passed on to the deceased's spouse or heirs.

You can count on us

Your Financial Advisor can work with you and your tax advisor to help manage your capital gains and losses whenever you sell an investment.

Special reduced rate for property held five years or longer

Starting in 2013, long-term capital gains will be taxed at 10% for those in the 15% bracket and 20% for those in the higher brackets. However, you may be eligible for a reduced 8% (if you're in the 15% bracket) or 18% (if you're in a higher bracket) rate for capital gains on assets held five years or longer. To be eligible for the 18% rate, the asset must have been purchased on or after Jan. 1, 2001.* This is not required for taxpayers who qualify for the 8% rate.

**The 18% rate may be available on assets purchased prior to Jan. 1, 2001, if the taxpayer made a "deemed" sale election in 2001. This means that the taxpayer elected to include unrealized capital gains in his or her taxable income for the 2001 tax year even though he or she did not actually sell the appreciated assets. In this case, any appreciation from Jan. 1, 2001, through the actual sale date would be eligible for the 18% rate.*

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