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Taxes on 2021 investments

Although there was much tax legislation enacted in 2020, the rules for taxation of investments were not changed. Capital gains and dividends are a special category of income with special rules that are important for investors to understand as they plan and manage their portfolios.

The profit from the sale of an asset held for a year or less will be taxed as ordinary income, and so falls into each taxpayer's highest tax bracket. Assets held for more than a year, as well as qualified dividends, are eligible for preferential tax rates, ranging from 0% for the lowest income taxpayers to 20% at the top. The boundaries for the 2021 tax year are given in the table below.

Single taxpayers, taxable income. Married filing jointly, taxable income. Tax rate on long-term gains and dividends:

Single taxpayers, taxable income	Married filing jointly, taxable income	Tax rate on long-term gains and dividends
$0 - $40,000	$0 –$80,000	0%
$40,001 - $445,850	$80,001 – 501,600	15%
$445,851 and up	$501,601 and up	20%

Source: Internal Revenue Service

However, there is a bit more to the story. A 3.8% surtax applies to the net investment income of higher-income taxpayers, including dividends and long-term gains. The threshold is $200,000 of adjusted gross income for singles and $250,000 for marrieds filing jointly (a potential marriage penalty there). Therefore top taxpayers will typically be paying a 23.8% tax on long-term gains, and there is an 18.8% bracket below that.

It is possible that realizing a long-term gain will lift a taxpayer into a higher bracket, as shown in these examples:

Example one. Single taxpayer Jack has $30,000 of ordinary income and realizes a $20,000 long-term gain. The first $10,000 of his gain will be tax free, the second $10,000 triggers tax at a 15% rate. Total tax on investment income comes to $1,500.

Example two. Single taxpayer Jill has $150,000 of ordinary income, $60,000 of long-term gain, and $15,000 in qualified dividends. The first $50,000 of her net investment income will be taxed at 15%, the remaining $25,000 at 18.8%. Total tax on investment income is $12,200.

Example three. Jack and Jill get married, so their combined ordinary income is $180,000, their long-term gains are $80,000, and qualified dividends are $15,000. The first $70,000 of investment income will be taxed at 15%, the remaining $25,000 at 18.8%. Total tax on combined investment income comes to $15,200. That's $1,500 more than they would have paid by staying single.

Tax factors are only one factor to account for in making buy and sell decisions, and usually not the most important factor. See your tax advisors to learn more.