Vermont Department of Taxes
TECHNICAL BULLETIN

TAX: Income Tax **TB 47**

SUBJECT: Capital Gains Treatment for 2009

STATUTORY REFERENCES: 32 V.S.A. § 5811(21) and (26)
2009, H. 442, secs. 16a, 17 and 18
2009, S. 1 (Spec. Sess.), sec. 22b

ISSUED: 06/30/2009
REVISED: 12/17/2009[*]
01/08/2010[†]

INTRODUCTION

Vermont tax treatment of capital gain income is changed effective July 1, 2009. For gains received prior to July 1, taxpayers may continue to exclude 40 percent of adjusted net capital gain from taxable income subject to the limitation that the total decrease may not exceed 40 percent of federal taxable income (referred to as the “40 percent exclusion” or “40 percent exclusion method”). For gains received on and after July 1, treatment of adjusted net capital gain income as defined in Section 1(h) of the Internal Revenue Code (also referred to as “capital gain[s]” or “net gain[s]”) depends upon the taxpayer and the source of gain. The purpose of this bulletin is to describe the calculation of the capital gains exclusion for filing 2009 Vermont Income Tax Form IN-111 and 2009 Vermont Fiduciary Return of Income Form FI-161.

STATUTORY SCHEME

A. General Rule:

The 40 percent exclusion is replaced by an exclusion of the first $2,500 of adjusted net capital gain income (referred to as the “flat exclusion” or “flat exclusion method”). Thus, taxable income may be decreased by 40 percent of adjusted net capital gains received on and after January 1, 2009 and before July 1, 2009 and by the first $2,500 of net capital gains received on and after July 1, 2009 to arrive at Vermont taxable income. Gains and losses must be allocated to the half of the year in which they were received (gains) or incurred (losses) and netted separately before applying the applicable exclusion, subject to the limitation that the base on which the exclusion is calculated may not exceed the total adjusted net capital gain included in federal adjusted gross income. Any carryforward of adjusted net capital loss is allocated to the first half of the year.

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[*] Clarifying language with respect to mutual fund was added to the penultimate sentence on page one and reference to the Vermont Fiduciary Return of Income Form FI-161 was added to pages one and two on December 17.2009

[†] The January 08, 2010 revisions in Section A (General Rule) provide additional clarity to the treatment of capital gains distributions.

Pass-through entities have the responsibility to determine when the capital gain or loss is properly taken into account (i.e., when received in the case of gain; when incurred in the case of loss). The issuer of pass-through income should notify the shareholder or other distributee of the capital gain or loss timing. Otherwise, the shareholder or other distributee of pass-through income should contact the entity for this information. If this information is not available, adjusted net capital gain must be allocated equally to the first and second halves of the year.

Information on capital gains from separate transactions within a mutual fund are typically not available to the taxpayer. Therefore, second half distributions from mutual funds should be allocated equally to the first and second half of the year. First half distributions should be allocated to the first half of the year. Capital gains from the sale of a mutual fund should be allocated to the half year in which the sale proceeds were realized.

B. Special Rules:

(1) Farmers who receive capital gain income from the sale of a farm use the 40 percent exclusion method for calculating the exclusion whether the income was received in the first or second half of the year. “Farmer” has the same meaning it has for the Use Value Appraisal Program. See 32 V.S.A. § 3752(7). The property sold must be used by the farmer in the “business of farming”, which is defined in Reg. 1.175-3 issued under the Internal Revenue Code of 1986.

(2) Taxpayers who receive capital gain income from the sale of standing timber also use the 40 percent exclusion method for calculating the exclusion regardless of whether the income was received in the first or second half of the year. The sale must be by the owner of the standing timber in a transaction that requires the owner to recognize a capital gain or loss as defined in Section 631(b) of the Internal Revenue Code. Under Section 631(b) the timber must have been held for more than one year and “owner” means any person who owns an interest in such timber, including a sublessor and a holder of a contract to cut.

(3) Taxpayers who are 70 years old or older on December 31, 2009 may use either the 40 percent exclusion method or the flat exclusion method to calculate the reduction for capital gains received in the second half of 2009[1]. Joint filers qualify for this option if either of them is 70 years old or older on December 31, 2009.

FILING THE 2009 VERMONT IN-111 and FI-161

The Vermont Department of Taxes will provide a schedule for calculating the capital gains that may be excluded from Vermont taxable income in 2009. The schedule will be available in the tax booklet and on the Department’s website. The total exclusion amount from the schedule must be transferred to Form IN-111 and FI-161.

[1] This option exists only for the second half of 2009 and all of 2010. For tax years beginning 2011 and after, only the flat exemption is available to taxpayers regardless of age unless they fall into the farm or timber sale categories.

A. Filing Using the Flat Exclusion for the Second Half of 2009

Unless all of the taxpayer's gain qualifies for one of the special rules - and in the case of taxpayers aged 70 and older, the taxpayer chooses the 40 percent exclusion method for the second half of 2009 - capital gains must be calculated separately for the first and second halves of 2009. Gain is allocated to the half of the year in which it was received. Loss is allocated to the half of the year in which it was incurred. The 40 percent exclusion applies to the first half net gain and the flat exclusion applies to – and is limited by – the second half net gain. Taxable income will be decreased by the total of the two exclusion amounts *subject to the limitation that the base on which the exclusion is calculated cannot in total exceed the total adjusted net capital gain included in federal adjusted gross income*. Thus, the amount of net gain in one half is offset by a net loss in the other half before calculation of the exclusion.

Capital gains received pursuant to an installment sale are calculated under the exclusion method in effect on the day of receipt. Thus, if a real estate conveyance in June gives rise to a capital gain, but is structured so that the seller receives a payment each August for the next 5 years, the seller may reduce the capital gain related to the August 2009 payment by up to $2,500, but may not use the 40 percent exclusion method.

Examples:

(1) First half gain, second half gain. Taxpayer has a net gain of $3,500 in the first half of the year. Taxpayer has a net gain of $500 for the second half of the year. Taxpayer may decrease his taxable income by $1,900 (40 percent of $3,500 + $500).

(2) First half gain, second half loss. Taxpayer has a net gain of $50,000 in the first half of the year. Taxpayer has a net loss of $10,000 for the second half of the year. Since there was no gain in the second half, there is no application of the flat exclusion. Taxpayer may decrease his taxable income by $16,000 (the 40 percent exclusion applied to the first half gain that is included in federal adjusted gross income, which is $40,000).

(3) First half loss, second half gain. Taxpayer has a net loss of $2,000 in the first half of the year. Taxpayer has a net gain of $3500 in the second half of the year. Since there was no gain in the first half, there is no application of the 40 percent exclusion. Since the taxpayer's net gain at the federal level is $1,500, his flat exclusion is limited to that amount. Thus, the taxpayer may decrease his taxable income by $1,500 (the flat exclusion amount applied to the second half gain that is included in federal adjusted gross income).

(4) First half loss, second half loss. Taxpayer has a net loss of $100 in the first half. Taxpayer has a net loss of $2000 in the second half. Taxpayer may not decrease taxable income since she had no capital gain in either half of the year and no capital gain was included in her federal adjusted gross income.

B. Filing Using the 40 Percent Exclusion in the Second Half of 2009

(i) Farm and Timber Sales:

The 40 percent exclusion method applies to capital gain on qualified sales of farms by farmers and qualified sales of standing timber any time in 2009. However, since this is a source-based, not a taxpayer-based exclusion, capital gains received from sources other than qualifying farm and timber sales in the second half of the year fall under the flat exclusion method even if received by a farmer or timber owner. The total exclusion is subject to the limitation described in the General Rule above.

Examples:

(1) Taxpayer has a $3000 capital gain from the sale of standing timber in April and another $3000 gain from a sale in September. Taxpayer also has an $8,000 capital gain from the sale of a vacation home in August. Taxpayer may decrease his taxable income by $4,900 (40 percent of the $6,000 gain on the timber sales, which is $2,400 + the flat exclusion amount of $2,500 for other gains).

(2) Same facts as above except the vacation home sale results in an $8000 *loss* instead of a gain. Since the taxpayer has no capital gain income included in federal adjusted gross income (his losses exceed his gain), he is not entitled to an exclusion from taxable income.

(3) A farmer has a $500,000 gain in February and a $300,000 loss in November. The capital gain included in federal adjusted gross income is $200,000. His exclusion is 40 percent of $200,000 or $80,000.

(ii) Taxpayers Who Are 70 Years of Age on December 31, 2009:

A taxpayer born before January 1, 1940 has the choice of using the flat exclusion method or the 40 percent exclusion method for calculating the capital gains for the second half of 2009. If the 40 percent exclusion is chosen for second half gains, it applies to all net gains of the qualified taxpayer because the option is *taxpayer*-based, not *source*-based as is the case with farm and timber sales. As with other taxpayers, capital gains received in the first half of the year are reduced by 40 percent. For taxpayers filing jointly (either married or civil union), only one spouse has to be 70 or older on December 31, 2009 for the second half option to be available.

Examples:

(1) A taxpayer who is over 70 years old on December 31, 2009 has a $2000 net capital gain in the first half and a $4000 net capital gain in the second half. Taxpayer may exclude $2,400 (40 percent of her entire $6000 gain). Alternatively, the taxpayer may use the flat exclusion for the second half to exclude $3,300 ($800 [40 percent of $2,000] + $2,500 [the flat exclusion amount]).

(2) Same facts as above except taxpayer has a second half loss of $4000 instead of a gain. Since taxpayer has no capital gain income included in federal adjusted gross income (she has a $2000 loss), she has no capital gain exclusion from taxable income.

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Molly Bachman Date
General Counsel

Approved:

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Richard Westman Date
Commissioner of Taxes