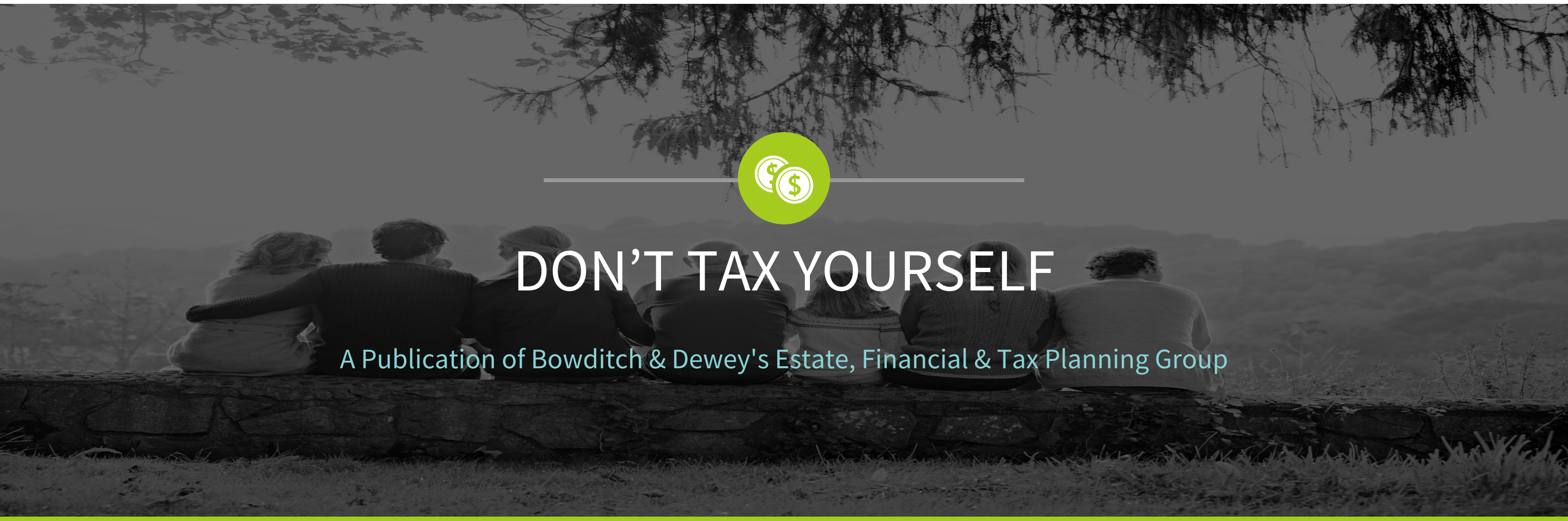

GameStop, Taxes, and the Next Trade

BY SCOTT C. CASHMAN • FEBRUARY 12, 2021

It appears the wild ride for traders in GameStop (GME) stock has ended with shares trading at a fraction of what they were trading just a few weeks ago. Shares which once soared from around $20 a shares to a high of $380, as a result of a purported short squeeze, have since fallen back to around $50. During the time the stock was soaring, many small traders reportedly realized large gains at the expense of the so called professionals. It was reported that one graduate student supposedly turned $500 into over $200,000 through a GameStop trade.

If you were one of the lucky investors who made significant profits trading GameStop or any of the growth stocks that have soared since the March 2020 lows (e.g. Amazon is up over 118% in the past year alone), you may wonder what you will owe in taxes.

Realized capital gains are taxed on the federal tax return at rates that, in large part, are determined by the holding period of the asset. The holding period is the length of time a taxpayer owns the asset before disposing of it. Short term gains are assets securities held less than a year and are taxed as ordinary income at tax rates as high as 37% for high earners. On the other hand, long term gains are assets held for more than a year and are taxed at preferential capital gain rates, which are 0, 15%, or 20% depending on the level of income.

For example, in 2020 a married couple with income less than $80,000 ($40,000 if single) will pay zero percent tax rate on long term capital gains. A high-income couple on the other hand will generally pay 20% rate if their combined incomes are $496,600 or more ($441450 if single). IRS Publication 550 is an excellent resource that explains the tax treatment of investments.

In addition to federal income taxes, traders may also be subject to state income taxes depending on where they live. Unlike the graduated federal capital gains rates, most states tax capital gains at a fixed rate. For example, Massachusetts imposes a flat 5% tax rate on capital gains.

There are strategies for minimizing capital gains tax. For one, taxpayers are allowed to net their realized capital gains

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against realized capital losses during the year. IRS Publication 409 explains the netting of capital gains. In addition, many taxpayers use a strategy called tax loss harvesting to minimize capital gains taxes. Another strategy is not really a strategy at all, but entails simply not selling. The tax code only taxes realized gains. So, for example, if you invested $10,000 in Tesla stock in 2016 when it was trading at around $50 per share your stake as swelled to around $160,000 now. However, taxes are not due until you decide to sell. The $150,000 gain will not be taxed until you realize the gain by selling.

To read more about day trading, see our previous blog post on day trading and cryptocurrency.

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