

Capital Gains vs. Ordinary Income

Think about your money in two buckets. The first is your paycheck—the steady income from your job that’s taxed right away, much like paying at the grocery store. The second comes from selling something valuable, such as shares of stock or property you’ve owned for years. That profit, called a **capital gain**, often gets taxed at a lower rate—almost like a reward for holding onto it longer.

That’s the core difference: **ordinary income** is your everyday earnings (like wages or interest), while **capital gains** are profits from selling investments or assets. Understanding how each is taxed can help you see why long-term investing is often more tax-friendly than short-term trading.

What Is Ordinary Income?

Ordinary income is taxed at standard federal rates, ranging from 10% to 37% depending on your income and filing status. It includes:

- Wages or salary from your job
- Interest from savings accounts or CDs
- Rental income, alimony, or unemployment benefits
- Short-term gains (profits on investments held less than a year)
- Business income if you’re self-employed

The IRS uses a progressive tax system, which means only the portion of your income that falls into each bracket is taxed at that rate. For example, in 2025, a single filer earning \$50,000 pays 10% on the first \$11,925, 12% on the next portion up to \$48,475, and 22% on the small slice above that—not 22% on the whole paycheck.

What Are Capital Gains?

A capital gain is the profit from selling an asset for more than you paid (your **basis**). Taxes depend on how long you held it:

- **Short-Term Capital Gains** (held one year or less): Taxed as ordinary income at your normal 10–37% rate.
- **Long-Term Capital Gains** (held more than one year): Taxed at lower, preferential rates of 0%, 15%, or 20%.

This structure encourages long-term investing. Selling quickly (day trading, for example) means higher taxes, while patience can result in significant savings.

You can also use **losses** to offset gains (a strategy called tax-loss harvesting), and in some cases—like selling a primary residence—you may qualify for special exclusions.

How Are They Taxed Differently?

The key difference comes down to **rates and timing**:

- Ordinary income is taxed immediately at higher progressive rates.
- Long-term capital gains are capped at 20% (often much lower for middle-income earners).
- Short-term gains get lumped in with ordinary income, making them more expensive.
- High earners may owe an extra 3.8% Net Investment Income Tax (NIIT).
- State taxes can also apply, depending on where you live.

This is why **buy-and-hold investing** is generally more tax-efficient than frequent trading.

Real-Life Examples

- **Short-Term Example:** You earn \$60,000 from wages and sell stock for a \$10,000 gain after six months. That \$10,000 is taxed as ordinary income—roughly 22%, or \$2,200.
 - **Long-Term Example:** Same situation, but you hold the stock for over a year. The \$10,000 gain is taxed at 15%, or \$1,500. That's a \$700 savings just for waiting.
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Why It Matters: Practical Tips

- **Hold Longer When Possible:** Shifting from short-term to long-term gains can cut your tax bill.
 - **Track Your Basis:** Keep records of purchase prices and fees.
 - **Use Losses Wisely:** Capital losses can offset gains (and up to \$3,000 of ordinary income).
 - **Sell Strategically:** In lower-income years, you might qualify for the 0% long-term rate.
 - **Use Tax-Advantaged Accounts:** IRAs and 401(k)s let investments grow without immediate capital gains taxes.
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The Bottom Line

Ordinary income (your paycheck) can be taxed as high as 37%, while long-term capital gains are capped at 20%—and often much less. That difference makes **patience and planning powerful tools** for investors.

Understanding how these tax rules work can help you make smarter choices, keep more of your gains, and build long-term financial security.

If you'd like to explore how these rules might apply to your own situation, our team at **Landis Wealth Management** can walk you through strategies tailored to your goals.