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The American Taxpayer Relief Act of 2012 raised the rates on both short-term and long-term capital gains. The rates in the article do not reflect these changes.

The most tax-efficient way to own gold

For the IRS, the investment is a collectible when it is held in the form of coins or bullion

By Robert N. Gordon

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All that glitters is not — well, you know the rest. The truth is that in terms of taxes, gold isn't all that glittery.

According to the Internal Revenue Service, gold is a collectible when it is held in the form of coins or bullion. As a result, the tax treatment of gains and losses on physical-gold investments is different from the tax treatment of investments in stocks, bonds and other paper assets.

For example, long-term capital gains on gold aren't taxed as favorably as the long-term profits on stock transactions.

Long-term gains on gold are taxed at 28%, which is almost double the 15% tax rate afforded similar gains in stocks and bonds. Short-term gold profits are taxed at an investor's ordinary income rate, which is similar to the way short-term profits on mutual funds and stocks are taxed.

Because of the tax treatment, it is no wonder that investors are asking about the best ways to invest in gold and speculate on its price direction.

One increasingly popular gold investment is SPDR Gold Shares (GLD), an exchange-traded fund from State Street Global Advisors.

One would think that the tax treatment of gains and losses in GLD shares would be similar to that of other ETFs. Unfortunately, that isn't the case, because GLD is structured as a grantor trust, not a mutual fund.

A grantor trust is ignored for tax purposes so that the investor is treated as owning a pro-rata share of the underlying holdings, not the entity. If GLD were a mutual fund, it would be taxed “normally,” but because it is a grantor trust, its long-term gains are taxed as a collectibles gain — at the 28% rate.

Futures on gold offer a possible opportunity.

Gold futures contracts, like all futures contracts and index options, come under the provisions of Section 1256 of the Internal Revenue Code. All Section 1256 profits are taxed as being 60% long-term gains and 40% short-term gains.

This is a trade-off because unrealized profits (or losses) are marked-to-market at the investor's year-end.

This blend creates an effective 23% tax rate [(60% of the gain x 15%) + (40% of the gain x 35%)]. This 23% rate is preferable to either short-term or long-term gains on gold itself.

Because many investors and financial advisers aren't comfortable with futures, they may do well by looking into listed options in gold-related investments.

A listed option on the GLD ETF, for example, would offer the same maximum 23% tax rate as a gold future. Exchange-traded options on GLD are treated as non-equity options and therefore are Section 1256 contracts.

Even better could be the taxation of an over-the-counter option on either the GLD ETF or gold itself. These non-exchange-traded options aren't available for Section 1256 treatment.

It seems that the rules governing long-term gains on collectibles don't govern the taxation of options on collectibles.

If this analysis is correct, OTC gold options are taxed “normally.” This means that if the options are held more for than 12 months, any profit is taxed at just 15%.
For those unlucky enough to have losses on gold, there is one saving grace: Because wash sale rules apply only to securities, and not to collectibles, those with gold losses aren't bound by the rules. They may sell gold to lock in a loss and buy back a similar quantity, with no tax impact.

One wonders whether the wash sale rules apply to a grantor trust holding gold, such as GLD. But that is a topic for another discussion.

Robert N. Gordon is chief executive of Twenty-First Securities Corp. and an adjunct professor at New York University's Leonard N. Stern School of Business. He can be reached at bob@twenty-first.com.