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Coins and income taxes

By Armen Vartian | 04-06-12
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Individuals can gain tax advantages by owning coins as investments. Net income from the sale of art and collectibles is taxable, but not until the item is sold or otherwise disposed of for value.

For some people, this makes coins a preferred investment vehicle over stocks, whose dividends are taxed annually even if they are in the form of new stock and not cash.

A coin investor can defer taxable gains until a time of his or her own choosing. However, "collectibles," which includes art and precious metals, are taxed at a rate higher than that for capital assets such as stocks and real estate, which is a disadvantage.

Specialized advice

I recommend specialized advice from financial professionals there.

The key income tax aspects of purchases and sales of art and collectibles relate to the treatment of expenses and losses, and depend largely upon whether you are a collector, an investor or a dealer for tax purposes.

Sounds simple enough, but many people spend a lot of time and effort arguing with the IRS and state taxing authorities over this characterization, because the tax consequences of each can be quite different.

Collectors, who buy and sell coins primarily for personal pleasure, are the most tax-disadvantaged class. They must pay tax on income they earn from their collections, but cannot deduct net losses they might have from collectible sales.

They cannot deduct any expenses relating to their collection, such as insurance, security, membership dues for collectors' clubs and subscriptions to relevant periodicals, but can offset these expenses against any net income they declare from the sale of items from their collections.

Unfortunately, even this benefit is substantially limited because it comprises a "miscellaneous" itemized deduction on Schedule A subject to the 2 percent adjusted gross income floor.

In other words, unless the collector's total miscellaneous expenses exceed 2 percent of adjusted gross income, there is no benefit.

Investors fare slightly better. They can deduct expenses relating to their art and collectibles portfolios, but not net losses from sales.

However, the IRS makes it more and more difficult to qualify as an investor, clearly preferring to characterize everyone interested in art and collectibles as a collector.

Fun or profit?

The key is whether the taxpayer is engaged in the activity for profit or for enjoyment. Taxpayers who show a profit from their activities for three of the past five years are presumed to be engaged in those activities for profit, although the IRS has the right to rebut that presumption. Relevant factors are the amount of time the taxpayer spent on the activity, whether the taxpayer relied on advice of experts and whether losses could be expected in a particular year (such as when the market drops in particular types of art or collectibles).

Finally, taxpayers who can establish that they buy and sell art or collectibles as part of a trade or business may acquire dealer status, enabling them to deduct expenses as well as net losses against their other income.

As one might expect, the IRS is loath to treat a collector with other sources of income as a “dealer.”

However, over the years, the regulations in this area have been expanded so that it is not impossible for a serious enthusiast to qualify.

The “for profit” determination is similar to that described above for investors. Dealers pay tax at ordinary income rates and may use losses to offset other ordinary income.

It’s always best to get professional help with tax matters.

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