



AB FINANCIAL

Special Edition

WHY THE TAX CODE FAVORS CAPITAL OVER WORK

Employment Income

VS.

Capital Gains Tax

A Plain-Language Guide to the U.S. Tax Structure for Wage Earners and Investors

2026 TAX YEAR EDITION

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Editor's Note

Of all the conversations in personal finance, the one Americans understand least is also the one that shapes wealth the most: how the U.S. tax code treats employment income differently from investment income.

The core fact is simple. The same dollar earned by working a job is taxed at a meaningfully higher rate than the same dollar earned by holding an investment for more than a year. This is not a loophole. It is the deliberate, decades-old structure of the federal tax code — and it has profound consequences for how families build wealth across generations.

This special edition explains that structure in plain English. It uses real 2026 brackets and walks through specific examples. No politics. No advocacy. Just the mechanics, so that listeners can make decisions with both eyes open.

HOW THIS GUIDE IS ORGANIZED

Part One explains how salary, FICA, capital gains, and the NIIT each work — one at a time.

Part Two stacks them side by side and walks through a \$150,000 comparison.

Part Three covers the strategies that actually move the needle: holding period, tax-advantaged accounts, loss harvesting, the step-up in basis at death, state taxes, and the 0% capital gains bracket.

Part Four closes with the AB Financial view on what to do with this information.

All figures use 2026 federal tax parameters. State tax varies — see Section 3.5. This is educational content, not personalized tax advice. Consult a licensed CPA or Enrolled Agent for your specific situation.

PART ONE

Understanding the Two Systems

Salary, FICA, capital gains, and NIIT — one at a time

Section 1.1 — How Salary Is Taxed

ORDINARY INCOME — THE SEVEN BRACKETS

The Progressive Bracket Structure

Salary, wages, bonuses, tips, and self-employment income are taxed as "ordinary income." The federal income tax uses a progressive bracket system: each additional dollar you earn is taxed at the rate of the bracket you're currently in — not your total income at one rate.

For 2026, the seven federal brackets (single filer) are:

Taxable Income (Single)	Marginal Rate
Up to \$12,400	10%
\$12,401 – \$50,400	12%
\$50,401 – \$105,700	22%
\$105,701 – \$201,775	24%
\$201,776 – \$256,225	32%
\$256,226 – \$640,600	35%
Above \$640,600	37%

For married couples filing jointly, every threshold roughly doubles — the top 37% bracket starts at \$768,700.

How "Marginal" and "Effective" Rates Differ

A common misconception: "I'm in the 24% bracket, so I pay 24% on everything I earn." That is not how it works.

If your taxable income is \$120,000, you pay:

- 10% on the first \$12,400 = \$1,240
- 12% on the next \$38,000 = \$4,560
- 22% on the next \$55,300 = \$12,166
- 24% on the remaining \$14,300 = \$3,432

Total federal income tax: \$21,398 on \$120,000 — an **effective rate of 17.8%**, even though your **marginal rate is 24%**. The marginal rate matters for decisions about the next dollar (overtime, bonus, side income). The effective rate matters for understanding your total tax burden.

Taxable Income vs Gross Income

Taxable income is not the same as your salary. To get from gross income to taxable income, you subtract the standard deduction or your itemized deductions, plus any "above-the-line" deductions like 401(k) contributions, HSA contributions, and traditional IRA contributions.

For 2026, the standard deduction is \$16,100 (single) or \$32,200 (married filing jointly). This is why a single filer earning \$60,000 gross might only have \$43,900 of taxable income — the first \$16,100 is tax-free, and additional pre-tax contributions reduce it further.

THE SINGLE MOST UNDERUSED TAX MOVE

Pre-tax 401(k) contributions are deducted from your salary before tax is calculated.

A worker in the 24% federal bracket who contributes \$10,000 to a traditional 401(k) reduces their federal tax bill by \$2,400 — money the IRS would otherwise have taken. The 401(k) account earns market returns on the full \$10,000 instead of \$7,600.

Over a 30-year career, the compounded advantage is enormous. This is why employer-sponsored retirement plans are the single most powerful wealth-building tool available to the typical American household.

Section 1.2 — FICA — The Tax You Forget About

THE HIDDEN 15.3%

What FICA Actually Stands For

FICA stands for the Federal Insurance Contributions Act. It is the payroll tax that funds Social Security and Medicare. Every employee in the United States pays it; every employer matches it; every self-employed worker pays both halves.

The Two Components

Component	Employee Rate	What It Funds	Income Cap
Social Security (OASDI)	6.2%	Retirement, disability, survivor benefits	\$176,100 (2026)
Medicare (HI)	1.45%	Medicare Part A hospital insurance	No cap
Additional Medicare Surtax	0.9%	Same	Wages above \$200K single / \$250K married

The total employee share for a typical worker: 7.65% (6.2% + 1.45%). High earners pay an additional 0.9% Medicare surtax above the threshold, bringing the marginal FICA bite to 2.35% once you exceed \$200K (single).

The Hidden Second Half

Your employer pays a matching 7.65% on your behalf. You never see it on your pay stub, and most workers do not realize it exists. But economists are broadly agreed that the employer's share ultimately comes out of your wages — if employers did not have to send that money to the federal government, they would have to pay competitive wages, and a portion of that 7.65% would end up in your paycheck.

This means the **true total FICA burden on a dollar of wages is 15.3%** — half visible, half invisible.

If You're Self-Employed

Self-employed workers pay the full 15.3% themselves through "self-employment tax," calculated on Schedule SE. You do get to deduct half of it on your income tax return as a partial offset — but the cash actually leaves your business.

This is the hidden tax cost of being a 1099 contractor versus a W-2 employee. Two people earning the same gross amount can have very different take-home pay because the contractor is paying both halves of FICA out of their own pocket.

THE STRUCTURAL POINT

FICA is the reason wage income is taxed harder than investment income. Capital gains, dividends, and interest pay zero FICA. Ever. That is a built-in 7.65% disadvantage for working income compared to investment income, before you even get to the difference between ordinary income brackets and long-term capital gains brackets.

This is the core mechanic behind Warren Buffett's famous observation that his secretary pays a higher effective tax rate than he does. Buffett's income is mostly capital gains and qualified dividends. His secretary's income is mostly wages, which face both ordinary income tax AND FICA.

Section 1.3 — How Capital Gains Are Taxed

THE REWARD FOR PATIENCE

The Single Biggest Distinction — Holding Period

Capital gains are profits from selling an investment (stock, bond, real estate, business interest) for more than you paid for it. How those gains are taxed depends almost entirely on one factor: how long you held the asset before selling.

Short-Term Capital Gains (Held One Year or Less)

Taxed at your ordinary income rate — the same seven brackets that apply to your salary, from 10% up to 37%. No preferential treatment. The IRS treats short-term trading profits like wages.

Long-Term Capital Gains (Held More Than One Year)

Taxed at a separate, much more favorable three-tier structure. For 2026, the long-term capital gains brackets are:

Filing Status	0% Bracket	15% Bracket	20% Bracket
Single	Up to \$49,450	\$49,451 – \$545,500	Above \$545,500
Married Filing Jointly	Up to \$98,900	\$98,901 – \$613,700	Above \$613,700
Head of Household	Up to \$66,200	\$66,201 – \$578,150	Above \$578,150

The thresholds are based on your total taxable income, not just your capital gains.

Qualified Dividends

Stock dividends from most U.S. and qualified foreign companies receive the same favorable long-term capital gains rates (0%, 15%, or 20%) — provided you held the stock for at least 60 days during the 121-day period around the ex-dividend date. This is why "dividend investing" is tax-advantaged compared to interest income from a savings account, which is always taxed as ordinary income.

WHY THIS MATTERS MORE THAN ALMOST ANYTHING ELSE IN PERSONAL FINANCE

Holding an investment for 366 days instead of 365 can change the tax on a \$50,000 gain by more than \$10,000. A single filer in the 24% federal bracket pays \$12,000 in tax on a \$50,000 short-term gain (at 24%), but only \$7,500 on the same \$50,000 if it's long-term (at 15%). That is a \$4,500 difference — and at higher incomes the gap is larger.

Decisions made for tax reasons alone are usually mistakes. But when the investment thesis is the same and the only question is timing, the calendar matters enormously.

The 0% Bracket — Real and Underused

A single filer with \$49,450 or less of taxable income pays ZERO federal tax on long-term capital gains. A married couple at \$98,900 or less pays zero. This is one of the most powerful — and most overlooked — provisions in the entire tax code.

Who actually qualifies: retirees living mostly on Social Security, freelancers in low-income years, anyone with significant tax-deferred income, families during a temporary income gap, and recent graduates in their first year of work. The strategy is examined in detail in Section 3.6.

Section 1.4 — NIIT — The 3.8% Surtax on Investment Income

THE ACA-FUNDING TAX

What NIIT Is

The Net Investment Income Tax (NIIT) is a 3.8% additional tax on investment income for higher-income households. It was created in 2013 as part of the Affordable Care Act. The thresholds were set in statute and have not been adjusted for inflation since.

Who Pays NIIT

Filing Status	Modified AGI Threshold
Single or Head of Household	\$200,000
Married Filing Jointly	\$250,000
Married Filing Separately	\$125,000

What Gets Taxed by NIIT

- Capital gains (both short-term and long-term)
- Dividends (both qualified and non-qualified)
- Taxable interest income
- Rental and royalty income (in most cases)
- Non-qualified annuity distributions

What Does NOT Get Taxed by NIIT

- Wages and salary (those already pay FICA)
- Self-employment income (already pays SE tax)
- Distributions from retirement accounts — IRAs, 401(k)s, pensions
- Tax-exempt municipal bond interest
- Gain from the sale of a primary residence within the \$250K single / \$500K married exclusion

How NIIT Is Calculated

NIIT is 3.8% of the SMALLER of two numbers:

- Your net investment income, OR
- The amount your modified AGI exceeds the threshold

Example: A single filer with \$220,000 MAGI (\$20,000 over the threshold) and \$50,000 of investment income owes NIIT on \$20,000, not \$50,000. NIIT due: \$760.

THE BOTTOM LINE ON NIIT

A high-income investor's true federal rate on long-term capital gains is 23.8% (20% + 3.8% NIIT), not 20%. Most published comparisons of tax rates miss this. The same investor's true rate on qualified dividends is also 23.8%.

This still leaves a substantial gap below the ~40% all-in marginal rate on wage income for the same household. But the gap is not as wide as the headline 20% LTCG rate suggests.

PART TWO

The Two Systems Side by Side

The total stack and a concrete comparison

Section 2.1 — The Total Stack

This table is the heart of the guide. It shows the all-in federal tax rate that a high-income single filer pays on the marginal dollar of each income type, for the 2026 tax year.

Income Type	Income Tax	Payroll/FICA	NIIT	Total Federal
Salary (top bracket)	37%	1.45% + 0.9% surtax	0%	~39.4%
Self-Employment Income	37%	2.9% Medicare + surtax	0%	~40.5%
Short-Term Capital Gain	37%	0%	3.8%	40.8%
Non-Qualified Dividend	37%	0%	3.8%	40.8%
Taxable Interest	37%	0%	3.8%	40.8%
Long-Term Capital Gain	20%	0%	3.8%	23.8%
Qualified Dividend	20%	0%	3.8%	23.8%
Municipal Bond Interest	0%	0%	0%	0%
Roth IRA Withdrawal (qualified)	0%	0%	0%	0%

Note: The 1.45% Medicare component of FICA has no cap. The Social Security 6.2% applies only up to \$176,100 of wages in 2026, so on the marginal dollar at the top bracket, only Medicare applies.

THE 17-PERCENTAGE-POINT GAP

On the marginal dollar at the top of the income distribution, the gap between salary (~39.4%) and long-term capital gains (23.8%) is roughly 15-17 percentage points. On a \$1 million bonus, that gap is over \$150,000 in federal tax. On a \$1 million long-held stock sale, it is the same difference in your favor.

This is the single most important number to understand about the U.S. tax code if you want to think clearly about wealth building. Earned income is taxed harder than long-term invested capital, by design.

Section 2.2 — The \$150,000 Comparison

Consider two single filers, both with \$150,000 of income for the year. One earned it as salary. The other earned it as long-term capital gains from a stock she bought five years ago. Both take the standard deduction (\$16,100). Their tax bills look like this:

Worker A — \$150,000 in Salary

Tax Type	Calculation	Amount
Federal income tax	On \$133,900 taxable income, through 24% bracket	~\$23,400
Social Security tax	6.2% × \$150,000 (under \$176,100 cap)	\$9,300
Medicare tax	1.45% × \$150,000	\$2,175
Employer FICA (hidden)	7.65% match	\$11,475
TOTAL FEDERAL TAX BURDEN	Visible: ~\$34,875 · All-in (incl. employer): ~\$46,350	~31%

Investor B — \$150,000 in Long-Term Capital Gains

Tax Type	Calculation	Amount
Federal LTCG tax	First \$49,450 at 0%, rest at 15%	~\$15,083
Social Security tax	Not applicable to capital gains	\$0
Medicare tax	Not applicable to capital gains	\$0
NIIT	Under \$200K MAGI threshold	\$0
TOTAL FEDERAL TAX BURDEN	Visible total	~10%

WORKER A PAYS ROUGHLY 3X THE FEDERAL TAX ON THE SAME \$150,000

Worker A's effective federal tax rate: ~23% visible (~31% all-in).

Investor B's effective federal tax rate: ~10%.

Same income. Same year. Same filing status. Investor B keeps roughly \$20,000–\$30,000 more after federal taxes — every year, as long as her income comes from long-term gains rather than work.

Over a 30-year career, the difference compounds into substantial wealth. This is not a flaw in the tax code; it is the structural design choice the United States has made for almost a century — and reinforced repeatedly through both Republican and Democratic administrations.

Section 2.3 — Why the Gap Exists

The favorable treatment of long-term capital gains is not an accident. It is a deliberate policy choice, and it rests on several arguments that legislators and economists have made for nearly a century. Whether the arguments are correct is debated; the arguments themselves are worth understanding.

Argument 1 — Encouraging Long-Term Investment

Lower long-term gains taxes are designed to reward patient capital. Investors who hold for years provide stable funding to companies, supporting business formation, expansion, and job creation. Short-term trading does not have the same economic effect, which is why short-term gains are taxed at full ordinary rates.

Argument 2 — Avoiding Double Taxation

When a corporation earns profit, it pays federal corporate income tax (currently 21%). When the corporation distributes that profit as dividends or its stock price reflects the retained earnings, the shareholder pays again. The lower long-term gains and qualified dividend rates partially offset this double taxation. (The math is debated — the offset is not exact — but the principle is real.)

Argument 3 — Inflation Erosion

A stock held for 20 years may show a large nominal gain even if the real, inflation-adjusted gain is modest. Capital gains taxes are based on nominal gains, which means investors are partially taxed on inflation. The lower rate is intended to roughly compensate.

Argument 4 — Capital Is Mobile, Labor Is Not

Workers cannot easily move countries to escape income taxes; capital can. If capital gains were taxed at full ordinary rates, the argument goes, more capital would flow to lower-tax jurisdictions. The lower rate is partly a competitive measure.

The Counter-Arguments

Critics make their case too: that the gap rewards wealth over work, that it disproportionately benefits households who already own significant financial assets, that it widens the wealth gap across generations, and that the empirical evidence for the "long-term investment" effect is mixed at best.

AB FINANCIAL'S NEUTRAL POSITION

Whether the gap is fair is a debate for policy. Whether the gap exists is a fact. Households that understand the gap and plan around it accumulate wealth faster than households that do not. The job of this guide is to make sure listeners understand the math, regardless of where they stand on the underlying policy questions.

PART THREE

Strategies & Special Situations

Where the leverage actually is

Section 3.1 — The Holding Period — The Most Valuable Tax Decision You Will Make

If you take only one practical lesson from this guide, take this one: the difference between selling on day 365 and selling on day 366 of holding a stock can equal thousands or tens of thousands of dollars in tax savings on the same trade.

The Math of One Extra Day

A single filer in the 24% bracket who sells a \$50,000 winner held for 11 months and 28 days pays \$12,000 in federal tax ($24\% \times \$50,000$).

The same investor selling the same position one week later — now held more than 12 months — pays \$7,500 (15% LTCG).

Difference: \$4,500. For waiting one week.

When Holding Period Matters Most

- On large gains in stocks you have held close to a year.
- On RSU and ISO/NSO sales from your employer's equity compensation.
- On real estate, where the holding period is critical to the section 121 exclusion.
- On any concentrated position where a partial sale could spread gains across two tax years.

When It Does Not Matter as Much

- In tax-advantaged accounts (401(k), IRA, Roth IRA, HSA), where holding period is irrelevant — those accounts are not subject to capital gains tax at all.
- On small gains, where the absolute dollar difference is modest.
- When the underlying investment thesis has changed and waiting would expose you to loss greater than the tax savings.

AB'S RULE OF THUMB

Never let the tax tail wag the investment dog. But when the investment decision is genuinely a coin flip on timing, the calendar wins. If you're within 60 days of crossing the long-term threshold and the position is large enough that the rate difference is real money, wait.

Section 3.2 — Tax-Advantaged Accounts

The federal government has created a series of accounts that shelter investment income from the tax structure described in Parts One and Two. These accounts are the single most powerful wealth-building tool available to ordinary American households.

Account	Tax Treatment	2026 Limit
Traditional 401(k)	Pre-tax contributions; growth tax-deferred; ordinary income tax on withdrawal	\$24,500 (\$31,500 if 50+)
Roth 401(k)	After-tax contributions; growth tax-free; qualified withdrawals tax-free	\$24,500 (\$31,500 if 50+)
Traditional IRA	Pre-tax (if eligible); growth tax-deferred; ordinary income tax on withdrawal	\$7,500 (\$8,600 if 50+)
Roth IRA	After-tax contributions; growth tax-free; qualified withdrawals tax-free	\$7,500 (\$8,600 if 50+)
HSA	Pre-tax in; tax-free growth; tax-free out for medical (triple-tax-advantaged)	\$4,400 single / \$8,750 family
529 Plan	After-tax in; tax-free growth; tax-free out for education	State-set; gift-tax limits

The Hierarchy Most Advisors Recommend

- Contribute to your 401(k) up to the employer match — that match is an immediate 50% to 100% return.
- Max out the HSA if you have a high-deductible health plan — it is the only triple-tax-advantaged account in the code.
- Max out a Roth IRA if eligible — \$7,500 of permanent tax-free growth.
- Return to the 401(k) and contribute up to the full limit.
- Only after these are full does taxable brokerage make sense for retirement savings.

THE HSA IS THE SECRET WEAPON

A Health Savings Account is the only account in the U.S. tax code with three tax advantages. Contributions are pre-tax. Growth is tax-free. Withdrawals for qualified medical expenses are tax-free. After age 65, withdrawals for any purpose are taxed at ordinary income rates — the same as a traditional IRA.

A household that maxes the HSA every year for 30 years and invests it (rather than spending it on current medical bills) builds a parallel retirement account specifically for healthcare — which is the single largest spending category in retirement.

Section 3.3 — Tax-Loss Harvesting

Tax-loss harvesting is the practice of intentionally selling losing investments to realize the loss for tax purposes, while reinvesting the proceeds in something similar enough to keep your overall market exposure intact.

How the Math Works

Capital losses offset capital gains dollar for dollar. If you have \$20,000 of gains and \$15,000 of losses, you owe tax on only \$5,000 of net gain.

Beyond that, up to \$3,000 of net capital losses per year can offset ordinary income — including salary. This is unusually generous: it lets a stock-market loss reduce the tax on your paycheck.

Any remaining losses carry forward to future tax years indefinitely. There is no expiration.

The Wash-Sale Rule

There is one important catch: you cannot claim a loss if you buy the same or a "substantially identical" security within 30 days before or after the sale. This is the wash-sale rule, and the IRS enforces it strictly.

The practical workaround: sell one ETF (say, an S&P 500 fund) and buy a different but similar ETF (say, a total stock market fund). Your market exposure stays roughly intact, but the IRS does not consider them substantially identical.

When to Harvest

- Late in the calendar year, when you have visibility into your full year's gains and income.
- During market drawdowns, when even disciplined long-term investors have positions trading below cost basis.
- When rebalancing — selling overweight winners and underweight losers is doubly useful if some of those positions have losses to capture.

A TYPICAL PATTERN

A high-income investor with \$50,000 of gains and \$50,000 of losses can wash both out and pay zero capital gains tax for the year. If their losses exceed gains, \$3,000 of the excess offsets ordinary income at their marginal rate — saving up to \$1,110 for someone in the 37% bracket — and the remainder carries forward.

Over a multi-decade investing career, disciplined loss harvesting can save tens of thousands of dollars in cumulative tax — without changing the underlying investment strategy.

Section 3.4 — Step-Up in Basis at Death

Of all the provisions in the U.S. tax code, the step-up in basis at death is among the most consequential for intergenerational wealth — and the least discussed in mainstream personal finance.

How It Works

When you inherit an asset (stock, real estate, business interest), your cost basis is "stepped up" to the asset's fair market value on the date of the original owner's death. All capital gains that accumulated during the owner's lifetime are erased for tax purposes.

A Concrete Example

Your father bought Apple stock in 1990 for \$1,000. By the time he passes away in 2030, those shares are worth \$500,000. His unrealized capital gain over 40 years: \$499,000.

If he had sold the shares the day before he died, he would owe long-term capital gains tax on \$499,000 — roughly \$99,800 at 20% federal, plus state tax and NIIT.

If instead the shares pass to you at his death, your cost basis is reset to \$500,000. You can sell the shares the next day for \$500,000 and owe zero capital gains tax. The lifetime gain disappears.

What This Means in Practice

- Concentrated, highly appreciated positions are often best held until death rather than sold during the original owner's lifetime.
- Older parents with large unrealized gains may want to defer sales they would otherwise make — gifting cash from other sources instead.
- Cost-basis records become irrelevant for the heir, but estate-tax appraisal records become important.

The Estate-Tax Interaction

This provision is sometimes paired with the federal estate tax, which currently exempts the first \$15 million (per individual, \$30 million per married couple, 2026 amounts). Below those thresholds, the step-up applies with no estate tax owed — a powerful combination.

THE INTERGENERATIONAL CONSEQUENCE

The step-up in basis is one of the largest single tax breaks in the U.S. code, and it disproportionately benefits households that already hold significant appreciated assets. It is a major reason that wealth accumulates across generations more effectively than the tax brackets alone would suggest.

Whether this is appropriate policy is debated. What is not debated is that estate planning around the step-up is one of the highest-value financial planning decisions a family can make. If your parents hold significant appreciated assets, the family conversation about

whether to sell during life or hold until death is one of the most important financial conversations you can have together.

Section 3.5 — State Taxes — The Forgotten Layer

Federal tax is only part of the story. Most states tax capital gains, and most tax them at full ordinary income rates rather than at preferential federal-style brackets.

The Three State Groups

Group	How Capital Gains Are Taxed	Examples
No State Income Tax	0% on all income, including capital gains	Texas, Florida, Washington, Nevada, Wyoming, South Dakota, Tennessee, New Hampshire, Alaska
Taxed as Ordinary Income	Top rate 5–10% applied to all gains	Most states — including New York, Maryland, Virginia, Georgia, Illinois, Pennsylvania, Massachusetts
High Capital Gains Tax	Top rate 10%+ on capital gains	California (13.3%), New Jersey (10.75%), Oregon (9.9%), Minnesota (9.85%), Hawaii (11%)

Washington State recently introduced a 7% capital gains tax on gains above \$250,000 — a notable exception to its general no-income-tax status.

The All-In Federal + State Math

A California high-earner selling a long-held stock at the top federal bracket pays:

- 20% federal LTCG
- 3.8% NIIT
- 13.3% California state income tax
- Total: roughly 37% combined — almost identical to the top federal ordinary income rate.

This is why so many wealthy households consider state residency carefully. Moving from California to Texas or Florida before a major liquidity event (selling a business, exercising stock options, downsizing a long-held home) can save six or seven figures in state tax — legally, provided the move is genuine and properly documented.

A PRE-LIQUIDITY-EVENT QUESTION

If you anticipate a large capital gain in the next 1-3 years (business sale, IPO, large home sale, RSU vesting cliff), the question of state residency is worth at least one conversation with a tax advisor before the event. The window to plan closes once the

event happens. After the gain is realized, you owe tax in the state where you lived when it was realized.

Section 3.6 — The Zero-Bracket Opportunity

The 0% federal long-term capital gains bracket — up to \$49,450 single, \$98,900 married for 2026 — is one of the most powerful and most overlooked provisions in the entire tax code. It allows investors to realize gains entirely tax-free at the federal level.

Who Qualifies

- Retirees living mostly on Social Security and modest IRA withdrawals.
- Freelancers and consultants in lower-income years.
- Recent graduates in their first year of work or first year of business.
- Families during a temporary job loss or sabbatical year.
- Married couples where one spouse takes a year off for caregiving, education, or child-rearing.

The "Gain Harvesting" Strategy

If you qualify, you can deliberately realize gains up to the threshold each year. The strategy:

- Calculate how much taxable income you will have for the year.
- Determine how much room you have under the 0% threshold.
- Sell appreciated long-term holdings up to that amount.
- Immediately repurchase the same securities (the wash-sale rule does not apply to gains — only losses).
- Your new cost basis is the higher purchase price. Future gains are smaller.

A Concrete Example

A married couple files jointly. Their taxable income for 2026 is \$70,000. The 0% LTCG threshold for joint filers is \$98,900. They have \$28,900 of "room" under the threshold.

They have an S&P 500 ETF position with \$40,000 of unrealized long-term gain. They sell \$28,900 worth of gains, pay zero federal tax, and immediately rebuy the same ETF.

Net result: \$28,900 of gain has been permanently "laundered" through the 0% bracket. Their new cost basis is higher. Any future sale will trigger less tax than it otherwise would have.

THE OPPORTUNITY FOR RETIREES

The early retirement years — after work stops but before Social Security and required minimum distributions begin — are the highest-leverage years for gain harvesting in most American financial lives. A retiree with a large taxable brokerage account can spend several years deliberately harvesting gains at 0%, dramatically reducing the eventual tax burden on the rest of the portfolio.

This requires advance planning. Once Social Security starts and RMDs kick in at age 73, taxable income usually rises and the 0% window closes. The narrowest possible message: if you are retiring in the next five years, this is a topic worth raising with your CPA today.

PART FOUR

The AB Financial View

Build both engines

Section 4.1 — Build Both Engines

After dozens of pages of tax mechanics, the AB Financial conclusion can be reduced to one sentence:

“Earn from your work. Build with your capital. Pay attention to both.”

Engine One — Earned Income

Your career is the cash-flow engine of your financial life. Without it, the investment engine has nothing to feed on. Maximize earned income through education, skill building, mentorship, switching jobs strategically, and developing high-value capabilities. This is where most families' wealth actually originates.

Accept that your earned income will be taxed at the higher rate. The trade-off is real, but the alternative — earning no income at all — is not actually an option for most people.

Engine Two — Invested Capital

Every dollar saved from earned income that gets invested in long-term assets becomes a smaller, slower second engine — one that operates on a fundamentally more favorable tax structure. Over decades, this second engine often produces more total wealth than the original career engine, precisely because of the tax mechanics described in this guide.

The Failure Modes

- Career-only households save little and rely entirely on employment, with no second engine. They retire with little besides Social Security.
- Investment-fantasy households neglect their careers in pursuit of trading or speculation. They usually lose at trading and also have weak careers.
- Tax-paralyzed households fail to invest because they overthink tax efficiency. They miss decades of compounding while waiting for the perfect setup.
- Liquidation households realize gains too early — repeatedly converting unrealized appreciation into taxable events — and never give compounding the runway it needs.

THE AB FINANCIAL FRAMING

Wealth in the United States is built primarily through two streams: high earned income invested patiently, and long-term capital appreciation taxed favorably.

Households that systematically feed the second engine from the first build wealth across generations. Households that feed only one or neither do not. The tax code is the same for everyone — what differs is how much each household understands it and uses it.

Section 4.2 — Closing Thought

The U.S. tax structure rewards capital over labor. This is a fact, not a complaint. Whether the structure is fair, optimal, or appropriate is a debate for democratic politics. Whether it shapes your financial life is not a debate at all — it does, every year, whether you understand it or not.

Most American households would benefit from spending more time understanding the difference between ordinary income tax brackets, FICA, long-term capital gains rates, NIIT, and the structure of tax-advantaged accounts than they currently do. The financial industry profits from this confusion; the IRS does not benefit from it; only the household that understands the rules clearly benefits from understanding them clearly.

This guide exists for that reason. If you finish it knowing only one thing, let it be this: the calendar matters. Holding period matters. Account type matters. State residency matters. None of these decisions is a one-time event. They compound, in your favor or against you, every year you remain an investor and an earner.

**“The tax code is the same for everyone.
What differs is whether you read it.”**

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