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Here's the Tax Beat broadcast for August 19

Subject Line: There's Gold in Them Thar Bills

130 years ago this week, on August 16, 1896, a prospector named George Carmack was fishing for salmon near the Klondike River when he looked down at the bank of Rabbit Creek and saw a nugget of gold sticking out of the dirt. Carmack staked his claim and got his name in the history books. (Carmack's two companions, Skookum Jim and Tagish Charlie, both said afterward that it was Skookum Jim — Carmack's brother-in-law — who actually spotted it first. An early and expensive lesson in whose name goes on the paperwork.)

Rabbit Creek was promptly rechristened Bonanza, which was no overstatement. Roughly a bazillion people stampeded into the Yukon over the next two years. (Okay, more like 50,000.) Klondike Fever peaked in July 1897, when two steamships tied up in San Francisco and Seattle carrying more than two tons of gold between them.

Most of the men who read those headlines and headed north got nothing at all, because the best ground had been claimed long before they bought their tickets. One of them was a broke 21-year-old named Jack London, who came home with no gold and but a notebook full of stories, which turned out to be the better haul anyway.

Carmack did fine, too. He walked out of the Yukon with a million dollars in gold. And here's the cherry on top of his sundae: he kept every penny. The Supreme Court had struck down the federal income tax the year before he found that nugget, and the Sixteenth Amendment was still seventeen years off. A million-dollar windfall, and not one dollar of it went to Washington.

Try that today.

Start with the discovery itself. Treasury Regulation section 1.61-14 provides that gold, pirate booty, and any other sort of treasure trove is gross income in the year you "reduce it to undisputed possession," valued at fair market value. That's not just some dusty footnote nobody enforces. In 1957 an Ohio couple named Cesarini bought a used piano for $15. Seven years later, they found $4,467 in cash stuffed inside. They reported it, changed their minds, sued for a refund, and lost. The court held the cash was ordinary income in 1964, the year they found it.

So if you strike gold, you'll owe tax on its value the moment you pull it out of the creek. Then you'll get hit again on further gains when you sell it. And here's the part that snares people who have never been within a thousand miles of the Yukon. Gold is a collectible under section 408(m). Tax rates on long-term collectible gains top out at 28% rather than the 20% that applies to your stocks. Oh, and don't forget the 3.8% net investment income tax – and state taxes, too!

Here's a different trap for many gold investors who buy their yellow metal on Wall Street. Most of the big gold ETFs are structured as grantor trusts holding physical bullion, which means the IRS looks straight through the ticker symbol to the metal underneath. Investors who are certain they own a stock fund — because they bought in a brokerage account, sitting right next to their index funds, purchased on a screen — will pay that collectibles rate when they sell. It shows up on the 1099, and almost nobody notices, because nobody reads the prospectus for something that trades like a stock.

Carmack found his fortune by looking down at the right patch of dirt at the right moment in tax history, and you're not going to get that lucky. But call us before you sell, and we'll show you where the gold's been hiding in your own portfolio — no pan, no mule, and no winter in the frigid Canadian Yukon!

Kevin