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Capital Gains and Losses: *A Few Things You Should Know*

Most of us are familiar with the concept of capital gains and losses, and even understand what our accountants require from us for tax purposes at year end.

Many aspects of capital gains and losses are not common knowledge. The objective of this article is to address some of the aspects that may impact individuals.

When Might a Gain or Loss Arise?

Generally, when a capital asset is disposed of (or deemed disposed of), a gain or loss can result. In some cases, it may not be clear to you that a disposition has, in fact, occurred. To realize after the fact that you have inadvertently triggered a taxable capital gain can be a nasty surprise! Here are a few scenarios where a disposition or sale may be considered to have occurred.

- You give some property other than cash (land, shares, and so on) as a gift.
- You transfer property to a family member as part of your estate plan.
- You transfer investments from your nonregistered account to your registered account (for example, RRSP).
- You change all or part of the use of your property (a rental house

is converted to personal use, for example).

- You exchange one property for another.
- Your property is expropriated.
- You leave Canada and become a nonresident.
- The shares or securities of a corporation you hold are redeemed or cancelled.
- You transfer property to a trust. The owner of the property passes away.

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Each of those situations can result in a disposition for tax purposes—a taxable capital gain or capital loss may need to be reported on your tax return. To avoid nasty surprises, you should always consider the tax implications *before* you change or undertake any such transaction, to ensure you understand the tax result!

When to Report a Capital Gain or Loss

A capital gain or loss must be reported on your return in the year of the disposition or deemed disposition. Even if a disposition does not result in a capital gain or loss, you are required to report it on your return, whether or not you have to pay any tax.

How Do You Calculate Your Capital Gain or Loss?

Generally, your capital gain or loss is determined as follows.

$$\begin{aligned} \text{Capital Gain (Loss)} = \\ \text{Proceeds of Disposition} \\ - \text{Adjusted Cost Base} \\ - \text{Selling Costs} \end{aligned}$$

Sometimes, special rules apply to deem your adjusted cost base to be something other than the original price paid and your proceeds of disposition to be something other than the actual proceeds received.

Consider the following examples.

If you inherit an investment from your elderly mother, your adjusted cost base is deemed to be the fair market value of the investment at the time of her death, even though you paid nothing for it. Further, the proceeds of disposition to her estate are deemed to be the fair market value at the time of her passing. As such, even though no actual proceeds were received, the estate may realize a taxable capital gain.

If you sell “personal use property” such as your car or furniture, you may realize a loss since these types of assets generally depreciate over time. The loss, however, is generally not deductible for tax purposes, although taxable capital gains on such property may arise! (If you sell personal use property that qualifies as “listed personal property,” such as jewellery or paintings, then additional rules

apply and a reportable gain or loss may be realized. (See Canada Revenue Agency's Website for a more detailed explanation and the related rules.)

Triggering a loss to shelter capital gains may be good tax planning, but you must ensure it is not a "superficial loss." A superficial loss can arise when you or an affiliated person acquires or had the right to acquire the same or identical property during the period that begins 30 days before, and ends 30 days after, the disposition of the property in question and, at the end of this 60-day period, you or an affiliated person owned or had the right to acquire the same or identical property. You cannot deduct a superficial loss. The purpose of this rule is to prevent taxpayers from realizing deductible capital losses without any real intention to dispose of the property in question.

What happens to a superficial loss? Once an individual's loss is determined to be a superficial loss, it is denied, but it doesn't disappear forever. Instead, the amount of the denied loss will be added to the adjusted cost base of the re-purchased investment and will, therefore, reduce any capital gains on the subsequent sale of the investment.

Capital gains were not taxed before 1972, so if you owned capital property before that time, special rules will apply. To assist you with calculating gains or losses on property owned before that time, Canada Revenue Agency has provided form T1105 "Supplementary Schedule for Dispositions of Capital Property Acquired Before 1972."

Currently, you pay tax on only 50 percent of your capital gains. The same inclusion rate applies to determine your allowable capital loss. In previous years, the inclusion rates have varied between 50 percent and 75 percent, so if you have a capital loss carried over from a prior year, you may need to adjust it to today's inclusion rate before you can claim it.

How Can you Benefit from a Capital Loss?

While no one is happy to realize a capital loss, the loss sometimes can be used to trigger offsetting benefits.

For example, a capital loss realized in the taxation year should first be applied to offset capital gains realized in the year.

If capital losses exceed capital gains realized in the year, then the excess amount becomes your "net capital loss." The net capital loss can be carried back to offset taxable capital gains in any of the 3 preceding years by filing form T1A for individuals. If you have no capital gains to offset in those prior years, you can carry forward your net capital loss indefinitely to offset future years' taxable capital gains.

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By carrying the loss back, you can claim a refund of taxes paid in the prior year. By carrying your loss forward and claiming it in a subsequent year, you can reduce the taxes that would otherwise be payable in that year.

For this reason, it is important that you report your capital losses in the year you realize them. By getting them "on record" with CRA, they will be available for carry forward or carry back to other years.

Caution

Any tax plan involving dispositions of capital property should be considered carefully, because the ultimate outcome may not be the expected or intended result. This article is general in nature and the comments herein may not apply to all situations. As always, it is recommended that you consult your tax professional to ensure your specific circumstances are considered in light of current and changing tax legislation, and that all potential results and implications are taken into account. ▲

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