

➤ capital gains & losses

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What is a capital gain (or loss) on an investment?

In simple terms, a capital gain is the difference between the purchase price and the sale price of an asset or investment such as a stock, bond or mutual fund. In other words, it is the increase in value of the asset. If you sell an investment for less than what you bought it for, you end up with a capital loss.

What are the tax implications of capital gains or losses?

If you sell an investment and end up with a resulting capital gain (you made money), you have to pay taxes on that capital gain. Currently you have to include half (50%) of the gain in your income and pay tax at your marginal tax rate. If you have capital losses (you lost money), they can offset your capital gains for that year or they can be carried back three years to offset any taxes you previously paid on capital gains. Alternatively, they can be carried forward indefinitely to offset capital gains in the future.

How do you calculate a capital gain or loss?

Three pieces of information are required to report a capital gain/loss: 1. Proceeds: The selling price of the investment. 2. Costs incurred on sale: This will typically be commission on sale. 3. Adjusted Cost Base (ACB): This is the cost of the asset or investment, plus costs such as commission on purchase.

To arrive at your capital gain amount, you subtract the adjusted cost base and the costs incurred on the sale from the proceeds.

Here's a simple example:

John purchased 100 shares of XYZ Inc. for \$25 each and paid commission of \$100. He later sold the shares for \$40 and paid commission of \$160

Proceeds = \$4,000 (His 100 shares are worth \$4,000 when he sells them)

Commission on sale = \$160

ACB = \$2,600 (Cost of the shares plus the commission paid when he bought them)

The capital gain is:

Proceeds (\$4,000) – ACB (\$2,600) – commission (\$160) = \$1,240

Taxable capital gain is 50% of \$1240 = \$620

Capital gains without the sale of an investment

In some situations a capital gain or loss can be triggered without actually selling an investment.

Mutual Fund Capital Gains:

You may also need to report capital gains from mutual funds even if you don't sell them. By selling investments held within the mutual fund, the fund manager can trigger gains or losses. You will receive your portion of these gains or losses based on how many units or shares of the fund you own. You will receive a tax slip from the Fund company outlining these capital

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gains or losses - a T3 form if the mutual fund is a trust or a T5 form if the fund is structured as a corporation (where it will appear as a Capital Gains Dividend). These amounts should be reported on Schedule 3. These capital gains will increase the adjusted cost base of the fund units so that you don't have to pay taxes on the increase in value again when you sell the units.

Transfers in kind to an RRSP:

If you transfer an investment into your RRSP, you will have to pay taxes on any capital gains from the date of purchase to the date of transfer. In this case the fair market value of the transferred investments is used both as the amount of the contribution and the proceeds for calculating the capital gain. A transfer of an investment with a loss will not however create a usable capital loss.

Switches in a Mutual Fund:

Most mutual fund companies will allow the investor to switch from one fund in a fund family to another. Although no cash changes hands, this is considered a sell and a buy and capital gains or losses created must be reported. Buying funds in a corporate class structure can avoid this.

Superficial Losses:

The CRA does not want people to be artificially creating capital losses for themselves to be used to offset capital gains. Briefly, the superficial loss rule states that if an investment is sold at a loss and repurchased by the taxpayer (or their spouse) within 30 days, the loss will not be allowed for tax purposes.

Further information on capital gains and losses:

How do you get the information needed to report the capital gain or loss? It is the investment owner's responsibility to calculate the adjusted cost base when the sale of an investment results in capital gains or losses. This can be quite complicated and you may need professional assistance to determine the correct ACB.

Where are Capital Gains/Losses reported? A summary of your capital transaction for the year will be made on Schedule 3 of your T1 Tax return. Any net taxable gain (gains minus losses) as calculated on Line 199 of Schedule 3 will be transferred to Line 127 of the T1 Return. To carry back losses to any of the prior three years, a T1A - Request for Loss Carry back can be filed with your return.

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