

► tax loss selling

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Minimizing your tax bill

Realized capital gains occur through the sale of an asset that was previously purchased at a lower price, or through year-end mutual fund distributions. By the same token, the same client may hold an asset that is currently valued below what he or she paid (unrealized loss). While you may fundamentally still believe in the asset and believe that over the long term performance will return, there still may be an opportunity to harvest that loss (realize the loss by selling the asset) to offset some or all of the capital gains earned during the year and consequently minimize your tax bill.

With tax loss selling, the sale transaction must be fully completed and settled in your account before the last business day of the year. In addition, you should be aware of Canada Revenue Agency's (CRA) superficial loss and stop-loss rules.

Superficial Loss Rules

If you sell a security to trigger and harvest a loss, and you or your spouse or a corporation controlled by either of you purchases the identical security or an option on the security within 30 calendar days before or after the sale date then the capital loss is denied. The denied loss will be added to the cost of the identical security or option acquired. If you wish to repurchase the security after tax loss selling, the rule of thumb is that you and your spouse need to wait at least 30 days before repurchasing the same security.

Below are possible strategies that you may wish to consider; and that we can discuss at your convenience.

Listed Securities

Sell the security into the market and use the proceeds to calculate the loss. Be certain not to repurchase that security for at least 30 calendar days. Depending on the security sold, there may be an opportunity to sell out of one security and buy a different, although similar, security without having to wait the 30 days. There are obvious complexities in organizing and selecting the correct security and substitution, so you and I must work together closely to ensure this process is structured correctly.

Loss Utilization

Although capital losses that are incurred in a year must first be applied to reduce any capital gains in the year, excess losses may be carried back up to three years or forward indefinitely. Consider realizing additional capital losses to utilize expiring loss carry back opportunities. Generally it is a good idea to carry back losses as far as possible because the oldest carry back year is expiring year by year. Also be mindful of optimizing your tax recovery, especially if you think future losses may not be available. The refund of tax available will depend on the marginal tax bracket and tax rate applied in the year chosen for allocating the loss to be carried back.

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Worthless Securities

If in the year a company becomes defunct and is not carrying on any business either directly or through a subsidiary, you may elect under subsection 50(1) of the Income Tax Act (Canada) to have a deemed disposition with proceeds equal to nil. This would trigger a capital loss of your remaining Adjusted Cost Base (ACB). These rules are complicated and other bad investments or debts may qualify so it is important to seek professional advice. It is also important to be vigilant as the election is not available in years other than the year the triggering event occurs. If you missed this window other planning may be possible so seek professional advice in this regard. Lastly, if during the 24 months following the end of the year for which the election was filed, the corporation resumes business activities, you must then recognize a capital gain equal to the capital loss written off and in effect reestablish the ACB.

There are basic tenets one should understand and employ when considering tax loss selling.

1. One should not allow tax considerations to overly sway an investment decision. If the investment no longer fits in your portfolio or you simply do not like its future prospects, then that should be reason enough to sell.
2. Tax loss selling should be done at the end of the year when you know what your net taxable gains are for the year. It is a good idea to leave a comfortable window for appropriate planning and to accommodate settlement dates.
3. For large or complex transactions, professional tax and legal advice should be obtained.

Summary of Terms:

Capital gain: you have a capital gain when you sell, or otherwise dispose of a security for more than the total of its adjusted cost base.

Capital loss: you have a capital loss when you sell, or otherwise dispose of a security for less than the total of its adjusted cost base.

Adjusted cost base (ACB): usually the cost of a security plus any commissions paid to acquire it (plus any distributions paid out).

Capital losses realized during the year may be used to offset capital gains realized during the year. A net capital gain is taxable in the year it occurred, a net capital loss may be carried back 3 years or forward indefinitely and applied against future capital gains.

Do you have capital losses that could be used to offset capital gains and reduce the amount of tax you pay this year? Let's get together to review your situation and uncover potential opportunities.

At DundeeWealth, we believe that having a financial plan forms the foundation necessary to grow, protect and transfer wealth from one generation to the next. We are committed to provide information on a variety of financial planning topics so our clients are able to make informed decisions.

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