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Tax advice Articles

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Tax loss selling, a strategy to reduce tax?

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Tax loss selling may be a smart tax planning strategy to utilize in this down year after five years of consecutive gains. This strategy is effective for investors who have money-losing investments outside their RRSPs and are looking for ways to reduce their tax liabilities.

With securities trading at depressed prices due to the market activity in recent months, it's now a good time to take a look at your portfolio, look at the losses and gains, and see how you might benefit from the strategy of selling securities to crystallize the loss this year. This strategy provides a way to ease the financial blow that people have taken this year — you can at least take advantage of the markets in terms of income tax.

Tax-loss selling involves the investor selling the investment at a loss, then applying the losses from the sale of that security against capital gains earned on the sale of another investment, thereby reducing income taxes.

What makes the tax-loss selling strategy particularly attractive once losses have been applied against this year's realized gains, any unused losses can be carried back and applied against any net realized gains incurred during the past three years. The losses can also be carried forward indefinitely, and applied against future gains to reduce taxable income - they never expire.

Likewise, unused capital losses from previous years may be brought forward to apply against this year's gains.

Keep in mind that it takes at least three business days for a trade to settle, so any tax-loss selling for this year must be done by Dec. 24.

As well, if a client has no capital gains, losses can be transferred to his or her spouse. The situation could be such that you're holding on to securities in a loss position, but you can't benefit from a capital loss situation. If you have a spouse or partner that had capital gains earlier in the year, you can sell the security to your spouse. It must be a real sale; in other words, your spouse provides proceeds for whatever the value of the security is.

One important consideration relates to a special tax rule known as "superficial loss rule" which says the security cannot be repurchased for 30 days, or the losses will be considered "superficial" and denied by the Canada Revenue Agency.



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However, there are a variety of ways to minimize the potential damage of the 30-day rule. One way would be to find another investment that is similar but not identical to the one being sold. Various mutual funds have similar portfolios but are not exactly the same.

Where tax losses are transferred to a spouse, the 30-day rule must still be observed. The original owner loses the ability to claim the tax loss, but the loss is applied to the cost base of the security now held by the spouse. After 30 days, the spouse may sell the security and realize the loss. The client's tax return must state that an interspousal transfer took place at fair market value.

Another alternative is to gift a losing fund or stock to a child. The security is considered sold at fair market value, and the investor may claim the loss. If the investment later increases in value, the child is responsible for paying taxes on the capital gain. But as long as he or she has income under the basic personal exemption of \$9,600, the gain would be tax-free.

Attribution rules would require the original owner to pay taxes on any dividends or interest income paid by the security.

