Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

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Capital losses and tax loss selling

Sometimes, you may realize a capital loss on the sale of your securities or you may own securities in a loss position. This article summarizes the tax rules and opportunities surrounding capital losses you've realized or may realize in your personal, non-registered investment portfolio.

Any reference to a spouse in this article also includes a common-law partner.

Capital losses on the sale of securities

When you realize a gain or a loss on the disposition of property, you must determine whether the gain or loss is on account of income (business income or loss) or capital (capital gain or loss). A gain or loss on account of income is fully included in or deducted from your taxable income. On the other hand, only a portion of capital gains or losses are included or deducted from your taxable income.

For most investors, gains and losses on the sale of their investments will likely be considered capital in nature. However, it's a question of fact in each particular situation, so you should speak to a qualified tax advisor to discuss the appropriate tax treatment that applies to you. The rest of the article assumes that the gain or loss you realize on the sale of securities will be on account of capital.

Allowable capital losses

When you sell a security at a loss that's on account of capital, the portion of the capital loss that's subject to the inclusion rate is referred to as the "allowable capital loss." This allowable capital loss is used to reduce any taxable capital gains you realize in the same year. Generally, capital losses can't be used to reduce your other income, such as employment income, for the year. As well, your ability to use the allowable capital loss in the year can be affected by the superficial loss rules, which will be explained in more detail later in this article.

Net capital losses

Allowable capital losses realized in a given year must first be used to offset taxable capital gains realized in the same year. When you have no capital gains in the current year or your allowable capital losses in the year

exceed your taxable capital gains, the remaining capital loss is referred to as a "net capital loss." Your net capital loss can be carried back to any of the three previous taxation years or carried forward indefinitely to offset future taxable capital gains.

In situations where you've realized a taxable capital gain in any of the three previous taxation years and you choose to carry back the net capital loss, you may receive a tax refund. For example, net capital losses realized in 20X4 could be applied against taxable capital gains realized in 20X1, 20X2 or 20X3. You can choose to carry the net capital loss back to any, or spread the net capital loss among all, of the three previous tax years. When deciding whether to carry back capital losses or which years to apply the losses, you should consider your marginal tax rate in those previous taxation years and your expectations for the future.

Why trigger capital losses?

While purposely selling securities to realize a capital loss may sound counterintuitive, you may wish to trigger capital losses in some circumstances. For example:

- A particular security no longer meets your investment criteria. You want to sell the security and use the proceeds for another investment or other uses.
- You've realized a capital gain in the current year, potentially from the sale of securities or your business, and you want to reduce your tax liability for the current year.
- You realized taxable capital gains in any or all of the previous three taxation years and want to recoup the taxes paid in those previous taxation years.

Different ways to realize capital losses

There are certain situations where you may realize a capital loss even if you didn't sell the security in the market. You're considered to have disposed of a security or other capital property at fair market value (FMV) when:

- You transfer assets to an individual other than your spouse during your lifetime; for example, to an adult child, whether by gift or sale for consideration.
- You transfer assets to any person other than your spouse or a spousal trust upon your death.
- You transfer assets to a family trust. Please note that if you or your spouse are a beneficiary of this trust, the superficial loss rules may apply, which will affect the ability for you to claim the loss.
- You file an election with your tax return relating to a qualifying share or bad debt of a bankrupt corporation.

In order to be able to claim a capital loss on the sale of a security, it's important to ensure the loss is not considered a superficial loss. Otherwise, you will not be able to use the capital loss to offset capital gains realized in the current taxation year or the previous three taxations years.

If you own a security you believe to be worthless, ask your RBC advisor for an article on worthless securities and speak with a qualified tax advisor to determine if you can claim a capital loss.

- In some cases, the shares you own are redeemed by the issuing corporation.

Beware of the superficial loss rules

In order to be able to claim a capital loss on the sale of a security, it's important to ensure the loss is not considered a superficial loss. Otherwise, you will not be able to use the capital loss to offset capital gains realized in the current taxation year or the previous three taxations years.

A capital loss is considered a superficial loss where:

- During the period that begins 30 days before and ends 30 days after the settlement date of the transaction, you or a person affiliated with you acquires the same security or identical property that was sold at a loss; and
- At the end of that period (i.e. 30 days after the settlement date of the disposition), you or a person affiliated with you owns or has a right to acquire the security or identical property.

The denied capital loss is added to the adjusted cost base of the security or identical property acquired. This will effectively allow you or the affiliated person to claim the loss or reduce the capital gain in the future when the newly acquired property is sold, provided the superficial loss rules are not once again triggered.

The affiliated person definition is complex. It includes you, your spouse, a corporation controlled by you and/or your spouse, and a trust where you and/or your spouse are majority interest beneficiaries. It also extends to partnerships and combinations of all of these, so care must be taken when you or any of these individuals or entities you have a connection with are considering purchasing an identical property within the timeframes discussed earlier.

Due to the complexity of these rules, you should consult with a qualified tax advisor in advance of a purchase where the superficial loss rules may be triggered. Keep in

mind that these rules apply to all accounts held by you or an affiliated person; you should take care if you're selling securities in one account and repurchasing in another.

For more information on the superficial loss rules, please ask your RBC advisor for an article on this topic.

Conclusion

This article provides an overview of capital losses and how you can use capital losses as a tax planning strategy in your personal, non-registered investment account. Speak to a qualified tax advisor to determine if triggering capital losses before the end of the year makes sense for you.

This article may contain strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal and/or insurance advisor before acting on any of the information in this article.



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