

# FineAnswers

## Answers to questions on Tax, Finance and Management

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### **SUPERFICIAL LOSSES - Realized Losses are not always deductible.**

**Is the last day I can sell my stocks and claim a loss in Canada 31st December 2007?**

**No!** It is 24<sup>th</sup> December 2007 for Canadian stocks and 26<sup>th</sup> December 2007 for US stocks.

**I understand that selling stocks which cost me more will give me a loss, but I was told that in the case of income trusts this may not be so. Is it true?**

**Yes!** The reason is that income trusts distribute more than their net income and they call this excess, return of capital. Return of capital reduces the cost of your stock purchase and therefore reduces your loss. If the units are held long enough it is possible that the cost would have been reduced below the selling price and in which case you may trigger a gain rather than a loss.

**How would this play out in the case of mutual funds that distribute nothing except their tax liability by issuing year end T3's?**

Year end T3's are information slips reporting the funds realized income and capital gains. In order for the fund to avoid being taxed, it either has to pay the income and capital gains to the unit holders or issue additional units. In the latter case they are using your income and capital gains entitlement to sell you more mutual fund units. So, what you initially paid for the units is not the tax cost of all your units when you sell them. Their tax cost is actually more. The excess is the cost of all

the additional units they allocated to you. Therefore, you may actually realize a loss in situations where units are trading more than what you initially paid for them.

**I have just sold some US stocks with a gain should I calculate the gain for tax purposes by taking the average exchange rate and apply it to the amount of gain computed in US dollars?**

**No. Big mistake!** You should first calculate your cost taking the exchange at the time of purchase and then calculate your sale by applying the exchange rate of the day you sold the stocks. This would make a big difference in your favour, given the US \$ has dropped significantly against the Canadian dollar.

**Some of my stocks have unrealized losses can I sell them realize the loss and buy them back the next day.**

**No!** This is what Section 54 of the Income Tax Act calls a superficial loss. The loss is denied and you cannot off set it against other gains. However, if you were to re-purchase it more than 30 days later you would be OK.

**If I was to sell the stocks with unrealized losses and immediately purchase a call option to buy the same stock; will it work?**

That will not work either. Options are substituted property and substituted property cannot be repurchased. (Section 54 of the Income Tax Act)

**So are those losses (superficial losses) lost for ever?**

**No!** They increase the cost of your stocks and once you sell them and not purchase them

back within 30 days, you can claim them as capital losses.

**What if I sold stocks with unrealized losses to my wife, my corporation, or sold it in the market and had any of them purchase it within 30 days?**

The realized loss is denied. But, the transferees' cost would be the same as your original cost and they would be able to sell the stocks and realize the loss.

**Would the situation be different if it was a corporation disposing of the stocks with unrealized losses to a controlling shareholder, his spouse (affiliated persons defined under subsection 251.1 (1) of the Income Tax Act etc)?**

The loss would be denied, but the cost to the affiliated person would be the market price and therefore, unlike the situation above, the transferee (affiliated persons) will not be able to realize the loss. It is the transferor (the corporation) which can realize the loss when the transferee sells the stocks.

**My husband and my minor children have capital gains and I have capital losses. Can we pool our gains and losses and claim my capital losses against their gains?**

**No!** But you can gift those stocks to your husband – NOT YOUR CHILDREN - and then he can sell them and realize the losses and claim them against his capital gains.

*Note: This newsletter cannot replace professional advice. The reader is invited to contact the writer to discuss the contents of the newsletter. Readers are advised to seek professional advice before acting on the material in this newsletter.*

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