Something for Nothing

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This past year I rediscovered a very helpful section of the *Income Tax Act* when a client came in with capital gains and was commiserating with me about the tax he would be required to pay. My first response was to ask whether or not he had something that had declined in value that he could sell to offset the gain. I checked the tax records for losses carried forward. You can carry back capital losses for three years and forward forever, or at least until you die. Nothing appeared to reduce the effect of the capital gains on the tax payable for the year.

Then my client mentioned that he had some delisted shares in another brokerage account (the only shares in that particular account). He had not given me the account statement for these shares because they were worthless, or so he thought.

My client walked out a happy camper. He got something for nothing. Those delisted shares that he had paid a goodly sum for a few years back reduced his capital gain to nil. Because the capital loss was larger than his capital gain in the year, there was even a capital loss to carry forward to use in the future.

Where would you find something for nothing?

Look for stocks in your portfolio that have declined in value so much so that they are delisted. Alternatively there may be a cease trade order because of a bankruptcy. I think it is human nature to want to bury our memories of loss. We grieve for a short time and then move on. Who thinks that you could claim a capital loss that would offset a capital gain? After all, you still own the stock. There has not been a disposition of property.

What can you do?

If you own the shares at the end of the year, you are allowed to elect under S. 50(1) of the *Income Tax Act* to deem a disposition of the shares in certain circumstances.

When would you be able to make a claim?

There are three circumstances discussed in S. 50(1) (b) when you can elect to deem a disposition of your shares:

1. When the corporation is bankrupt during the year as defined in the *Bankruptcy and Insolvency Act*.
2. When the corporation is insolvent and a winding-up order has been made under Section 6 of the *Winding-Up and Restructuring Act*.
3. If the corporation is insolvent and neither that corporation nor a corporation controlled by it carries on business and the fair market value of the shares is nil. Furthermore, it is reasonable to expect it will be dissolved or wound up and will not ever carry on business again. (Insolvent is when you are not able to pay your debts.)

Why would you want to make a claim?

Capital losses carry forward forever if they are not used in the year. They also carry back for three years. If you had a capital gain that you paid tax on in the past three years, you could go back and reduce the tax payable in that year and ask for a refund of tax paid in the past.

How do you make a claim?

Write a letter to elect under Subsection 50(1) (b) for the year, asking for the shares to be deemed disposed of for nil consideration and reacquired at a cost of nil. Specify, the year in which the election pertains.

What else should you know?

If those shares ever are sold for proceeds greater than nil, the gain would be reportable as a capital gain for the whole amount of the proceeds in the year of the disposition.

What should you do to assist your tax preparer?

I recommend that you provide your tax preparer with your entire investment portfolio every year—well before April to allow time for processing of your investment accounting and reconciliation with your tax return each year. Include registered accounts like the RRSP or RRIF and non-registered accounts such as broker accounts, mutual fund accounts, bank accounts with investments like GICs, or share certificates with documentation about the price and date of purchase.

Look for a tax preparer who will account for your portfolio and reconcile your income to the changes in your portfolio each year. A tax preparer worth their weight in gold should be able to provide you with annual reports of the changes in your Adjusted Cost Base and the changes in your Fair Market Value by security and account. The transactions each year should reconcile the changes in your portfolio consisting of RRSP or RRIF contributions or withdrawals, income reported on T3s and T5s, the capital gains calculations, transfers in and out of your portfolio and other investment income and expenses.

Do not throw out the monthly, quarterly or annual statements. Keep all of the statements for all the years you have held the account. Store each portfolio account in a separate file folder. If your tax preparer does not have access to these records, they will have a really tough time advising you on how to pay less tax. If it's advice you want, then be prepared to ante up with the historical documentation. Like my client, you may find you too can get something for nothing.

Looking for more details? Here's additional reference materials for more in-depth coverage of the subject:

- Canada Revenue Agency (CRA) website at http://www.cra-arc.gc.ca
- *Capital Gains Guide 2004* T4037 published by Canada Revenue Agency and updated each year at http://www.cra-arc.gc.ca/E/pub/tg/t4037/README.html
- *Income Tax Act* S. 50(1) debts established to be bad debts and shares of bankrupt corporations at http://laws.justice.gc.ca/en/I-3.3/section-50.html

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