



# Bumping Up and Bumping Down

Eileen Reppenhagen

**A** *MoneySaver* reader who uses Quicken software to account for his portfolio recently e-mailed to ask for help. He could not figure out a way to record the capital gains distribution for iShares S&P/TXS 60.

ETFs, closed-end funds and iShares distribute income but there is no cash nor are additional units or shares issued. These investment vehicles deem cash distributions as undesirable and do not allow for fractional units. All the investor sees is an income slip which advises them of income and a bump in their adjusted cost base. The income may be “other income” or a “capital gains distribution”.

## Bumping Up

The cost base of an investment may be adjusted for too many reasons to contemplate in this article. Here are three basic reasons to adjust the cost base of investments:

- Adjustments for outlays of funds during or after acquisition. You want to track these adjustments because they reduce the capital gain when you sell the asset. A simple example is the commission on the purchase and on the sale.
- Adjustments because capital is returned to you, i.e. a return of capital, for which there are no immediate tax consequences. The tax consequence is deferred. The reduced cost base eventually generates a larger capital gain, or less of a capital loss. Take your money out now, pay tax later when you sell.
- Adjustment for distribution of income. You receive a dividend which causes an increase in the cost base of your shares without any additional shares or units distributed. Distribution is reconsolidated into the existing units or shares. Your increased cost base eventually generates a smaller capital gain or larger capital loss. No money now, but you pay tax now. If the income is on account of capital, your income is a capital gain distribution. In some cases, your income could be “other income”. For example,

iShares MSCI EAFE Index Fund (XIN) included index futures and treasury bills, so the distribution is other income rather than capital gains distribution.

A distribution where nothing is distributed is a bit unnerving. Most investors are more familiar with the distribution of cash or stock dividends and reinvested dividends with mutual funds, where the dividend automatically purchases more units or shares.

When you sell these shares with the adjusted cost base bump, you pay less tax because the adjusted cost base was bumped up by the distribution. This transaction is not exactly the opposite of a return of capital transaction where the amount is subtracted from the adjusted cost base and you receive cash.

Quicken software has a return of capital transaction type, but there isn't a transaction type for a distribution where there is no increase in the number of units and no cash.

## Not Recommended

I thought about going back to the original transaction and adjusting the original cost. If you were to add a capital gains distribution using the dividend income screen, the cash would eventually balance. But what if you have been buying and selling shares in the interim? Adjusting the opening cost would affect the gains calculations between the original purchase date and the date of the distribution. I realized that this was not a solution because it will disturb your historical calculations of capital gains and losses on transactions in the interim if you went back and changed the opening cost base. It will also disturb your cash balance, making it difficult to figure out what you did after the fact. Your cash balance will not balance to your broker statements each month.

## A Solution

I settled on a solution that I thought would work and e-mailed the *MoneySaver* member this response:

Here is a solution to calculate the bumped up adjusted cost base of your investment in iShares where the dividend

does not produce additional units or shares, using Quicken software. Try these steps to see if it works for you:

Make an entry to Reinvest - Income Reinvested. Enter the dollar amount of the dividend with a notional .0001 units. Why do you have to enter these notional units? The software will not let you enter zero units. The maximum number of decimal points allowed is 4 points.

To correct the number of units, Remove – Shares Removed the .0001 shares without any price. The shares will be removed at zero cost and zero proceeds, or depending on the figures, there might be an entry for a few pennies where the cost base and the proceeds are each reported for the removal. Run a capital gains report for the date you removed the shares to check for consequences of the removal.

The cash account balance stays the same. The units are the right number and your ACB has been re-calculated. Depending on the figures, you might be out a few cents in the calculation of your ACB. No one in their right mind (Canada Revenue Agency [CRA] included) is going to quibble if your calculations on your investments are out less than \$1. CRA have bigger fish to fry.

Here is what our *MoneySaver* member wrote after trying out this solution:

“Thank you very much. That does seem to work. I pretended to sell all my shares in that ETF and recorded the sale in Quicken. The ACB came out right.

The only change I made was to enter it as a Reinvested Long Term Capital Gain rather than a Reinvested Dividend. I think that will remind me what it is when I sell.”

You want to record bumps upward in adjusted cost base because you will pay less tax when you sell if you have correctly adjusted your cost base to reflect these distributions.

## Bumping Down

As for bumping down, use the Return of Capital transaction window. Take the amount of the return of capital out of the dividend previously recorded. Set up a return of capital transaction to reduce your adjusted cost base. Your cash account balance increases and re-balance your cash in the account.

This spring, return of capital was reported on your T3 slip for the first time. For any investments with a return of capital from past years, you might want to make the effort to calculate the effect on your cost base for all the years you have owned the investment. That tax deferral could come back to bite you when you sell for more than the adjusted cost base. You might have to do a little digging to find out the return of capital amount and adjust your prior year's dividends to exclude that amount from your income calculations.

## Reconciliation

Run a report called the “Investment Income” report. Return of capital will show as uncategorized income. You might think that this is odd until you consider that the investment income report is reporting on all of the changes in the investment accounts and this is a change to those accounts. If you run the income and expense report, you will not find it listed as income on that report.

The investment income report provides valuable information to compare your investment transactions to your tax return. It will be discussed in my instructions on using Quicken software, which is in progress.

*Eileen Reppenhagen, CGA, Tsawwassen, BC (604) 943-7414, eileen@taxdetective.ca*