THE GLOBE AND MAIL

CESTNICK

TAX MATTERS

Make lemonade from your market lemons before year-end

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It was Nelson Mandela who said "I never lose. I either win or learn." This is a great outlook for those who might have experienced declines in their investment portfolios this year. And if you're going to learn from your losses, you should also learn to make the most of those losses when they happen. Here are eight ideas for you to consider before year-end if you're an investor.

Harvest investment losses. It's no secret that if you sell an investment for a loss, you're generally going to gain some tax relief. In most cases your losses will be considered capital losses, in which case you can offset those losses against capital gains you might have realized or will realize in the future. In some cases, if you're day-trading for example, the taxman might consider your profits and losses to be business income and losses, which could mean your losses can be applied against any type of income, not just capital gains. Just be aware, you have to be consistent here. If you're going to report your losses as business losses, you'll generally have to report any profits as business income, not capital gains.

Carry losses back to a prior year. If you sell some of your losing investments before year-end, you can apply your capital losses to offset capital gains this year, or in the three prior years (2021, 2020 or 2019). This could allow you to recover taxes you might have paid in the past. To carry losses back, you need to file Form T1A with your 2022 tax return.

Watch the superficial loss rules. If you sell a capital property (that is, any investment that will give rise to a capital gain or loss) at a loss, and then you – or someone affiliated with you – buys that same investment in the period that is 30 days before, or 30 days after your sale (a 61-day window), your capital loss will be denied. You won't lose the loss forever. The denied loss will be added to the adjusted cost base of the newly acquired investment, so that you'll eventually have a smaller capital gain or larger capital loss when you ultimately sell the investment. By the way, examples of those who are affiliated with you include your spouse (including a common-law partner), a corporation that is controlled by you or your spouse and a trust of which you're a beneficiary.

Avoid contributions in-kind. If you're thinking of contributing a losing investment to your registered retirement savings plan or tax-free savings account as a contribution in-kind, think again. The capital loss that will be realized on that contribution will be denied. You'd be smarter to sell the losing investment, then contribute the cash to your registered plan. And if you really want to own that losing investment inside your plan, be sure to wait more than 30 days before you repurchase it, otherwise the superficial loss rules will deny your capital loss.

Donate losers to charity. If you want to realize your capital losses before year-end, consider donating a losing investment to charity. You'll be entitled to a donation tax credit for the fair market value of the investment, and you'll be able to claim the capital loss to boot (I'll talk next time about donating investments that have appreciated in value).

Give losers to your kids. As part of an effective estate plan, you might consider giving some investments to your kids. It could help them save for a home, start a business, or with some other financial need. It will also reduce taxes and probate fees that you might otherwise pay upon your death because you'll no longer own those investments. If you give your kids some of your investments with accrued losses, you'll be able to claim the losses (your kids are not considered to be affiliated with you under our tax law). Your kids can keep the securities or sell them to reinvest or use the proceeds for another purpose.

Deduct all the interest you can. If you're going to borrow for any purpose, borrow to invest or for business purposes. This way, you can claim an interest deduction. If you borrowed to buy an investment that has declined in value, and you sell that losing investment, you can still deduct the interest provided you reinvest whatever proceeds you receive from the sale. (In Quebec, your investment expenses – including interest expense – is limited to the amount of investment income earned in the year.)

Transfer capital losses. If you have losers in your portfolio but have no capital gains this year, or in 2021, 2020 or 2019 against which to apply capital losses, it's possible to transfer unrealized capital losses to your spouse or common-law partner if he or she can use the losses. See my article from Oct. 22, 2020, (Give the Gift of Tax Savings to Your Spouse) for details.

Tim Cestnick, FCPA, FCA, CPA(IL), CFP, TEP, is an author, and co-founder and CEO of Our Family Office Inc. He can be reached at tim@ourfamilyoffice.ca