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TAX MATTERS

Reporting your profits and losses properly is no easy task

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When filing your tax return you have to decide how to report your profits and losses on the sale of securities, crypto assets, real estate, and many other assets. It's not always easy to figure out.

The issue

Suppose you buy and sell stocks on a regular basis and made a profit last year. Or perhaps you bought a piece of real estate a couple of years ago and have just sold it at a loss. Maybe you've disposed of crypto assets and made money in the process.

Will your profits and losses from these types of transactions be taxed as capital gains and losses (referred to as "on capital account"), or business income and losses (on "income account")? In the case of profits, you'll often want to report these as capital gains, because just one half of capital gains are taxable. Although reporting profits as business income, while fully taxable, may entitle you to deductions for business expenses against that income.

When it comes to losses, capital losses can only be applied to reduce capital gains and not other income. Business losses, however, can be applied against any type of income you might have.

Depending on your situation, you might have the ability to choose how you'd like to report your profits and losses, but you have to be consistent. That is, you could not, for example, report your profits as capital gains and losses from the same activities as business losses. In most cases, the facts of your situation will point to whether capital or income treatment is appropriate.

If the taxman considers you to be carrying on a business, or what is called an "adventure in the nature of trade," then your profits and losses will be on income account.

The factors

So, what does the Canada Revenue Agency (CRA) look at when assessing whether your profits or losses are on account of capital or income? Consistent with what the courts have said over the years, the taxman will look at your "course of conduct" over time, and your "intention" when you bought the asset.

Most notably, your course of conduct might suggest that you're carrying on a business (and therefore your transactions would be on income account) if the following is true:

- **Frequency of transactions:** you have a history of extensive buying and selling of securities or other assets, or quick turnover of properties;
- **Period of ownership:** you usually own the asset for a short period of time;
- **Knowledge of markets:** you have some knowledge of, or experience in, securities markets or the markets in which you're selling;
- **Business of trading:** trading in the asset forms part of your ordinary business;
- **Time spent studying:** a substantial part of your time is spent studying securities markets or the market for the asset you're selling, and investigating potential
- **Borrowing money to trade:** your purchases are financed primarily on margin or by some other form of debt;
- **Advertising your trading:** you have advertised or otherwise made it known that you're willing to purchase securities or other assets;
- **Nature of the securities or assets:** you've purchased speculative securities or assets, often those that don't pay dividends or other income.

The nuances

There are a few points worth noting here. First, your intention when you bought the asset is a factor in determining whether a transaction should be taxed as capital or income. See my article from last week where I shared an analogy about buying a tree with the intention of selling its fruit.

Second, it's possible to make a special election, called the Canadian Securities Election, by filing Form T123 to have all your transactions in Canadian securities treated as capital transactions. You can't rescind this election – so think twice before making it. In many cases your transactions may be considered on account of capital anyway, so it may not be necessary to file this election.

Finally, our government introduced a new residential property flipping rule that took effect Jan. 1, 2023, and applies if you sell a residential property within 12 months of buying it. The rule will deem any profit to be business income in this case.

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