Capital Gains and Losses

Capital Gains

Occur on the disposition, or deemed disposition, of capital property

Remember to distinguish capital property from income earning property:

•Length of ownership
•Intention to resell
•Frequency of purchases/sales

Only since 1971 (V-Day) when capital gains became taxable

Calculating Gain or Loss

Proceeds	$10,000	
Adjusted Cost Basis (ACB)	(3,000)	
Disposition Costs	(1,500)	(ex. lawyer fees)

Capital Gain	$5,500	
Taxable Capital Gain 50%	2,750	

When A Disposition Occurs

Whenever Proceeds are Received and Assets Given Up:

- Sale of property
- Redemption of shares by a company
- Expropriations (property is taken from you)
- Exchanging one type of property for another

Transfers of Property – Change in 'beneficial' ownership

Deemed Dispositions

- Death, Change in Use, Ceasing to be a Resident
- Proceeds deemed to be FMV

Proceeds of Disposition

<u>An Actual Disposition</u>

- Sale Price
- Insurance or other compensation for property given up (destroyed, appropriated).

<u>Deemed Dispositions & Related Party Sales</u>

- Proceeds deemed to be FMV, or
- Greater of FMV or actual proceeds.

Capital Cost - Refresher

- Recall from Session 5 – CCA, how to calculate the cost of a capital asset acquired:

- Purchase price

  + Cost to bring the asset to the location of use (shipping & duties)

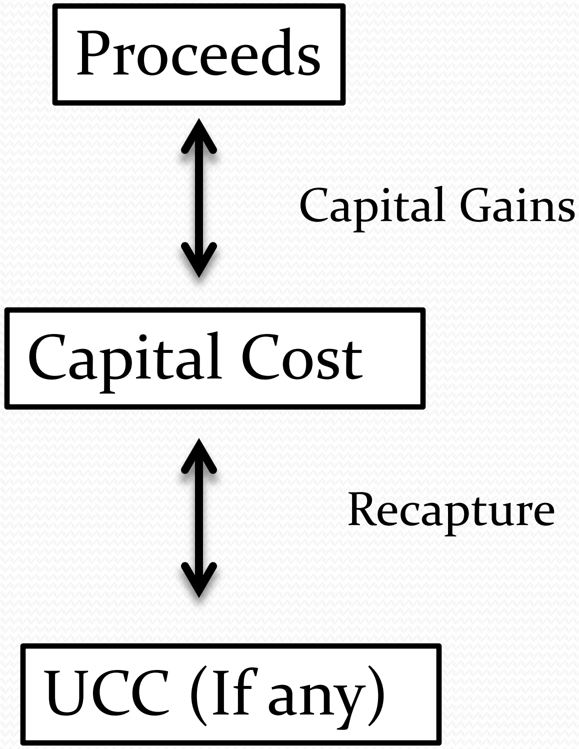
  + Cost to purchase the asset (legal/valuation fees)

  - Government assistance to purchase the asset

  + Superficial losses incurred on identical property (New)

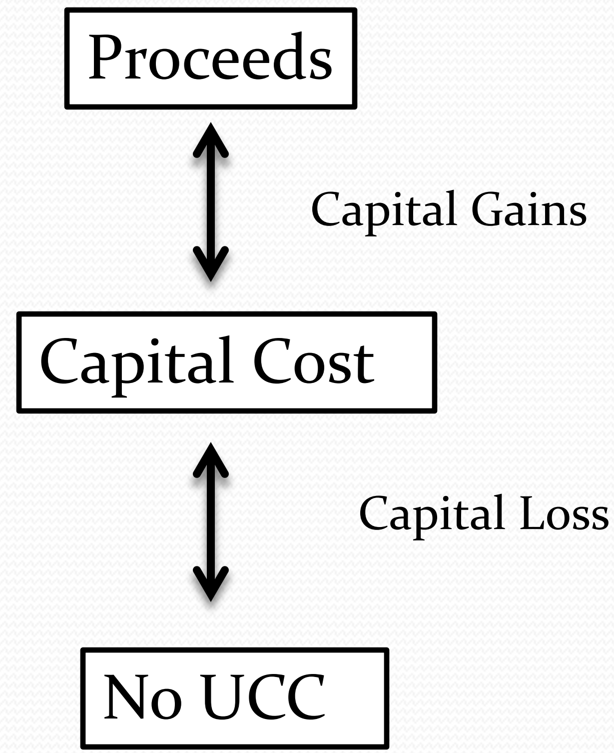
Adjusted Cost Base (ACB)

- <u>Depreciable Property</u>
  - Capital Cost (original cost).
  - NOT UCC



Adjusted Cost Base (ACB)

- <u>Other Property (Land)</u>
  - Capital Cost (original cost)



ACB Identical Properties

- Marketable Securities and other Liquid Assets

  - When you buy assets at different times you don't use a First In First Out (FIFO) method for ACB.
  - Instead, the ACB of the properties is the combined average cost of all the units you hold.

This calculation must be redone after each purchase.

ACB Identical Properties

Ex. Dave purchases 100 shares for $25 in February, and 100 shares for $10 in March. In June he sells 100 shares. What is the ACB of the shares sold?

$2,500 Calculated as 100 shares x $25/share February purchase
$1,000 Calculated as 100 shares x $10/share March purchase

$3,500 Total ACB/ 200 shares = $17.50 per share

$1,750 Total ACB sold in June Calculated as 100 shares x 17.50 per share

ACB Identical Properties

After Dave sells his 100 shares in June, he purchases another 200 shares in September for $40 each. In December he sells 50 shares for $35. What is the gain on the shares he sells in December?

$3,500 Total ACB after purchases / 200 shares = $17,50 per share
(1,750) Total ACB of 100 shares sold in June

1,750 Remaining ACB for 100 shares Dave has left
8,000 Calculated as 200 shares x $40 each September purchase

9,750 Total ACB for 300 shares on hand = $32.50 per share

1,750 Proceeds of disposition of 50 shares sold
(1,625) ACB of 50 shares sold (50 shares x $32.50 ACB per share)
125 capital Gain x ½ = $62.50 taxable capital gain on sale.

Partial Dispositions

- Generally, partial dispositions involve prorating the cost based on a reasonable basis.
- Ex. 100 shares owned with ACB of $100,000. If selling 40 of these shares, ACB will be $40,000 (40%)
- Ex 2.
- 600 acres of land owned that has a cost of $500,000. If selling 300 acres of that land, cost of disposition is assumed to be $250,000 (50%).
- Exceptions: when reason to believe some part is not equal (ex. part of the land is waterfront property)

Reserves

- <u>If Proceeds Aren't All Received at Once</u>
  - Can defer gain over 5 years if normal sale.
  - Can defer gain over 10 years if QSBC shares sold to a child.

  (Qualified Small Business Corporation Shares)

- <u>Not Given to:</u>
  - Non-Residents
  - Exempt Entities (Charities)
  - When the sale is to a Corporation you own.
  - Deceased Individuals

Reserves - Calculated

- <u>Deduction is Lesser of:</u>

1) $\dfrac{\text{Unpaid Proceeds}}{\text{Total Proceeds}} \times \text{Capital Gain}$

and

2) Year 1 – 4/5 of the gain
Year 2 – 3/5 of the gain
Year 3 – 2/5 of the gain
Year 4 – 1/5 of the gain
Year 5 – No reserve

<u>& Prior year reserve is included in current year income</u>

Example A

Mr. Anderson sold a piece of land for $150,000 during the year. He had purchased the land for $100,000 six years ago.

He is paid his proceeds in chunks of $25,000 in years 1-3 and then the remainder is paid off in year 4.

Calculate the impact on his income in each year.

Reserves – Calculated Year 1

- 150,000 Proceeds – 100,000 Cost = 50,000 Capital Gain

Year 1: Reserve is the lesser of:

$$\frac{\text{Unpaid Proceeds}}{\text{Total Proceeds}} = \frac{(150{,}000-25{,}000)}{150{,}000} = \frac{125{,}000}{150{,}000}$$

=83.33% x 50,000 Capital Gain = 41,666.67

OR

4/5 Capital Gain = 40,000

Income Inclusion: 50,000 Gain – 40,000 Reserve = 10,000 Gain x 50% Capital Gains Rate = $5,000 income inclusion

Reserves – Calculated Year 2

- 150,000 Proceeds – 100,000 Cost = 50,000 Capital Gain

  Year 2: Reserve is the lesser of:

  $$\frac{\text{Unpaid Proceeds}}{\text{Total Proceeds}} = \frac{(150{,}000-50{,}000)}{150{,}000} = \frac{100{,}000}{150{,}000}$$

  =66.67% x 50,000 Capital Gain = 33,333.33

  OR

  3/5 Capital Gain = 30,000

Income Inclusion: 40,000 P/Y Reserve – 30,000 C/Y Reserve = 10,000 Gain x 50% Capital Gains Rate = $5,000 income inclusion

Reserves – Calculated Year 3

- 150,000 Proceeds – 100,000 Cost = 50,000 Capital Gain

  Year 3: Reserve is the lesser of:

  $$\frac{\text{Unpaid Proceeds}}{\text{Total Proceeds}} = \frac{(150{,}000-75{,}000)}{150{,}000} = \frac{75{,}000}{150{,}000}$$

  =50% x 50,000 Capital Gain = 25,000

  OR

  2/5 Capital Gain = 20,000

Income Inclusion: 30,000 P/Y Reserve – 20,000 C/Y Reserve = 10,000 Gain x 50% Capital Gains Rate = $5,000 income inclusion

Reserves – Calculated Year 4

- 150,000 Proceeds – 100,000 Cost = 50,000 Capital Gain

Year 4: Reserve is the lesser of:

$$\frac{\text{Unpaid Proceeds}}{\text{Total Proceeds}} = \frac{(150{,}000-150{,}000)}{150{,}000} = \frac{0}{150{,}000}$$

=0% x 50,000 Capital Gain = 0

OR

1/5 Capital Gain = 10,000

Income Inclusion: 20,000 P/Y Reserve – 0 C/Y Reserve = 20,000 Gain x 50% Capital Gains Rate = $10,000 income inclusion

Reserves – Calculated Year 5

- <u>150,000 Proceeds – 100,000 Cost = 50,000 Capital Gain</u>

Year 5: Reserve is the lesser of:

Income Inclusion: 0 P/Y Reserve

Therefore, no reason to calculate reserve in year 5 since all proceeds collected and no p/y reserve to take into income.

Bad Debts on Loans Receivable

When an amount owed to a taxpayer becomes uncollectible, it is called a bad debt.

Taxpayers have the option to treat bad debts as though they were sold for $0 proceeds and reacquired for $0 (new ACB of $0).

This creates a capital loss for the taxpayer

Bad Debts - Example

Marley was owed $120,000 from a sale of land two years ago. The purchaser went bankrupt and Marley does not think she will ever be repaid.

What can she do and what are the tax implications to her?

Marley can elect under subsection 50(1) to dispose of her debt for $0 proceeds.

$0 proceeds - $120,000 ACB of debt = (120,000) loss x ½ = (60,000) taxable capital loss. Can be applied against capital gains in current, past, or future years, if any.

Sale of Land and Building

Land and Building are ordinarily sold together as a package, under a single purchase price.

Sale of land gives rise to capital gains, sale of building gives rise to recapture or terminal loss.

There is incentive to shift proceeds to land vs. building to take advantage of lower taxable income and higher terminal losses.

CRA reallocates proceeds under ITA 13(21.1)

Sale of Land & Building - $30,000 net income

Cannot have a terminal loss on a building and a capital gain on land where they are sold as part of one transaction. – proceeds gets reallocated until the terminal loss is eliminated or the loss has been, whichever comes first.

	Building	Land
Proceeds	30,000	220,000
Cost	60,000	120,000
UCC	50,000	

This would create a terminal loss of ($20,000) (50,000 – 30,000 = 20,000)

And taxable capital gain of $50,000 (220,000 – 120,000 = 100,000 x 50% = 50,000)

Sale of Land & Building - $40,000 net income

	Building		Land	
Proceeds	30,000	(50,000)	220,000	(200,000)
Cost	60,000		120,000	
UCC	50,000			

This would create a terminal loss of $0 (50,000 – 50,000 = 0)

And taxable capital gain of $40,000 (200,000 – 120,000 = 80,000 x 50% = 40,000)

Principle Residence Exemption

- Tax free residence with no gain on sale
- Available on 1 family home (per couple) per year.
- Can be claimed on any house that is “ordinarily inhabited” by the family (Cottage, regular home, etc.)

Principle Residence Exemption

$$\frac{1+\text{ Number of years after 1971 that the property was the principle residence of the taxpayer}}{\text{The number of years after 1971 that the taxpayer owned the property.}} \times \text{Capital Gain}$$

Principle Residence Example

Kimberley and her husband, Mark, have owned their family home since 2005 when they purchased it for $150,000. This home is worth $200,000

In 2003, they purchased a cottage for $100,000. It is currently worth $170,000.

They wish to sell both of these properties in 2015 for their FMV. Which property should the exemption be used on? What is the amount of income they will report?

Principle Residence Solution

Which property should the exemption be used on?

The decision should be based on the highest gain per year.

Cottage has a gain of $70,000 and was owned for 13 years = $5385 / year

Home has a gain of $50,000 and was owned for 11 years = $4,545 / year

Therefore, the family should use the exemption first against the gain on the cottage to minimize taxes.

Principle Residence Solution

What is the amount of income they will report?

Cottage: (12 years exempted + 1 from formula)/13 years of ownership = 100% exempt

$70,000 gain - $70,000 exempt = $0 gain to report

Home: (1 years exempted + 1 from formula)/11 years of ownership = 18% exempt

$50,000 gain – (50,000 x 18%) = $41,000 gain to report

$41,000 total gains x 50% taxable = $20,500 taxable income.

Principle Residence Example

Kimberley and her husband, Mark, have owned their family home since 2005 when they purchased it for $150,000. This home was sold in 2010 for $200,000 and the principle residence exemption was used on it for the 2006 to 2010 years.

In 2003, they purchased a cottage for $100,000. It is currently worth $170,000.

In 2013 the couple wish to give the cottage to their children for their use. The couple plans to move to Florida to retire.

Has a disposition occurred? Which property should have the principle residence exemption used on it? What is the taxable gain to the couple?

Principle Residence Solution

Has a disposition occurred?

Yes, a change in beneficial use has occurred. Kimberley and Mark have gifted the cottage to their children. Gifts to family members are deemed to occur at FMV.

What property should the principle residence exemption be used on?

In this case, the principle residence exemption from 2006-2010 was used on the home, therefore the exemption can only be used on the cottage for the other years that it was owned (2003, 2004, 2005, 2011, 2012, 2013).

Principle Residence Solution

What is the taxable gain to the couple?

1+ 6 (2003, 2004, 2005, 2011, 2012, 2013) Years since 1971 that the property was the principle residence of the taxpayers

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11 (number of years the taxpayer owned the property (2003-2013)

70,000 Ordinary gain on sale of cottage (170,000 FMV-100,000 Cost)

(44,545) Exempt gain on sale of cottage (170,000 FMV – 100,000 Cost = 70,000 Gain on cottage x (7/11 ratio from above)

25,455 Total Non-Exempt Gain on Sale

X 50% Taxable

12,728 taxable gain on sale to be included in income

Principle Residence - Rental

- When a portion of the principle residence is used to earn rental income, a partial disposition occurs and that portion is no longer a "principle residence"

- However, CRA will ignore this impact on the principle residence exemption where:
  - The income earning use is ancillary to the main purposes (not the major use).
  - There are no structural changes
  - No CCA is taken

Personal Use Property (PUP)

- Held for the personal use or enjoyment of the owner or related person
- No losses are allowed on this property
- When reporting gains, a deemed ACB and Proceeds of Disposition occurs of $1,000. Only proceeds higher than this will trigger a gain.

PUP - Example

- Michaela has several pieces of furniture that she no longer wants. She decides to sell them on eBay/Kijiji.
- Calculate the gain on sale she must report.

	Cost	FMV	Gain	Tax. Gain
Chair	500	300		
Loveseat	800	900		
Couch	2500	1500		
TV	800	1200		

PUP - Example

- Michaela has several pieces of furniture that she no longer wants. She decides to sell them on eBay.
- Calculate the gain on sale she must report.

	Cost	FMV	Gain	Tax. Gain
Chair	500	300	0	0
Loveseat	800	900	0	0
Couch	2500	1500	0	0
TV	800	1200	200	100

Listed Personal Property (LPP)

- Prints, drawings, sculptures, jewelry, rare books, stamps, coins
- Losses only deductible against LPP Gains.
- 3 year carry back, 7 year carry forward
- $1,000 floor on cost and FMV

LPP - Example

- Michaela has several collectibles that she no longer wants. She decides to sell them on eBay.
- Calculate the gain on sale she must report.

	Cost	FMV	Gain	Tax. Gain
Stamp	300	500		
Painting	15000	8000		
Sculpture	20000	23000		
Coin	900	1400		

LPP - Example

- Michaela has several collectibles that she no longer wants. She decides to sell them on eBay/kijiji.
- Calculate the gain on sale she must report.

	Cost	FMV	Gain	Tax. Gain
Stamp	300	500	0	0
Painting	15000	8000	(7,000)	(3,500)
Sculpture	20000	23000	3,000	1,500
Coin	900	1400	400	200

*Only 1,700 of taxable losses are able to be used (applied against current year gains). The remainder must be used in other years.

Superficial Losses

If a property is disposed of and 30 days before or after that disposal, an affiliated person held the same or an identical property any loss on the disposal is denied and added to the ACB of the purchaser.

<u>Examples:</u>

I sell shares of RBC, but then reacquire them in 5 days.

I sell shares of RBC but then my spouse buys some in 20 days.

I sell a piece of land to my spouse.

Superficial Losses - Example

I own shares of RBC which I bought for $1,000. I sell them for $500 on August 1. My spouse buys shares of RBC on August 20 for $2,000.

Superficial Losses - Example

I own shares of RBC which I bought for $1,000. I sell them for $500 on August 1. My spouse buys shares of RBC on August 20 for $2,000.

Someone affiliated with me (my spouse) owns identical property purchased within 30 days before or after my sale.

Therefore, my loss of $500 (1,000 cost – 500 sale price) is denied.

Spouses ACB gets increased for my denied loss $2,500 (2,000 amount paid + 500 denied loss).

Emigration/Immigration

When entering or leaving Canada permanently, an individual is deemed to dispose of all their assets at FMV except:

- Real Property (land or buildings)
- Deferred Income Plans (TFSA, RRSP, RESPs)
- Property used in active business carried on in Canada

Example

Stan is leaving Canada to work in France. He isn't certain he'll ever come back. He owns the following property when he leaves, what is his income inclusion on emigration?

	ACB	FMV	Gain	Tax Gain
Home	5,000	10,000		
Common Shares	2,000	10,000		
RRSP	3,000	7,000		
Land	10,000	25,000		

Example

Stan is leaving Canada to work in France. He isn't certain he'll ever come back. He owns the following property when he leaves, what is his income inclusion on emigration?

	ACB	FMV	Gain	Tax Gain
Home	5,000	10,000	0	0
Common Shares	2,000	10,000	8,000	4,000
RRSP	3,000	7,000	0	0
Land	10,000	25,000	0	0

Replacement Property – Real Property

Capital Gain on the disposition of property can be deferred if a similar property is purchased to replace the one disposed of.

Deferral is limited to the amount expended on the new property compared to the proceeds of the old (ie. If you spend less on the new building, you don't get to defer 100% of the old building's gain)

Replacement Property – Real Property

ACB of new property decreased by the deferral

Time limit to purchase:

Involuntary Dispositions – 24 months to buy replacement
Voluntary Dispositions – 12 months to buy replacement

Replacement Property - Shares

A similar deferral is available on the disposition of Eligible Small Business Corporation Shares (ESBC Shares) when the proceeds are invested in another ESBC.

A CCPC more than 90% of whose assets are used 50% of more of the time in active business carried on in Canada, and whose book value of assets is less than $50 million.

During the year of disposal or 120 days after year end to buy replacement shares

You must have held the shares for at least 185 days before the sale occurred.