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STRATEGIES FOR SUCCESSFUL INVESTING

TAX-WISE INVESTOR

Tax loss selling can be a lucrative strategy, know how to

TRIGGER A LOSS

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WE'RE STARTING TO APPROACH the end of the year which may mean holiday shopping lists for some of us. But for those investors who are tax-conscious, it means the countdown for year-end tax planning is already here.

Tax loss selling is the process of triggering capital losses against an immediate or deferred tax gain. And with the recent run-up of the Canadian loonie, tax planning may be focused on "tax loss selling" for investors still holding U.S. investments.

Even if you don't hold U.S. investments, tax loss selling can still be a lucrative tax strategy to offset any capital gains incurred through 2009.

So, with that in mind, here are some key rules everyone should know in order to embrace the art of tax loss selling.

Current year losses. Let's start with the current year, 2009. If you had losses to offset your capital gains, the claim is mandatory: you cannot pass up claiming 2009 losses against 2009 gains.

Losses carried back. If, after applying those losses against your gains, there is still an excess loss (and you had taxable capital gains between 2006 and 2008), you can carry back those losses to offset capital gains. This offset is optional and you can choose the year to which you apply the losses.

Losses carried forward. If, after that, you still have excess capital losses, you can carry them forward forever. This means that, if you don't have gains this year or back to 2006, there is no rush to go out and claim a tax loss.

When you are claiming a loss, consider the following.

Settlement date. To trigger a tax loss in 2009, the trade must actually "settle" by December 31. The settlement delay on Canadian stock exchanges is three trading days after the date of the sell order.

To be sure that you don't miss the last possible "settlement date," you should consider December 24 as the last trading day since the Canadian stock exchanges will be closed on the 25th and 26th (but confirm with your investment advisor).

Different rules may apply in the U.S., and if the transaction is a "cash sale" (payment made and security documents delivered on the trade date) you may have until later in the month.

Letting go of losers. You may have been thinking of realigning your investment portfolio and taking some profits. If paying capital gains tax on your winners has deterred you, sheltering these by letting go of your losers could be a tax-smart strategy.

Again, the surging loonie may have caused your U.S. investments to suffer. You may have more "losers" than you think.

Mutual funds. Another source may be money market funds that were hit hard with the collapse of

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asset-backed commercial paper a couple of years ago.

Make sure that there isn't a surprise gain this year, for instance, if you hold a mutual fund outside your RRSP and it sells off some winners. You may have potential tax losses with which to offset these gains. Place a call to the mutual fund's manager to see if there are some capital gains in store this year.

Take a pass. There are instances in which you may want to pass on claiming a loss carry back. Primarily, if you were in a lower tax bracket in earlier years than you expect to be in the near future, and you are anticipating capital gains.

Although, capital losses can be carried forward indefinitely – i.e., to be applied against future capital gains, the farther into the future your capital gain is, the lower the "present value" of your capital loss carryforward.

So if capital gains are a long way off, it might be better to apply for a carryback and get the benefit of a tax refund now – even if you were in a relatively low tax bracket.

If you intend to sell off an investment for a capital gain around the end of the year, you may want to defer the gain to 2010. That's because you can postpone the capital gains tax for a year. Note: you don't have to actually wait until the new year to do this, as long as you sell after the year-end settlement deadline.

However, you would not apply this strategy if you expect to move into a higher tax bracket next year.

SURGING LOONIE

As I mentioned earlier, one place you may want to consider looking for tax losses is U.S. investments. You may find some hidden losses since capital gains and losses are measured in Canadian dollars.

In the past number of weeks, the loonie has been rising against the U.S. dollar. So the chances are pretty high that your U.S. investments may throw off losses. (Note: CanRev's position seems to be that sundry conversions of foreign currency by individuals may be capital losses, even if connected to personal activities, such as a conversion of travellers cheques in foreign funds to Canadian dollars on return from a vacation.)

FINDING LOSSES

When hunting for losses, another thing to consider is checking to see whether you incurred capital losses in a previous year which you have never used.

This is quite possible because deductions for capital losses can only be claimed against capital gains and unclaimed capital losses can be carried forward indefinitely.

If you don't have back records, contact CanRev to request your personal "carryforward balances."

Other possibilities for tax losses include bad loans (including such items as bad mortgage investments, junk bonds, a no-good advance to your company or a bad loan to a business associate).

Finally, check your 1994 return to see whether you have made the "last chance" election to take advantage of the now-defunct $100,000 capital gains exemption. For most investments, this will result in an increase to the cost base of the particular item.

If your gain is on a mutual fund and you made the election on it, you may have a special tax account – known as an "exempt capital gains balance." This can be used to shelter capital gains from the fund until the end of this year, after that it must be added to the cost base of the particular investment.

MORE STRATEGIES

Here are some other things you should know about tax-loss selling:

Hanging in. One complication can arise if you want to hold on to the investment. So if you're thinking of selling an investment and then repurchasing it, watch out for the superficial loss rules.

These rules eliminate the benefit of a tax loss if you're simply selling to take a loss and then buying the identical investment within 30 days.

Either wait until after the 30-day period or have another family member (other than your spouse) buy back the investment – if you want it again.

These rules apply only if you buy the identical investment within the 30-day period. So if you sell, say, Royal Bank and buy Bank of Montreal, you're okay, tax-wise at least.

Switch your fund. If your mutual fund is down, one way to trigger a tax loss is by switching it to another fund within the same family e.g., from a Canadian equity to a U.S. equity or money market fund run by the same mutual fund company (remember, tax losses can't be claimed if the investment is in your RRSP).

However, some funds have been set up so that, when this conversion takes place, there is no gain or loss recognized for tax purposes (of course, the idea behind this type of structure is to defer capital gains). This should be checked before making the switch.

ABILs. Losses from invest-

ments in "private" corporations devoted to Canadian business may qualify as "allowable business losses." This is a fancy term which means that your tax loss can be deducted against all sources of income, not just capital gains. (Tax drones use the acronym "ABIL" – as is the case with capital gains and losses, 50 per cent of the actual loss can be deducted.)

In many cases, Canadian "over-the-counter-traded" shares may qualify. Warning: ABIL claims are closely-monitored by CanRev, so you should be in a position to back up your claim.

Basically, the corporation's assets must be devoted to active Canadian business ventures. Also, to the extent that you've claimed the capital gains exemption in prior years, the "ABIL" will turn back into a garden-variety capital loss. In any event, I strongly suggest you speak to your tax advisor before making a claim for an ABIL.

IN THE BUSINESS

In some cases, you could be treated as being "in the business" of trading investments. If so, 100 per cent of your losses are deductible against all sources of income, not just capital gains.

In fact, it may often be possible to claim a loss by "writing down" the investment to its current market value, if this is less than its original cost (the investment must be "written back up" if it recovers in value).

But before you file on this basis, you'd better make sure you can back up your claim that you're in the "investment business." ▼

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