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Tax-loss selling could save you money

Do you have investments in a non-registered account that have dropped in value? It may make sense to remove some of the sting – by using a strategy called tax-loss selling.

Tax-loss selling involves selling securities with accrued capital losses before the end of the year. The capital losses would first be applied against any realized capital gains in 2015, thus reducing your 2015 tax bill, and to the extent the capital losses exceed capital gains in 2015, they could be carried back to a previous year to trigger a refund.

Is tax-loss selling appropriate for you?

Here are seven key points to consider:

Any decision to sell a security should be driven by investment considerations – not merely the desire to eliminate or reduce taxes. Just because an asset has declined in value doesn't mean it is no longer an appropriate investment for your needs. Consider how long it may be before the investment might rebound and, if you plan to repurchase it, keep in mind transaction costs and the risk that it will increase in value before repurchase.

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Determine whether you can actually benefit from the tax-loss selling strategy. Tax-loss selling only provides tax savings if you otherwise expect to have overall capital gains for 2015, or have reported taxable capital gains on your 2012, 2013 or 2014 tax returns. If you have no realized capital gains, any 2015 capital losses can be carried forward indefinitely to offset future capital gains.

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Keep the superficial loss rules in mind. You should consider the superficial and denied loss provisions of Canada's Income Tax Act, which were implemented to prevent the recognition of artificial capital losses. If you sell an investment, you or an affiliated entity (such as your RRSP, your spouse, and your spouse's RRSP) cannot purchase the identical investment 30 days prior, or 30 days following, your disposition.

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Tax-loss selling could save you money *cont'd*

Can your spouse benefit from your loss? If you have capital losses but no capital gains against which to apply those capital losses, you might be able to transfer unrealized capital losses (losses still on paper) to your spouse. You would trigger a capital loss by selling a security that has dropped in value, and your spouse would then acquire the identical security on the open market – within 30 days of your sale. This would cause your capital loss to be deferred because of the superficial loss rules. The deferred loss would be added to the adjusted cost base of the investment acquired by your spouse. Your spouse can sell the same investment (after the 30th day from the date of your sale) and realize a capital loss that he or she may be able to use. This is an effective tax planning tool where one spouse has reported capital gains and the other has not.

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Corporate class shares may allow you to generate a tax benefit while remaining fully invested. Switching from a United Financial mutual fund to the equivalent United Corporate Class fund may create a capital loss that you can use to offset capital gains. At the same time, you would continue to hold a similar investment which would be consistent with your Investment Policy Statement.

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Thursday, December 24, 2015 is the last day to execute a trade on a Canadian stock exchange that would settle in 2015. If you make a trade after that, it would settle in 2016 – too late to be of use as tax-loss selling for the 2015 tax year.

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Proceeds from tax-loss selling can be rolled into your tax-free savings account. The tax-free savings account (TFSA) is available to Canadians aged 18 and older. TFSAs are an ideal home for proceeds generated from tax-loss selling because investments within these accounts grow tax-free and no tax is payable when the securities are withdrawn. TFSA-eligible investments include stocks, mutual fund units, pool units, corporate class shares, segregated funds and bonds. To avoid having the capital losses denied, you must comply with the superficial loss rules.

Tax-loss selling is an established strategy that could reduce your taxes. Please consult with your Assante Wealth Management advisor to determine whether you can benefit.

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