Getting the most out of Capital Losses

Do you have unrealized capital losses?
If you do…read this before selling!

In order to maximize the tax refund that can be realized from crystallizing capital losses, consider 'transferring' your losses to your spouse (or common law partner).

This strategy should be followed if your spouse:

- is in a higher marginal tax bracket than you or,
- has net capital gains from the past three years (2000, 2001 or 2002).

How does this work

In order for your spouse to be able to claim your capital loss you will need to sell your spouse your shares at today's market value. Because of the superficial loss rules, your loss will be denied for tax purposes. However, your loss will be added to your spouses cost base. As a result, you have effectively transferred your loss to your spouse. Please note your spouse must hold the shares for 30 days prior to selling the shares in the open market in order for their loss not to be denied for tax purposes.

Here is an example

Jane and Rob Smith are in the same marginal tax bracket. Currently, Jane Smith owns shares with a cost base of $20,000, and a current market value of $12,000. Rob Smith, has capital gains from the year 2000 which could be offset however, he does not have capital losses in the current year. Jane sells her shares to her husband Rob for $12,000. Jane is not able to claim her capital loss of $8,000 ($20,000 cost base less the $12,000 current market value) because the tax rules known as superficial loss rules, deny the loss as her husband now owns the shares and 30 days have not passed. However, Jane's denied loss is added to Rob's cost base for tax purposes. Therefore, Rob's adjusted cost base is $20,000 (the $12,000 that he paid for the shares plus the $8,000 superficial loss that was denied to Jane). After 30 days, Ron sells the shares in the open market for $12,500. His loss for tax purposes would be$7,500 ($20,000 cost base less the $12,500 current market value). This loss can now be used to offset his capital gains for this year or can be carried back to any of the three prior years.

As with all tax strategies, it is important to consult with your own tax advisor before implementing this strategy however, this is a very simple yet effective tool to reduce your families tax liability.

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