

Summarizing the Tax-Loss Selling Rules and Opportunities in Equities, Preferred Shares and ETFs

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Tax-loss selling is a strategy whereby investments that have declined in value are sold to generate a capital loss for tax purposes, in order to offset realized capital gains in a taxable account. This report – from the BMO Nesbitt Burns Portfolio Advisory Team – summarizes the benefits and rules of tax-loss selling, and outlines specific opportunities for generating a capital loss, as well as reinvesting the proceeds from a tax-loss sale.

Over the past year, some stocks have performed exceptionally well, while others have declined in value. As such, year-end is a good time for investors to consider:

1. Taking profits in stocks that have done well.
2. Generating offsetting tax-losses in stocks that have not performed.
3. Redeploying the proceeds to new investments that may offer better opportunities.

The amount of capital gains subject to tax in a taxation year is based on the calculation of net capital gains, which is the sum of all capital gains less all capital losses realized in the year. To the extent that a net capital loss is realized in a given year, it can be accumulated and carried back up to three tax years (i.e., to the 2013 tax year for a net loss realized in 2016) or carried forward indefinitely and applied against future capital gains. A capital loss that is carried back

can reduce income taxes payable in that year, which could result in a refund of taxes already paid. Since October 18, 2000, the inclusion rate of capital gains and losses has been 50%. It's important to note that capital losses cannot be used to offset other income (except when realized in the year of death).

For example, a stock with a tax cost base of \$100 is sold for \$30. This results in a \$70 capital loss, which may be used to offset capital gains. The maximum tax benefit on this \$70 capital loss, for an Ontario resident in the top marginal tax bracket in 2016, equals \$18.74 and it is derived as follows:

- $\$70 \text{ capital loss} \times 0.5 \text{ (taxable portion)} \times 0.5353 \text{ (Ontario's top marginal tax rate)} = \$18.74 \text{ per share in potential tax savings}$

Tax-loss selling rules

Before considering this strategy, it is important to understand the relevant tax rules, including the need to determine the adjusted cost base (ACB) of the security being sold for tax purposes, which will often be different from the original purchase price. Changes to the purchase price can result from corporate re-organizations, tax elections and distributions (such as a return of capital), or the requirement to calculate a weighted average cost for identical securities held in all taxable accounts.

In addition, it is important to be aware of the “superficial loss” rule, which may deny a capital loss realized on a sale or disposition of an investment property. The superficial loss rule generally applies if:

- i. During the period that begins 30 days before the disposition and ends 30 days after the disposition, you (or any person or entity considered to be affiliated with you for tax purposes) acquired the same or identical property; and,
- ii. At the end of the period you (or an affiliated person or entity) owned or had a right to acquire the same or identical property. In general, identical properties are the same in all material respects, such that a prospective buyer would be indifferent between purchasing either security. Identical properties would include shares that have the same interests, rights and privileges, but it isn’t always clear, so a complete review of the specific attributes of the securities (or consultation with a tax professional) is often necessary to make this determination.

An affiliated entity includes (among other entities): the individual; his/her TFSA, RRSP or RRIF; his/her spouse; his/her spouse’s TFSA, RRSP or RRIF; or a corporation that he/she and/or his/her spouse controls.

If an individual incurs a superficial loss, the loss will be denied and thus cannot be used in the current tax year. However, the loss that was denied will be added to the cost base of the substituted property (re)purchased and held by the affiliated entity. This will either decrease a future capital gain or increase a future loss when the substituted property is later sold by a taxable entity.

Corporate investors may have a tax year-end other than the calendar year-end, but should be aware of similar rules as the superficial loss rules for individuals, which will deny and “suspend” the capital loss in the corporation. Corporate investors should also take note of another “stop-loss” provision that can deny a capital loss where a dividend was received by the corporation on a share prior to the sale of the share at a loss, unless the corporate investor held the share for at least 365 days and did not own more than 5% of any share class in the dividend-paying company.

In considering any tax-loss selling strategy, it is important to focus on the appropriate investment decisions, instead of undertaking transactions solely for the potential tax benefits. To determine the particular tax implications and any planning available in their particular situation, investors should consult with their tax advisor.

Equities – Tax-loss selling opportunities

The BMO Nesbitt Burns Portfolio Advisory Team suggests the following stocks could be considered for a tax-loss sale, should a client own these in their portfolio:

1. Avigilon (AVO-T)
2. Cameco (CCO-T)
3. CF Industries (CF-US)
4. CI Financial (CIX-T)
5. Empire (EMPA-T)
6. Gildan (GIL-US; GIL-T)
7. Gilead Sciences (GILD-US)
8. Kroger (KR-US)
9. Valero (VLO-US)
10. Wells Fargo (WFC-US)

Investors looking for additional tax-loss selling ideas, have further questions regarding these specific recommendations, or tax-loss selling in general, please contact your BMO Nesbitt Burns Investment Advisor. For specific tax advice, please speak to your professional tax advisor.

Preferred shares – Tax-loss selling opportunities

Market prices of preferred shares recovered in 2016 and the BMO Capital Markets 50 Index Total Return was up 5.84% year-to-date as of October 31, 2016. However, not all issues have increased as investors have been re-evaluating their exposure to the preferred share market following relatively weak performance in 2015.

The Bank of Canada (BoC) has held interest rates steady for 2016, while BoC Governor, Stephen Poloz, discussed the possibility of adding further monetary stimulus. It is unlikely that the BoC would be in a position to raise interest rates in the near future, with BMO Capital Markets expecting the earliest raise in January 2018. During 2016, yields of 5-year government bonds have been volatile (between 0.57% to 0.88%), and are currently at 0.88%, approximately 0.15% higher than compared to the beginning of the year.

Compared to the difficult preferred market of 2015, preferred shares have seen some buying interest and new issues are attracting investors, with increasing participation from institutional investors. One of the largest new issues (ever) in 2016 was TD.PF.H from TD Bank (a \$1 billion preferred issue). And since late last year, issues with an interest rate floor have been a very attractive investment opportunity (banks are not allowed to have minimum yields).

Selling a preferred share that is down significantly in price, and using the loss to offset gains on other investments is a good way to benefit from a tax perspective. Since some preferred shares are under pressure to some degree, holders can sell one issue and reinvest the proceeds in a different issue with more attractive characteristics, helping to upgrade the portfolio. The table on the following page highlights selected rate-reset preferred shares to consider for a tax-loss sale this year.

BMO Capital Markets expects the BoC overnight interest rates to remain low for at least another year, and possibly longer. In a recent report, BMO Capital Markets Economics forecast flat interest rates in the five-year Government of Canada bond yield and that it will reach approximately 0.9% by the end of 2017.

Different strategies are available to income-oriented investors wishing to take a tax-loss. Some investors find it easier to access the preferred share market with the help of professional management rather than “cherry picking” individual issues. Those investors are exchanging their individual holdings for an actively managed mutual fund or Exchange-Traded Fund (ETF).

Investors who enjoy the relatively high yield and tax efficiency that preferred shares offer, but who demand liquidity and growth potential, are using their sale proceeds to add to their holdings of high dividend yielding stocks. Alternatively, income-oriented investors who are more concerned with capital preservation than high yield are turning their attention to traditional debt securities for the fixed income component of their portfolio.

The Portfolio Advisory Team believes that the best way to enhance returns and minimize risk is to build a portfolio that is well diversified with quality income investments. For example, we advocate holding a blend of investment-grade bonds and debentures, high-yielding blue chip common equities, high quality preferred shares or funds, and/or principal protected notes. We encourage clients to meet with their BMO Nesbitt Burns Investment Advisor to discuss tax-loss selling opportunities and the different types of investments that meet their specific goals and risk tolerance.

Rate-reset preferred shares: Select tax-loss selling candidates

Share description	Symbol	Closing price November 10, 2016	Price change since December 31, 2015
Power Financial 4.20%	PWF.PR.T	\$20.13	-15.0%
Brookfield Office Float	BPO.PR.X	\$9.30	-10.5%
Manulife Financial 3.80%	MFC.PR.K	\$18.72	-10.5%
Capstone Infrastructure 3.27%	CSE.PR.A	\$11.65	-10.4%
Brookfield Asset Man. 4.50%	BAM.PR.T	\$16.48	-10.2%
Power Financial Float	PWF.PR.A	\$11.71	-9.9%
Manulife Financial 4.40%	MFC.PR.I	\$21.52	-8.9%
Sun Life Financial. 2.84%	SLF.PR.H	\$17.34	-8.7%
Brookfield Asset Man. Float	BAM.PF.B	\$10.62	-8.7%
Brookfield Asset Man. 4.80%	BAM.PR.Z	\$20.14	-8.3%
Manulife Financial 2.18%	MFC.PR.F	\$13.79	-8.2%
Brookfield Asset Man. 4.60%	BAM.PR.X	\$14.98	-7.9%
Brookfield Asset Man. 4.60%	BAM.PF.A	\$14.98	-7.7%
Manulife Financial 4.00%	MFC.PR.J	\$20.47	-7.6%
Bank of Montreal 1.81%	BMO.PR.Q	\$20.45	-7.7%
Aimia 6.25%	AIM.PR.C	\$15.09	-7.5%
Manulife Financial 3.90%	MFC.PR.M	\$19.84	-7.5%
Sun Life Financial Float	SLF.PR.J	\$13.15	-7.3%
Power Financial 2.31%	PWF.PR.P	\$13.70	-7.3%
Sun Life Financial 4.25%	SLF.PR.I	\$20.27	-6.9%

Source: BMO Nesbitt Burns Portfolio Advisory Team, November 10, 2016.

Selected income recommendations

Preferred share funds and ETFs

Preferred share funds and ETFs offer investors an alternative to choosing individual preferred shares, and help diversify risk. Certain actively managed funds have the advantage of being able to purchase issues with attractive attributes that exist outside of the Canadian market.

Preferred share fund / ETF	Series / Symbol	NAV as of 31-Oct-16	Annualized distribution yield	Total return year-to-date as of 31-Oct-16	Management style	Exposure	Management Expense Ratio (MER)
Dynamic Preferred Yield Class	Series F	\$8.57	5.1%	4.75%	Active	Diversified	0.95%
Dynamic Preferred Yield Class	Series A	\$8.55	4.2%	4.03%	Active	Diversified	1.81%
Horizons Active	HPR	\$8.48	4.3%	5.42%	Active	Diversified	0.64%
BMO S&P/TSX Laddered Preferred ETF	ZPR	\$10.27	5.0%	1.53%	Passive	Rate-Resets	0.50%

Source: BMO Nesbitt Burns Portfolio Advisory Team, October 31, 2016.

Corporate debentures

Conventional debt instruments offer a fixed coupon and a known maturity date and value. These attributes are important to conservative income investors.

Description	Maturity date	Approximate price as of 10-Nov-16	Yield	Credit rating DBRS/ S&P
Bank of Nova Scotia FF NVCC 3.367%	December 8, 2020	\$102.27	2.772%	BBB+/ A(L)
CIBC FF NVCC 3.42%	January 26, 2026	\$102.32	2.829%	BBB/A(L)
Laurentian Bank Senior 2.75%	April 22, 2021	\$102.02	2.268%	BBB/A(L)
Royal Bank FF NVCC 3.45%	September 29, 2026	\$102.19	2.963%	A-/A(L)
Westcoast Energy 3.883%	October 28, 2021	\$107.70	2.23%	BBB/A(L)
Telus 2.35%	March 28, 2022	\$100.50	2.25%	BBB+/BBB(H)
Sunlife FF 3.05%	September 19, 2028	\$100.33	2.996%	BBB+/A(L)
Citigroup 4.09% (Maple Bond)	June 9, 2025	\$102.70	3.719%	BBB/A-
Bell 2.90%	August 12, 2026	\$98.25	3.109%	BBB+/BBB(H)
TD Bank FF NVCC 4.859%	March 4 2031	\$110.36	3.541%	A-/A(L)

Source: BMO Nesbitt Burns Portfolio Advisory Team, November 10, 2016.

Blue chip common equities

Common equities with a relatively high dividend offer an attractive yield that, in many cases, is comparable to the yield on a preferred share. Common shares also offer tax efficiency, dividend growth potential and good liquidity. Investors who are willing and able to add to the equity component of their investment portfolio will find many attractive choices in this sector. The table below highlights some of the holdings in the Portfolio Advisory Team's Dividend and Income Guided Portfolio.

Common shares	Symbol	Closing price 10-Nov-16	Dividend	Yield	Target price forecast
Home Depot	HD	US\$129.03	\$2.76	2.06%	US\$148.00
Bank of Montreal	BMO	\$86.17	\$3.99	4.00%	\$90.00
BCE	BCE	\$57.69	\$4.73	4.60%	\$64.00
Suncor	SU	\$40.09	\$2.89	2.90%	\$45.00
Johnson & Johnson	JNJ	US\$119.54	\$2.68	2.70%	US\$132.00

Source: BMO Nesbitt Burns Portfolio Advisory Team, November 10, 2016.

Principal protected notes

Principal protected notes are a structured investment that offer exposure to the price performance of a basket of common shares or stock indices, plus principal protection at maturity. The notes will generate a positive return if the average return on the underlying stocks or index is positive. If the return is negative, an investor's principal will be returned at maturity, and this return of principal is guaranteed by a major Canadian bank. Principal protected notes are available on an ongoing basis. Contact your BMO Nesbitt Burns Investment Advisor for more information on available notes.

ETFs – Tax-loss selling opportunities

ETF assets in Canada have grown rapidly over the years and at the end of October 2016 assets stood at \$108 billion. The Canadian ETF market continues to grow with over 600 ETF products listed in Canada through 18 ETF providers. BMO Global Asset Management Inc. offers 72 different ETFs that provide a range of exposures that include broad markets, asset classes, targeted and strategy-specific exposures. This broad and diverse product suite gives investors more efficiency when executing their tax-loss strategy. Investors should consult with their own tax advisor before executing an ETF tax-loss strategy.

The following are the Portfolio Advisory Team's suggested BMO ETFs for tax-loss selling.⁽ⁱ⁾

BMO ETFs for Canadian equity tax-loss selling strategies⁽ⁱⁱ⁾

Ticker	Name	YTD Return (as of Oct. 28, 2016)	BMO ETF	Ticker
VRX	Valeant Pharmaceuticals International	-80.4%	BMO Equal Weight U.S. Health Care Hedged to CAD ETF	ZUH
CCO	Cameco Corp.	-37.8%	BMO S&P/TSX Capped Composite Index ETF	ZCN
JE	Just Energy Group Inc.	-27.9%	BMO Equal Weight Utilities Index ETF	ZUT
EMP/A	Empire Co Ltd.	-26.0%	BMO Low Volatility Canadian Equity ETF	ZLB
BB	BlackBerry Ltd.	-25.9%	BMO S&P/TSX Capped Composite Index ETF	ZCN
STN	Stantec Inc.	-13.9%	BMO S&P/TSX Equal Weight Industrials Index ETF	ZIN
MDA	MacDonald Dettwiler & Associates Ltd.	-8.3%	BMO S&P/TSX Equal Weight Industrials Index ETF	ZIN
AX-U	Artis Real Estate Investment Trust	-8.3%	BMO Equal Weight REITs Index ETF	ZRE

Source: BMO Nesbitt Burns Portfolio Advisory Team, October 28, 2016.

BMO ETFs for U.S. equity tax-loss selling strategies⁽ⁱⁱ⁾

For tax-loss selling, investors need to consider the returns in Canadian dollars.

Ticker	Name	YTD Return (as of Oct. 28, 2016)	BMO ETF	Ticker
AGN	Allergan plc	-31.7%	BMO Equal Weight U.S. Health Care Hedged to CAD Index ETF	ZUH
GILD	Gilead Sciences Inc.	-27.0%	BMO Equal Weight U.S. Health Care Hedged to CAD Index ETF	ZUH
BMJ	Bristol-Myers Squibb Co.	-25.9%	BMO Equal Weight U.S. Health Care Hedged to CAD Index ETF	ZUH
F	Ford Motor Co.	-16.8%	BMO S&P 500 Index ETF	ZSP
NKE	NIKE Inc.	-16.8%	BMO Dow Jones Industrial Average Hedged to CAD Index ETF	ZDJ
WFC	Wells Fargo & Co.	-15.0%	BMO Equal Weight U.S. Banks Hedged to CAD Index ETF	ZUB
CVS	CVS Health Corp.	-14.7%	BMO Low Volatility US Equity ETF	ZLU
ABT	Abbott Laboratories	-12.0%	BMO Equal Weight U.S. Health Care Hedged to CAD Index ETF	ZUH
LLY	Eli Lilly & Co.	-11.5%	BMO Equal Weight U.S. Health Care Hedged to CAD Index ETF	ZUH
DIS	The Walt Disney Co.	-10.7%	BMO Dow Jones Industrial Average Hedged to CAD Index ETF	ZDJ
AMGN	Amgen Inc.	-10.6%	BMO Equal Weight U.S. Health Care Hedged to CAD Index ETF	ZUH
KMB	Kimberly-Clark Corp.	-10.0%	BMO Low Volatility US Equity ETF	ZLU
COST	Costco Wholesale Corp.	-7.3%	BMO Low Volatility US Equity ETF	ZLU

Note that some of the BMO ETFs recommended are currency hedged, whereas the underlying securities are not.

Source: BMO Nesbitt Burns Portfolio Advisory Team, October 28, 2016.

Tax-loss selling questions

When considering any tax-loss selling strategy, it is important to remember to focus on the appropriate investment decisions, instead of undertaking transactions solely for the potential tax benefits. Therefore, if you have further questions regarding any of the information in this report, please contact your BMO Nesbitt Burns Investment Advisor. For specific tax advice or to determine the particular tax implications when executing any tax strategy, investors should consult with their professional tax advisor.

Footnotes:

⁽ⁱ⁾ Please note the above tables are used for illustrative purposes only, where losses are calculated based on year-to-date. For tax purposes, capital losses are based on the difference between price sold and book value.

⁽ⁱⁱ⁾ Please note the above considerations are based on realizing the loss on the stocks in a tax loss harvesting strategy, rather than recommendation on the future performance of the security.



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