Consider Tax-Loss Selling in Your Year-End Planning

As the end of the year approaches, it's a good idea to review your investment portfolio in order to consider possible rebalancing opportunities. In conjunction with this review, if it makes sense to sell an under-performing security from an investment perspective, you may want to consider the possibility of engaging in a 'tax-loss selling' strategy before the end of the year to reduce your overall tax liability, or to receive a refund of taxes paid in a previous year.

With a tax-loss selling strategy, investments that have declined in value are sold in order to generate a capital loss for tax purposes which can be used to offset capital gains already generated during the year. Alternatively, an aggregate net capital loss in the current year can be carried back and applied against net capital gains realized in the three preceding years, or carried forward for use in a future year.

The amount of capital gains subject to tax each 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. Therefore, to the extent that an investor realizes capital losses in the same taxation year that a significant capital gain is triggered, the tax liability on the capital gain can be reduced (or eliminated).

Therefore, as the end of the year approaches, it may be worthwhile to review your portfolio with your BMO financial professional to consider the sale of certain investments with unrealized losses, provided a sale makes sense from an investment perspective.

Considerations before implementing a tax-loss selling strategy

Before implementing a tax-loss selling strategy, consider the following:

1. Losses can be applied to current or previous year's gains

Since capital losses can be applied in the current year and any unapplied net capital losses can be carried back for up to three years, you should review your 2016 capital gains and losses realized to-date and review your tax returns from 2013, 2014 and 2015 to determine if you reported net capital gains in any of these years. If so, check with your tax advisor to understand the possible tax benefit of applying any net capital losses to offset these gains.

2. Foreign currencies

Remember that capital gains or losses on foreign securities denominated in another currency are calculated in Canadian dollars. The foreign exchange rate at the time of purchase is used in the calculation of the tax cost base and the foreign exchange rate at the time of sale is used to calculate the proceeds on the sale. Therefore, fluctuations in the foreign currency relative to the Canadian dollar over the period of ownership will also factor into the analysis.

3. Confirm tax cost base of the security

Speak to your accountant or other tax advisor to confirm the actual tax cost base of your investments. The tax cost will often be different from the original purchase price as a result of corporate re-organizations, tax elections, distributions such as return of capital, or the requirement to calculate a weighted-average cost for tax purposes of a security that is held across more than one non-registered account.

4. Be aware of the superficial loss rule

The superficial loss rule within the Canadian tax legislation may deny a capital loss realized on a sale or disposition of an investment. The rule generally applies if:

i. During the period that begins 30 days before the sale and ends 30 days after the sale, you – or any person or entity considered to be affiliated with you for tax purposes – acquired the same or identical security, and

ii. At the end of the period, you – or an affiliated person or entity – owned or had the right to acquire the same or identical security.

Corporate investors should be aware of similar rules as the superficial loss rule for individuals, that 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 365 days and did not own more than 5% of any share class in the dividend-paying company.

5. Pay attention to the settlement date

Since it is the settlement date of the trade which is relevant for tax purposes (i.e., it generally takes three business days from the trade date for an equity trade to settle), ensure that there is sufficient time remaining after the trade date to allow the transaction to settle in 2016. The last day to make an (Canadian) equity trade that settles in 2016 is expected to be December 23, 2016.

Seek professional advice

Be sure to consult with your tax advisor prior to implementing a tax-loss selling strategy to ensure that it is appropriate for your situation and is implemented properly.

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Please contact your BMO financial professional if you have any questions about tax-loss selling in your BMO investment account.

BMO Wealth Management

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