

MAKE UP FOR THE CRASH WITH TAX-LOSS SELLING

NEW TAX FREE SAVINGS PLAN A GOOD PLACE TO PUT YOUR MONEY

By John Chevreau

Financial Post, December 11, 2008

With two weeks to go till we put the boots to 2008, there are several new year-end tax considerations this year that will help defray your tax liability next April.

With two weeks to go till we put the boots to 2008, there are several new year-end tax considerations this year that will help defray your tax liability next April.

The two big ones are tax-loss selling and the upcoming tax-free savings accounts. TFSAs don't come into play until the new year, although you can pre-open accounts now. Couples with a spare \$10,000 lying around should be thinking of earmarking the cash for TFSAs. Given the shaky economy and job security, cash in a high-yield daily interest savings account could grow tax-free and be available as an emergency account.

Where to get that cash? Enter tax-loss selling. The Crash of 2008 has created losses for investors in most asset classes. But unlike such items as charitable gifts, medical expenses and RRSP contributions, you can't wait until Dec. 31 to trigger tax losses in losing security positions. You must sell positions by Wednesday, Dec. 24, to allow time for trades to settle before year-end.

Tax-loss selling does not apply to registered accounts, such as TFSAs or RRIFs. If you have paper losses, there is no way to recoup the lost contribution room and you may as well let it ride and hope markets recover in the next year or two.

But the pain of paper losses in taxable accounts can be alleviated by converting them to actual losses, a gambit that may get you some money back from the taxman on capital gains taxes paid in previous years.

Sandy Cardy, senior vice-president, tax and estate planning for Mackenzie Financial Corp., says this doesn't mean you should abandon your long-term investment plan. "It's just that the tax system can offer some relief if you're disciplined. But you need to know the rules."

The main one is the superficial loss rule. If you want to stay invested, you can't just sell Stock X, declare a loss and repurchase it a day later. (You can sell it at a gain and repurchase right away, but not with a loss.) The Canada Revenue Agency would disallow your tax loss on the grounds it was a "superficial" loss. The rule is you must wait 31 days before repurchasing the identical security.

However, if you're worried the market may jump higher in that time, you can buy something similar. For example, you could sell Bank Stock A and book a loss, and immediately purchase Bank Stock B without waiting the 31 days. Similarly, mutual fund or ETF investors could sell a particular fund and buy a similar one covering the same asset class. Investors may also

sell a mutual fund and repurchase the identical one, as long as they switch between a trust structure and capital class structure.

Consider, too, rules on “in-kind” contributions to RRSPs (or to TFSAs in the new year). In past years, people who were cash poor at this time of year sometimes could make their annual RRSP contribution with in-kind contributions of securities from non-registered plans. This had the effect in good years of crystallizing non-registered capital gains.

But Cardy warns against doing so if you have unrealized losses. The CRA will deny the loss if you try to transfer the security directly to your RRSP. Instead, you must sell the losing security first, booking the loss, then contribute the cash to the RRSP.

You can also donate securities in kind to charity. Normally, you do this to eliminate capital gains tax on profits from a security. Cardy says you can also claim a capital loss on in-kind donations, despite a misconception that you can't.

Another new wrinkle in 2008 is taxable withdrawals by seniors from their registered retirement income funds (RRIFs). The government recently announced a one-time reduction of the minimum withdrawal amount by 25% to accommodate those who incurred sizeable losses from the stock market.

However, Cardy says not all financial institutions are making it easy for seniors to withdraw less than the legislated minimum. Seniors shouldn't worry, though. Cardy says they can withdraw the full amount

previously legislated, then contribute the extra 25% next year before March 1. This will also lower the 2009 minimum amount based on the fair market value of the RRIF on Jan. 1, 2009.

KPMG national tax partner Paul Hickey warns the CRA has been cracking down on RRSP overcontributions in recent years. So, in your zeal to maximize RRSP contributions, don't exceed the \$2,000 overcontribution limit. In any case, unless you turned 71 in 2008, you have till the end of February to reach your 2008 contribution limit.

Finally, while labour-sponsored investment funds are being phased out, you can still get full tax credits on them in 2008 and 2009. According to John Varghese, managing partner at VentureLink Funds, the funds still qualify for a 15% federal grant on a \$5,000 purchase, while some provinces, such as Ontario, offer 15% or 20% tax credits on LSIFs on a \$7,500 purchase. The combined credits on a research-oriented investment fund (ROIF) qualifying for a special 20% provincial tax credit come to a hefty \$2,250, or \$4,500 if a couple each invested \$7,500 in something like VentureLink Brighter Future Fund. Those doing tax-loss selling might deploy the freed-up capital to an LSIF and reap a double tax harvest.

VentureLink LP

One Richmond Street W., Suite 701
Toronto, Ontario M5H 3W4
www.venturelinkfunds.com

Phone 416 681 6676
Toll Free 800 253 1043
Fax 416 681 6661