Capital Gains

Includes Form T2017

2001

T4037(E) Rev. 01

Before you start

Is this guide for you?

Use this guide to get information on capital gains or capital losses in 2001. You generally have a capital gain or loss whenever you sell, or are considered to have sold, capital property. Capital property is defined on page 6. Use Schedule 3, *Capital Gains (or Losses) in 2001*, to calculate and report your taxable capital gains or allowable capital losses.

You can get Schedule 3 from your tax services office, from our Web site, or by picking up the *T1 General – Forms* book from any postal outlet.

If your only capital gains or losses are those shown on information slips (T3, T4(PS), T5, or T5013), and you did not file Form T664 or T664(Seniors), *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*, you do not have to read the entire guide. See "Chart 1 – Reporting capital gains (or losses) and other amounts from information slips" on page 19 to find out how to report these amounts.

If you sell the units, shares, or securities for which you were issued an information slip, you will have to report a capital gain or loss. See "Mutual fund units and other shares including publicly traded shares" on page 13.

If you are a farmer and you sell eligible capital property that is qualified farm property or farmland in 2001 that includes your principal residence, see the *Farming Income* or the *Farming Income and NISA* guide.

If you are a non-resident, emigrant, or new resident of Canada, you should see whichever one of the following guides applies to your situation:

- *Newcomers to Canada*
- *Emigrants and Income Tax*
- *Non-Residents and Income Tax*

We explain the most common income tax situations in this guide. If you need help after reading this guide, please contact your tax services office toll free at 1-800-959-8281. Our addresses and telephone numbers are listed in the government section of your telephone book and on the "Contact us" page of our Web site.

Forms and publications

In the middle of this guide, you will find two copies of Form T2017, *Summary of Reserves on Dispositions of Capital Property*, that you may have to complete. Throughout the guide, we also refer to other forms and publications. If you need any forms or publications, you can order them by mail, by calling 1-800-959-2221 toll free, or by visiting your local tax services office.

Internet

Most of our publications are available on our Web site at **www.ccra.gc.ca**

What's new for 2001?

Inclusion rate – For dispositions of capital property in 2001, the inclusion rate is 1/2. This rate was announced in the October 18, 2000, economic statement. For more details, see "Inclusion rate" on page 10.

T3 slip reporting – Capital gains and losses reported on a T3 slip are now to be entered on line 176 of Schedule 3, *Capital Gains (or Losses) in 2001.* For more information on where to report capital gains or losses from information slips, see "Chart 1 – Reporting capital gains (or losses) and other amounts from information slips" on page 19.

Spouse – Throughout this guide, references to "spouse" have been revised. You will find the definitions of **spouse** and **common-law partner** on page 8.

Visually impaired persons can order publications in braille or large print, and on audio cassette or computer diskette, by calling **1-800-267-1267** weekdays from 8:15 a.m. to 5:00 p.m. (Eastern Time).

La version française de cette publication est intitulée *Gains en capital*.

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Glossary

This glossary describes, in a general way, technical terms that we use in this guide. Whenever practical, we define technical terms in detail in the applicable chapters.

Note
Throughout this guide, we use the terms **sell**, **sold**, **buy**, and **bought** to describe most capital transactions. However, the information in this guide also applies to other dispositions or acquisitions, such as when you give or receive a gift. When reading this guide, you can substitute the terms **disposed of** or **acquired** for **sold** or **bought**, if they more accurately describe your situation.

Acronyms – The following is a list of some of the acronyms that we use in this guide:

ABIL – Allowable business investment loss
ACB – Adjusted cost base
CCA – Capital cost allowance
CNIL – Cumulative net investment loss
FMV – Fair market value
LPP – Listed personal property
RFL – Restricted farm loss
UCC – Undepreciated capital cost

Adjusted cost base (ACB) – This is usually the cost of your property plus any expenses to acquire it, such as commissions and legal fees.

The cost of a capital property is its actual or deemed cost, depending on the type of property and how you acquired it. It also includes capital expenditures such as the cost of additions and improvements to the property. You cannot add current expenses, such as maintenance and repair costs, to the cost base of a property.

Allowable capital loss – Your allowable capital loss for a tax year is your capital loss for the year multiplied by the inclusion rate for that year.

Arm's length transaction – This is an expression used to describe a transaction between persons in which each one acts in his or her own self-interest. Related persons are not considered to deal with each other at arm's length. Related persons include individuals connected by a blood relationship, marriage or common-law partnership, or adoption (legal or in fact). Also, a corporation and a shareholder who controls the corporation are related.

Unrelated persons usually deal with each other at arm's length, although this might not be the case if, for example, one person is under the influence or control of the other.

Business investment loss – See "Allowable business investment loss (ABIL)" on page 37.

Canadian-controlled private corporation – A Canadian-controlled private corporation is a private corporation that is a Canadian corporation **other than**:

a) a corporation controlled directly or indirectly in any way by one or more non-resident persons, by one or more public corporations (other than a prescribed venture capital corporation), by one or more corporations described in paragraph (c), or by any combination of the above;

b) a corporation that would be controlled by one person if that one person owned all the shares of any corporation that are owned by any non-resident person, by any public corporation (other than a prescribed venture capital corporation), or by a corporation described in paragraph (c); or

c) a corporation, a class of the shares of capital stock of which is listed on a prescribed stock exchange.

Canadian security – A Canadian security is:

- a share of a corporation that is resident in Canada;
- a unit of a mutual fund trust; or
- a bond, debenture, bill, note, mortgage, or similar obligation, issued by a person resident in Canada.

Prescribed securities (defined on page 7) are not considered to be Canadian securities.

Capital cost allowance (CCA) – In the year you buy a "depreciable property" (defined on page 7), such as a building, you cannot deduct its full cost. However, since this type of property wears out or becomes obsolete over time, you can deduct its cost over a period of several years. The deduction for this is called "capital cost allowance." When talking about capital cost, a reference is often made to "class." You usually group depreciable properties into classes. You have to base your CCA claim on the rate assigned to each class of property.

Capital gain – You have a capital gain when you sell, or are considered to have sold, a capital property for **more** than the total of its adjusted cost base and the outlays and expenses related to the sale of the property. The term "outlays and expenses" is defined on page 7.

Capital loss – You have a capital loss when you sell, or are considered to have sold, a capital property for **less** than the total of its adjusted cost base and the outlays and expenses related to the sale of the property. The term "outlays and expenses" is defined on page 7.

Capital property – This includes depreciable property, and any property which, if sold, would result in a capital gain or a capital loss. You usually buy it for investment purposes or to earn income. Capital property does not include the trading assets of a business, such as inventory. Some common types of capital property include:

- cottages;
- securities, such as stocks, bonds, and units of a mutual fund trust; and
- land, buildings, and equipment you use in a business or a rental operation.

Common-law partner – See definition of "spouse" on page 8.

Deemed acquisition – This expression is used when you are considered to have acquired property, even though you did not actually buy it.

Deemed cost – This expression refers to the price of property you are considered to have acquired, even though you did not actually buy it.

Deemed disposition – This expression is used when you are considered to have disposed of property, even though you did not actually sell it.

Deemed proceeds of disposition – This expression is used when you are considered to have received an amount for having disposed of property, even though you did not actually receive the amount.

Depreciable property – This is usually capital property used to earn income from a business or property. The cost can be written off as CCA over a number of years.

Disposition (dispose of) – This is usually an event or transaction where you give up possession, control, and all other aspects of property ownership.

Eligible capital property – This is property that does not physically exist but gives you a lasting economic benefit. Examples of this kind of property are goodwill, customer lists, trademarks, and milk quotas.

Excepted gift – This is a gift of a share you made to someone (other than a private foundation) with whom you deal at arm's length. If the donee (that is, the recipient of the gift) is a charitable organization or public foundation, it will be an excepted gift if you deal at arm's length with each director, trustee, officer, and official of the donee.

Fair market value (FMV) – This is usually the highest dollar value you can get for your property in an open and unrestricted market, between a willing buyer and a willing seller who are acting independently of each other.

Flow-through entity – We explain this term in Chapter 4, beginning on page 28.

Listed personal property (LPP) – See "Listed personal property" on page 18.

Net capital loss – Generally, if your allowable capital losses are more than your taxable capital gains, the difference between the two is your net capital loss for the year.

Non-arm's length transaction – This is a transaction between persons who were not dealing with each other at arm's length at the time of the transaction.

Non-qualifying real property – Generally, non-qualifying real property is real property that you or your partnership disposed of after February 1992 and before 1996.

It also generally includes the following property you or your partnership disposed of after February 1992 and before 1996, if its fair market value is derived principally (more than 50%) from real property:

- a share of a capital stock of a corporation;
- an interest in a partnership;
- an interest in a trust; or
- an interest or an option in any property described above.

Non-qualifying security – Non-qualifying securities are securities you, or an individual's estate, donated to a "qualified donee" (defined on page 8). Non-qualifying securities include:

- a share of a corporation with which you do not deal at arm's length after the donation was made;
- an obligation of yours, or of any person or partnership with whom you do not deal at arm's length after the donation was made; or
- any other security issued by you, or by any person or partnership with whom you do not deal at arm's length after the donation was made.

The above excludes:

- shares, obligations, and other securities, listed on a prescribed stock exchange; and
- obligations of a financial institution to repay an amount deposited with the institution.

Outlays and expenses – These are amounts that you incurred to sell a capital property. You can deduct outlays and expenses from your "proceeds of disposition" (defined on this page) when calculating your capital gain or capital loss. You cannot reduce your other income by claiming a deduction for these outlays and expenses. These types of expenses include fixing-up expenses, finders' fees, commissions, brokers' fees, surveyors' fees, legal fees, transfer taxes, and advertising costs.

Personal-use property – This refers to items that you own primarily for the personal use or enjoyment of your family and yourself. It includes all personal and household items such as furniture, automobiles, boats, a cottage, and other similar properties.

Prescribed security – A prescribed security generally includes:

- a share of a corporation (other than a public corporation) whose value at the time you dispose of it, comes mainly from real estate, resource properties, or both;
- a bond, debenture, bill, note, mortgage, or similar obligation of a corporation (other than a public corporation) that you do not deal with at arm's length at any time before you dispose of the security; and
- a share, bond, debenture, bill, note, mortgage, or similar obligation you acquire from a person with whom you do not deal at arm's length.

A prescribed security is not considered to be a "Canadian security" (defined on page 6).

Proceeds of disposition – This is usually the amount you received or will receive for your property. In most cases, it refers to the sale price of the property. This could also include compensation you received for property that has been destroyed, expropriated, or stolen.

Public corporation – This is a corporation that is resident in Canada and:

- has a class of shares listed on a prescribed Canadian stock exchange; or
- is a corporation (other than a prescribed labour-sponsored venture capital corporation) that has elected, or has been designated by the Minister of

National Revenue, to be a public corporation. Also, at the time of the election or designation, the corporation complied with prescribed conditions concerning the number of its shareholders, the dispersal of ownership of its shares, and the public trading of its shares.

Qualified donee – A qualified donee includes:

- a registered Canadian charity;
- a registered Canadian amateur athletic association;
- a Canadian non-profit organization that exclusively provides low-cost housing for seniors;
- a Canadian municipality;
- the United Nations or an agency thereof;
- a prescribed university outside Canada;
- a charitable organization outside Canada to which the Government of Canada has made a donation in 2000 or 2001; and
- the Government of Canada, a province, or a territory.

Qualified farm property – See "Qualified farm property" on page 13.

Qualified small business corporation shares – See "Qualified small business corporation shares" on page 12.

Real property – This is property that cannot be moved, such as land or buildings. We commonly refer to such property as real estate.

Recapture – When you sell a depreciable property for less than its capital cost, but for more than the undepreciated capital cost (UCC) in its class, you do not have a capital gain. However, if there is a negative UCC balance at the end of the year, this balance is a recapture of capital cost allowance. You have to include this amount in income for that year.

Small business corporation – This is a Canadian-controlled private corporation in which all or most (90% or more) of the fair market value of its assets:

- are used mainly in an active business carried on primarily in Canada by the corporation or by a related corporation;
- are shares or debts of connected corporations that were small business corporations; or
- are a combination of these two types of assets.

Spouse – This applies only to a person to whom you are legally married.

A **common-law partner** is a person of the same or opposite sex with whom you live and have a relationship, but who is not your spouse. In addition, at least one of the following has to apply. He or she:

- is the natural or adoptive parent (legal or in fact) of your child;
- has been living and having a relationship with you for at least 12 continuous months; or
- lived with you previously as your spouse or common-law partner for at least 12 continuous months.

The above includes any period that you were separated from your common-law partner for less than 90 days because of a breakdown in your relationship.

Taxable capital gain – This is the portion of your capital gain that you have to report as income on your return.

If you realize a capital gain when you donate certain properties to a qualified donee (as defined earlier) other than a private foundation or make a donation of ecologically sensitive land, special rules will apply. For more information, see pages 10 and 28.

Terminal loss – This type of loss occurs when you have an undepreciated balance in a class of depreciable property at the end of the tax year or fiscal year, and you no longer own any property in that class. You can deduct the terminal loss when you calculate your income for the year.

Undepreciated capital cost (UCC) – Generally, UCC is equal to the total capital cost of all the properties of the class **minus** the capital cost allowance you claimed in previous years. If you sell depreciable property in a year, you also have to subtract from the UCC one of the following two amounts, **whichever is less**:

- the proceeds of disposition of the property (either actual or deemed), **minus** the related outlays and expenses; or
- the capital cost of the property.

Chapter 1 – General information

This chapter provides the general information you need to report a capital gain or capital loss.

Generally, when you dispose of a property and end up with a gain or a loss, it may be taxed in one of two ways:

- as a **capital** gain or loss (capital transaction); or
- as an **income** gain or loss (income transaction).

When you dispose of a property, you need to determine if the transaction is a capital transaction or an income transaction. The facts surrounding the transaction determine the nature of the gain or loss.

For more information on the difference between capital and income transactions, see the following Interpretation Bulletins:

IT-218 *Profit, Capital Gains and Losses From the Sale of Real Estate, Including Farmland and Inherited Land and Conversion of Real Estate From Capital Property to Inventory and Vice Versa*;

IT-459 *Adventure or Concern in the Nature of Trade*; and

IT-479 *Transactions in Securities*, and its Special Release.

For information on how to report income transactions, see the guide called *Business and Professional Income*.

When do you have a capital gain or a capital loss?

Usually, you have a capital gain or capital loss when you sell or are considered to have sold capital property. The following are examples of cases where you are considered to have sold capital property:

- you exchange one property for another;
- you give property (other than cash) as a gift;
- you convert shares or other securities in your name;
- you settle or cancel a debt owed to you;
- you transfer certain property to a trust;
- your property is expropriated;
- your property is stolen;
- your property is destroyed;
- an option that you hold to buy or sell property expires;
- a corporation redeems or cancels shares or other securities that you hold (you will usually be considered to have received a dividend, the amount of which will be shown on a T5 slip);
- you change all or part of the property's use (see "Changes in use" on page 41);
- you leave Canada (get the pamphlet called *Emigrants and Income Tax*); or
- the owner dies (get the guide called *Preparing Returns for Deceased Persons*).

Disposition of Canadian securities

If you dispose of Canadian securities, you may have an income gain or loss. However, in the year you dispose of Canadian securities, you can choose to report your gain or loss as a capital gain or loss. This is referred to as an "election." If you make this election for a tax year, we will consider every Canadian security you owned in that year and later years to be capital properties. A trader or dealer in securities (other than a mutual fund trust or a mutual fund corporation) or anyone who was a non-resident of Canada when the security was sold cannot make this election. Special transitional rules apply to mutual fund trusts and mutual fund corporations. For more information, call us.

If a partnership owns Canadian securities, each partner is treated as owning the security. When the partnership disposes of the security, each partner can elect to treat the security as capital property. An election by one partner will **not** result in each partner being treated as having made the election.

To make this election, complete Form T123, *Election on Disposition of Canadian Securities*, and attach it to your 2001 return. Once you make this election, you cannot reverse your decision.

Disposing of personal-use property (including your principal residence)

Most people are not affected by the capital gains rules because the property they own is for their personal use or enjoyment.

Personal-use property

When you sell personal-use property such as cars and boats, in most cases you do not end up with a capital gain. This is because this type of property usually does not increase in value over the years. As a result, you may end up with a loss. Although you have to report any gain on the sale of personal-use property, generally you are not allowed to claim a loss. For more information, see "Personal-use property" on page 18.

Principal residence

If you sell your home for more than what it cost you, you usually do not have to report the sale on your return or pay tax on any gain as long as:

- your home is your principal residence; and
- you or a member of your family did not designate any other house as a principal residence while you owned your home. For more information, see Chapter 6.

When do you report a capital gain or a capital loss?

Report the disposition of capital property in the calendar year (January to December) you sell, or are considered to have sold, the property.

> **Note**
> Regardless of whether or not the sale of a capital property results in a capital gain or a capital loss, you have to file a return to report the transaction (even if you do not have to pay tax). This rule also applies when you report the taxable part of any capital gains reserve you deducted in 2000.

Do you own a business?

If you own a business that has a fiscal year end other than December 31, you still report the sale of a capital property in the calendar year the sale takes place.

Example
Pauline owns a small business. The fiscal year end for her business is June 30, 2001. In August 2001, she sold a capital property that she used in her business. As a result of the sale, she had a capital gain. Pauline has to report the capital gain on her return for 2001. She does this even though the sale took place after her business' fiscal year end date of June 30.

Are you a member of a partnership?

If you are a member of a partnership, it is possible that your partnership has a fiscal year end other than December 31. If the partnership sells capital property during its fiscal year, you generally report your share of any capital gain or capital loss in the calendar year in which that fiscal year ends.

Inclusion rate

The inclusion rate for the year 2001 is 1/2. This means that you must multiply your capital gain for the year by this rate to determine your taxable capital gain. Similarly, you must multiply your capital loss for the year by 1/2 to determine your allowable capital loss.

Calculating your capital gain or capital loss

To calculate any capital gain or loss, you need to know the following three amounts:

- the proceeds of disposition;
- the adjusted cost base (ACB); and
- the outlays and expenses related to selling your property.

To calculate your capital gain or loss, subtract the total of your property's ACB and any outlays and expenses involved in selling your property, from the proceeds of disposition.

You have a capital gain when you sell, or are considered to have sold, a capital property for **more** than its ACB plus the outlays and expenses related to the sale of the property.

Example
In 2001, Jack sold 400 shares of XYZ Public Corporation of Canada for $6,500. He received the full proceeds at the time of the sale and paid a commission of $60. The adjusted cost base of the shares is $4,000. Jack calculates his capital gain as follows:

Proceeds of disposition				$ 6,500	**A**
Adjusted cost base	$ 4,000	**B**			
Outlays and expenses on disposition	+ 60	**C**			
Line B **plus** line C	= $ 4,060	▶	–	4,060	**D**
Capital gain, line A **minus** line D			=	$ 2,440	**E**

Because only 1/2 of the capital gain is taxable, Jack reports $1,220 as his taxable capital gain at line 127 on his return.

When you sell, or are considered to have sold, a capital property for **less** than its ACB plus the outlays and expenses involved in selling the property, you have a capital loss. You can deduct 1/2 of your capital losses against any taxable capital gains in the year. For more information on capital losses, see Chapter 5, beginning on page 30.

Use Schedule 3, *Capital Gains (or Losses) in 2001*, to calculate and report all your capital gains and losses. Do not include any capital gains or losses in your business or property income, even if you used the property for your business. For more information on how to complete Schedule 3, see Chapter 2, beginning on page 12.

Special rules may apply if you donate any of the following properties to a qualified donee (other than a private foundation):

- a share, debt obligation, or right listed on a prescribed stock exchange;
- a share of a mutual fund corporation;
- a unit of a mutual fund trust;
- an interest in a related segregated fund trust; and
- a prescribed debt obligation.

Use Form T1170, *Capital Gains on Gifts of Certain Capital Property*, if you donated these properties from February 19, 1997, to December 31, 2001, and you have a capital gain. Enter the amount you calculate on Schedule 3.

The taxable portion of the capital gain on donations that you include in income will be calculated by multiplying the capital gain by 1/4 (50% of the inclusion rate of 1/2).

This rate does not apply to capital losses you may have from such donations.

> **Note**
> Before 1972, capital gains were not taxed. Therefore, if you sold capital property in 2001 that you owned before 1972, you have to apply special rules when you calculate your capital gain or loss, to remove any capital gains accrued before 1972. We do not explain these rules in this guide. To calculate your gain or loss from selling property you owned before 1972, use Form T1105, *Supplementary Schedule for Dispositions of Capital Property Acquired Before 1972*.

What happens if you have a capital gain?

If you have a capital gain, you may be able to:

- defer part of the capital gain by claiming a reserve (see the next section);
- reduce or offset all or a part of the gain by claiming a capital gains deduction (see "Claiming a capital gains deduction" on page 11); or
- reduce or offset all or a part of the gain by claiming a capital gains reduction (applicable to flow-through entities). For more information, see Chapter 4, beginning on page 28.

Claiming a reserve

When you sell a capital property, you usually receive full payment at that time. However, sometimes you receive the amount over a number of years. For example, you may sell a capital property for $50,000 and receive $10,000 when you sell it and the remaining $40,000 over the next four years. When this happens, you can claim a reserve. Usually, a reserve allows you to report a portion of the capital gain in the year you receive the proceeds of disposition.

Who can claim a reserve?

Most people can claim a reserve when they dispose of a capital property. Generally, you **cannot** claim a reserve if you:

- were not a resident of Canada at the end of the tax year, or at any time in the following year;

- were exempt from paying tax at the end of the tax year, or at any time in the following year; or
- sold the capital property to a corporation that you control in any way.

How do you calculate and report a reserve?

If you claim a reserve, you still calculate your capital gain for the year as the proceeds of disposition **minus** the adjusted cost base and the outlays and expenses involved in selling the property. From this, you deduct the amount of your reserve for the year. What you end up with is the part of the capital gain that you have to report in the year of disposition.

To deduct a reserve in any year, you have to complete Form T2017, *Summary of Reserves on Dispositions of Capital Property*. The information provided on the back of Form T2017 explains the limits on the number of years for which you can claim a reserve and the amount of the reserve you can deduct. You will find two copies of this form in the middle of this guide.

If you claimed a reserve in the previous year, include that reserve in the calculation of your capital gains for the current year. For example, if you claimed a reserve in 2000, you have to include it in your capital gains calculation for 2001. Claim the new reserve that you have calculated for 2001 in the appropriate area on Form 2017. If you still have an amount that is payable to you after 2001, you may be able to calculate and claim a new reserve. However, you will have to include it in your capital gains calculation for 2002.

A capital gain from a reserve brought into income qualifies for the capital gains deduction **only** if the original capital gain was from a property eligible for the deduction. For more information, see the following section.

> **Note**
> You do not have to claim the maximum reserve in a tax year (Year A). However, the amount you claim in a later year (Year B) cannot be more than the amount you claimed for that property in the previous year (Year A).

Reserve for a gift of securities

If you donate a non-qualifying security (other than an excepted gift) to a qualified donee and have a capital gain, you may be able to claim a reserve in order to postpone the inclusion of the capital gain in income. For the definitions of "excepted gift," "non-qualifying security," and "qualified donee," see the Glossary which begins on page 6.

You can claim this reserve for any tax year ending within 60 months of the time you donated the security. However, you **cannot** claim a reserve if the donee disposes of the security, or if the security ceases to be a non-qualifying security before the end of the tax year. If this happens, you will be considered to have made a charitable donation in that year, and you can claim the charitable donation tax credit.

If the security is not disposed of within the 60-month period, you will not be required to bring the reserve back into income in the year following the end of that period.

To deduct this type of reserve, you have to complete Form T2017, *Summary of Reserves on Dispositions of Capital Property*.

Claiming a capital gains deduction

If you have a capital gain on the sale of certain properties, you may be eligible for the $250,000 capital gains deduction.

What is a capital gains deduction?

It is a deduction that you can claim against taxable capital gains you realized from the disposition of certain capital properties. You can reduce your taxable income by claiming this deduction.

Which capital gains are eligible for the capital gains deduction?

You may be able to claim the capital gains deduction on taxable capital gains you have in 2001 from:

- dispositions of qualified farm property after 1984;
- dispositions of qualified small business corporation shares after June 17, 1987; and
- a reserve brought into income in 2001, from either of the above.

> **Note**
> Any capital gains from the disposition of these properties while you were a non-resident of Canada are not eligible for the capital gains deduction.

You will find the definition of "qualified small business corporation shares" on page 12, and the definition of "qualified farm property" on page 13.

Who is eligible to claim the capital gains deduction?

You have to be a resident of Canada throughout 2001 to be eligible to claim the capital gains deduction. For the purposes of this deduction, we will also consider you to be a resident throughout 2001 if:

- you were a resident of Canada for at least part of 2001; and
- you were a resident of Canada throughout 2000 or 2002.

Residents of Canada include factual and deemed residents. For more information on factual and deemed residents, see "Before you start" in the *General Income Tax and Benefit Guide*, or get Interpretation Bulletin IT-221, *Determination of an Individual's Residence Status*, and its Special Release.

What is the capital gains deduction limit?

For 2001, if you disposed of qualified farm property or qualified small business corporation shares, you may be eligible for the $500,000 capital gains exemption. Because you only include one-half (1/2) of the capital gains from these properties in your taxable income, your cumulative capital gains deduction is $250,000 (1/2 of $500,000).

The total of your capital gains deductions from 1985 to 2001 for **all** types of capital properties cannot be more than your cumulative deduction of $250,000.

How do you claim the capital gains deduction?

Use Form T657, *Calculation of Capital Gains Deduction for 2001*, to calculate the capital gains deduction. If you have investment income or investment expenses in any years from 1988 to 2001, you will also have to complete Form T936, *Calculation of Cumulative Net Investment Loss (CNIL) to December 31, 2001*. You can get these forms from us.

> **Tax tip**
> You can claim any amount you want to in a year, up to the maximum.

What happens if you have a capital loss?

If you have a capital loss in 2001, you can use it to reduce any capital gains you had in the year, to a balance of zero. If your capital losses are more than your capital gains, you may have a net capital loss for the year. You can apply your net capital losses to other years. For more information on capital losses, see Chapter 5, beginning on page 30.

What records do you have to keep?

You will need information from your records or vouchers to calculate your capital gains or capital losses for the year. You do not need to include these documents with your return as proof of any sale or purchase of capital property. However, it is important that you keep these documents in case we ask to see them later.

If you own qualified farm property or qualified small business corporation shares, you should also keep a record of your investment income and expenses in case you decide to claim a capital gains deduction in the year of sale. You will need these amounts to calculate the cumulative net investment loss (CNIL) component of the capital gains deduction. You can use Form T936, *Calculation of Cumulative Net Investment Loss (CNIL) to December 31, 2001*, for this purpose.

In addition, you should keep a record of the fair market value of the property on the date you:

- inherit it;
- receive it as a gift; or
- change its use.

Chapter 2 – Completing Schedule 3

This chapter gives you information about how and where you should report some of the more common capital transactions on Schedule 3, *Capital Gains (or Losses) in 2001*. Schedule 3 is included in the General income tax return package.

You will notice that Schedule 3 has five numbered columns and is divided into several sections for reporting the disposition of different types of properties. Report each disposition in the appropriate section and make sure you provide the information requested in all columns. Complete the bottom portion of the schedule to determine your taxable capital gain or your net capital loss. If you have a taxable capital gain, transfer the amount to line 127 of your return. If you have a net capital loss, see Chapter 5, beginning on page 30, for information on how you can apply the loss.

> **Note**
> You may need to refer to the Glossary which starts on page 6 for the definition of certain terms used in this chapter.

Qualified small business corporation shares

Report dispositions of qualified small business corporation shares on lines 106 and 107 of Schedule 3.

A share of a corporation will be considered to be a qualified small business corporation share if **all** the following conditions are met:

- at the time of sale, it was a share of the capital stock of a small business corporation, and it was owned by you, your spouse or common-law partner, or a partnership of which you were a member;
- throughout that part of the 24 months immediately before the share was disposed of, while the share was owned by you, a partnership of which you were a member, or a person related to you, it was a share of a Canadian-controlled private corporation and more than 50% of the fair market value of the assets of the corporation were:
  - used mainly in an active business carried on primarily in Canada by the Canadian-controlled private corporation, or by a related corporation;
  - certain shares or debts of connected corporations; or
  - a combination of these two types of assets; and
- throughout the 24 months immediately before the share was disposed of, no one owned the share other than you, a partnership of which you were a member, or a person related to you.

As a general rule, when a corporation has issued shares after June 13, 1988, either to you, to a partnership of which you are a member, or to a person related to you, a special situation exists. We consider that, immediately before the shares were issued, they were owned by an unrelated person. As a result, to meet the holding-period requirement, the shares cannot have been owned by any person other than you, a partnership of which you are a member, or a person related to you, for a 24-month period that begins after the shares were issued and that ends when you sold them. However, this rule does not apply to shares issued:

- as payment for other shares;
- for dispositions of shares after June 17, 1987, as payment of a stock dividend; or
- in connection with a property that you, a partnership of which you were a member, or a person related to you,

disposed of to the corporation that issued the shares. The property disposed of must have consisted of either:

– all or most (90% or more) of the assets used in an active business carried on either by you, the members of the partnership of which you were a member, or the person related to you; or

– an interest in a partnership where all or most (90% or more) of the partnership's assets were used in an active business carried on by the members of the partnership.

Note
Do not report the following transactions in this section of Schedule 3:

- the sale of other shares, such as publicly traded shares or shares of a foreign corporation; and
- your losses when you sell any shares of small business corporations to a person with whom you deal at arm's length. For more information, see "Allowable business investment loss (ABIL)" on page 37.

Capital gains deduction

If you have a capital gain when you sell qualified small business corporation shares, you may be eligible for the $250,000 capital gains deduction. For more information, see "Claiming a capital gains deduction" on page 11.

Qualified farm property

Generally, when you dispose of qualified farm property, you report any capital gain or loss in this section of Schedule 3. Report dispositions of qualified farm property on lines 109 and 110 of Schedule 3.

Qualified farm property is certain property you or your spouse or common-law partner owns. It is also certain property owned by a family-farm partnership in which you or your spouse or common-law partner holds an interest.

Qualified farm property includes:

- a share of the capital stock of a family-farm corporation that you or your spouse or common-law partner owns;
- an interest in a family-farm partnership that you or your spouse or common-law partner owns;
- real property, such as land and buildings; and
- eligible capital property, such as milk and egg quotas.

For more information on what is considered to be qualified farm property, see the *Farming Income* or the *Farming Income and NISA* guides.

If the capital gain or loss is from a mortgage foreclosure or conditional sales repossession, report it on lines 123 and 124 of Schedule 3. For more information, see "Other mortgage foreclosures and conditional sales repossessions" on page 17.

If you dispose of farm property, other than qualified farm property, report it on lines 136 and 138 of Schedule 3. For more information, see "Real estate, depreciable property, and other properties" on page 15.

Special reporting instructions apply to the disposition of eligible capital property that is qualified farm property. For more information, see the chapter called "Eligible Capital Expenditures" in the *Farming Income* or the *Farming Income and NISA* guides.

Capital gains deduction

If you have a capital gain when you sell qualified farm property, you may be eligible for the $250,000 capital gains deduction. For more information, see "Claiming a capital gains deduction" on page 11.

Mutual fund units and other shares including publicly traded shares

Use this section to report a capital gain or loss when you sell shares or securities that are not described in any other section of Schedule 3. These include:

- units in a mutual fund trust;
- publicly traded shares;
- shares that qualify as Canadian securities or prescribed securities, if they are not qualified small business corporation shares or qualified family farm corporation shares; and
- shares issued by foreign corporations.

Report dispositions of units or shares on lines 131 and 132 of Schedule 3.

This section should also be used if you make a donation of the following properties:

- shares listed on a prescribed stock exchange;
- shares of the capital stock of a mutual fund corporation;
- units in a mutual fund trust; or
- interest in a related segregated fund trust.

If you donated any of these properties from February 19, 1997, to December 31, 2001, to a qualified donee (other than a private foundation), use Form T1170, *Capital Gains on Gifts of Certain Capital Property*, to calculate the capital gain to report on line 193 of Schedule 3.

If you sold any of the items listed above in 2001, you will receive either a T5008 slip, *Statement of Securities Transactions*, or an account statement.

You may buy and sell the same type of property (for example, units of a mutual fund trust or publicly traded shares) over a period of time. If so, you have to calculate the average cost of each property in the group at the time of each purchase to determine your ACB. For more information, see "Identical properties" on page 21.

If you report a capital gain from the disposition of shares or other securities for which you filed Form T664, *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*, you may be able to reduce all or part of the gain. For more information, see Chapter 4, beginning on page 28.

Note
If you own shares or units of a mutual fund, you may have to report the following capital gains (or losses):

- capital gains (or losses) you realize when you sell your shares or units of the mutual fund (report these amounts in the "Mutual fund units and other shares including publicly traded shares" area of Schedule 3); and
- capital gains realized by the fund from its investment portfolio which are then flowed out to you. For information on how to report these amounts, see "Information slips – Capital gains (or losses)" on page 19.

Employees' stock options

When your employer grants you a stock option, it does not immediately affect your tax situation. A stock option is an opportunity to buy stocks at a certain price.

Note
The rules in this section also apply to options granted by mutual fund trust employers to their employees to buy trust units.

If you decide to exercise your option and buy stocks at less-than-market value, you will have a taxable benefit received through employment. The taxable benefit is the difference between what you paid for the stocks and the fair market value at the time you exercised your option. You can reduce the amount of the benefit by any amount you paid to acquire the stock option.

Note
The taxable benefit included in your income as an employee stock option benefit is **not** eligible for the capital gains deduction.

If you buy stocks through an employee stock option granted to you by a Canadian-controlled private corporation (CCPC) with which you deal at arm's length, you do not include the taxable benefit in your income in the year you acquire the stocks. You wait until the year you sell the stocks.

For eligible stock options exercised in 2001 which are not granted by a CCPC, an income deferral of the taxable benefit may be allowable so that you do not have to include the benefit in your income until the year you sell the stocks. This deferral is subject to an annual $100,000 limit, which we explain in more detail below. To qualify for this deferral, you must be an eligible employee and receive options to acquire eligible securities.

Generally, an eligible employee is one who, at the time the option is granted:

- deals at arm's-length with the employer; and
- is not a specified shareholder. A specified shareholder is generally one who owns 10% or more of any class of a corporation's shares.

Such an employee must also be a resident of Canada at the time the option is exercised in order to qualify for the deferral.

An eligible security is:

- a common share of a class listed on a prescribed stock exchange in or outside Canada; or
- a unit of a mutual fund trust; and
- the total amount payable to acquire the security is not less than the fair market value of the security at the time the option is granted.

If you qualify for a stock option and shares deduction, you can claim 1/2 of the amount recognized as an employment benefit from the sale of eligible securities in 2001.

Annual limit on deferred stock option benefits

If you are an eligible employee, you can defer the taxable benefit arising on the acquisition of eligible securities with a fair market value of up to $100,000. You can do this annually by filing an election in the form of a letter with your employer or the person who would be required to file an information return in respect of the acquisition. You must also complete Form T1212, *Statement of Deferred Stock Option Benefits*, and file it with your paper return each year.

The $100,000 limit applies to the value of the stock options that first become exercisable by you each year and across all stock option plans of your employer. The value of a stock option is the fair market value of the share at the time the option is granted.

The inclusion into income of the taxable benefit will be deferred until the earlier of the year in which the employee disposes of the eligible security, or the employee (or former employee) dies or becomes a non-resident.

Note
The deferral of the taxable benefit applies to any stock option exercised in 2001, regardless of when the option was granted or became exercisable.

Adjusted cost base (ACB) of shares

Regardless of when the stock option was exercised, the ACB of the shares you purchased through an employee stock option agreement is not the actual price you paid for them. To calculate the ACB of your shares, add the following two amounts:

- the actual purchase price; and
- any amount included in your income as a taxable employee stock option benefit for the shares (even if you claimed a stock option deduction for them).

Disposition of shares

Report the capital gain (or loss) in the year you exchange or sell the shares purchased through an employee stock option. If the shares are qualified small business corporation shares (see page 12), report the transaction in the "Qualified small business corporation shares" area on Schedule 3. In all other cases, report the transaction in the "Mutual fund units and other shares including publicly traded shares" area.

Example
In 1998, Lauren, an eligible employee of Widget Corporation, received an option to buy 5,000 eligible shares at $9 each. Widget Corporation is not a Canadian-controlled private corporation. On February 1, 2001, Lauren exercised her option to buy the shares. The fair market value of the shares at that time was $15 each. In 2002, she sells her shares for $20 each. Lauren's tax implications are as follows:

In 1998, when she received the option, there were no tax implications.

In 2001, when she bought the shares, there are no tax implications because she elected to defer the taxable benefit arising from the purchase of shares. Therefore, the taxable benefit on the entire 5,000 shares she purchased is deferred and is calculated as follows:

Fair market value (5,000 × $15)		$ 75,000
Minus: Amount paid (5,000 × $9)		– 45,000
Taxable benefit (shown in box 53 on T4 slip)		= $ 30,000

In 2002, when she sells the shares:

Fair market value of the shares (5,000 × $15)		$ 75,000
Minus:		
Amount paid (5,000 × $9)		– 45,000
Taxable benefit		= $ 30,000
Proceeds of disposition (5,000 × $20)		$ 100,000
Minus:		
Amount paid (5,000 × $9)	$ 45,000	
Taxable benefit	+ 30,000	
Total	= $ 75,000 ▸	– 75,000
Capital gain		= $ 25,000

The $30,000 taxable benefit that was deferred in 2001 will be included in income in 2002 on line 101. It will also be reported on line 4 of Form T1212. She will be able to claim a stock option deduction of $15,000 ($30,000 × 1/2) on line 249 of her 2002 return. The capital gain of $25,000 will be reported on Schedule 3.

Donations under employee stock options

If you donate shares or mutual fund units in 2001 under your employee stock options to a qualified donee (other than a private foundation), use Form T1170, *Capital Gains on Gifts of Certain Capital Property*, to calculate your capital gain. You may qualify for an additional stock option and shares deduction equal to 1/4 of the taxable benefit. For further information on these donations, see the pamphlet called *Gifts and Income Tax*.

Real estate, depreciable property, and other properties

If you sold real estate or depreciable property in 2001, you have to report your capital gain or loss in this section. Report dispositions on lines 136 and 138 of Schedule 3.

Do not use this section to report the sale of personal-use property (for example, a cottage), or the sale of mortgages and other similar debt obligations on real property. Report these transactions under the sections called "Personal-use property" and "Bonds, debentures, promissory notes, and other similar properties," respectively.

Real estate

Real estate includes the following:

- vacant land;
- rental property (both land and buildings);
- farm property, including both land and buildings (other than qualified farm property); and
- commercial and industrial land and buildings.

For each real property you sold in 2001 that includes land and a building, you must:

- determine how much of the selling price relates to the land, and how much is for the building; and
- report the sale of your land and building separately on Schedule 3.

To help you understand how to report a disposition of real property that includes land and a building, see the example on page 43.

If you dispose of a building and end up with a loss, special rules may apply. Under these rules, you may have to consider your proceeds of disposition as an amount other than the actual proceeds. For more information, see "Selling a building in 2001" on page 23.

Special rules may also apply if you dispose of, or are considered to have disposed of, a property that was your principal residence for 1994 for which you or your spouse or common-law partner has filed Form T664 or T664(Seniors), *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*. If this is your situation, see "Disposition of your principal residence" on page 40.

Depreciable property

When you dispose of depreciable property, you may have a capital gain. In addition, certain rules on capital cost allowance (CCA) may require that you add a recapture of CCA to your income or allow you to claim a terminal loss. You can find definitions of these and other terms used in this section in the Glossary, which begins on page 6.

Capital gain

Usually, you will have a capital gain on depreciable property if you sell it for more than its adjusted cost base plus the outlays and expenses that arose from selling the property.

Note
A loss from the sale of depreciable property **is not considered** to be a capital loss. However, you may be able to claim a terminal loss.

Recapture of CCA and terminal losses

This section will provide you with a general look at the rules for the recapture of CCA and terminal losses.

When you sell a depreciable property for less than its original capital cost, but for more than the undepreciated capital cost (UCC) in its class, you **do not have** a capital gain.

Generally, the UCC of a class is the total capital cost of all the properties of the class **minus** the CCA you claimed in previous years. If you sell depreciable property in a year, you also have to subtract from the UCC one of the following amounts, **whichever is less**:

- the proceeds of disposition of the property, **minus** the related outlays and expenses; or
- the capital cost of the property at the time of sale.

If the UCC of a class has a **negative** balance at the end of the year, this amount is considered to be a recapture of CCA. Include this recapture in your income for the year of sale.

If the UCC of a class has a **positive** balance at the end of the year, and you do not have any properties left in that class, this amount is a terminal loss. Unlike a capital loss, you can deduct the full amount of the terminal loss from your income in that year.

If the balance for the UCC of a class is **zero** at the end of the year, then you do not have a recapture of CCA or a terminal loss.

For more information about CCA and how to report a recapture of CCA or a terminal loss, see the chapter called "Capital Cost Allowance (CCA)" in one of the following guides:

- *Business and Professional Income*;
- *Farming Income*;
- *Farming Income and NISA*;
- *Fishing Income*; or
- *Rental Income*.

Note
The rules for the recapture of CCA and terminal losses do not apply to passenger vehicles in Class 10.1.

Example
In 1992, Peter bought a piece of machinery, at a cost of $10,000, for his business. It is the only property in its class at the beginning of 2001. The class has a UCC of $6,000. He sold the piece of machinery in 2001 and did not buy any other property in that class. The following chart gives you three different selling prices (proceeds of disposition) to show how Peter would handle a variety of situations.

Description	A ($)	B ($)	C ($)
Calculation of capital gain			
Proceeds of disposition	4,000	8,000	12,000
Minus: Capital cost	– 10,000	– 10,000	– 10,000
Capital gain	= 0	= 0	= 2,000
Calculation of terminal loss or recapture of CCA			
Capital cost	10,000	10,000	10,000
Minus: CCA 1992-2000	– 4,000	– 4,000	– 4,000
UCC at the beginning of 2001	= 6,000	= 6,000	= 6,000
Minus the lesser of:			
The capital cost of $10,000 and the proceeds of disposition	– 4,000	– 8,000	– 10,000
Terminal loss or (recapture of CCA)	= 2,000	= (2,000)	= (4,000)

In **example A**, Peter does not have a capital gain. However, he does have a terminal loss of $2,000 which he can deduct from his business income.

In **example B**, Peter does not have a capital gain. However, he does have a recapture of CCA of $2,000 that he has to include in his business income.

In **example C**, Peter has a capital gain of $2,000. He also has a recapture of CCA of $4,000 that he has to include in his business income.

When you dispose of eligible capital property, you may qualify to make an election to treat the disposition as a capital gain which you would report in this section of Schedule 3. For more details, see "Eligible capital property" on page 26.

Bonds, debentures, promissory notes, and other similar properties

Use this section to report capital gains or capital losses from the disposition of bonds, debentures, Treasury bills, promissory notes, and other properties. Other properties include bad debts, foreign exchange gains and losses, and options, as well as discounts, premiums, and bonuses on debt obligations.

Report dispositions on lines 151 and 153 of Schedule 3.

Donations made to a qualified donee of a debt obligation or right listed on a prescribed stock exchange, or a prescribed debt obligation are treated differently. If you made such a donation after February 18, 1997, and before 2002, use Form T1170, *Capital Gains on Gifts of Certain Capital Property*. If you have a capital gain, report the amount calculated on Form T1170 at line 193 of Schedule 3. This does not apply to donations made to a private foundation.

If you sold any of the types of properties listed above in 2001, you will receive either a T5008 slip, *Statement of Securities Transactions*, or an account statement.

If you have bought and sold the same type of property over a period of time, a special rule may affect your capital gain (or loss) calculation. For more information, see "Identical properties" on page 21.

Treasury bills (T-bills) and stripped bonds

When a T-bill or a stripped bond is issued at a discount and you keep it until it matures, the difference between the issue price and the amount you cash it in for is considered to be interest that accrued to you. However, if you sell the T-bill or stripped bond before it matures, you may have a capital gain or capital loss in addition to the interest accrued at that time.

Before you calculate your capital gain or loss, you have to determine the amount of interest accumulated to the date of disposition. Subtract the interest from the proceeds of disposition and calculate the capital gain or loss in the usual manner.

Example
Jesse bought a T-bill on May 1, 2001, for $49,000. The T-bill's term is 91 days and its maturity value on August 1, 2001, is $50,000. However, he sold it on June 13, 2001, for $49,500. The effective yield rate was 8.19%.

Jesse calculates interest on the T-bill as follows:

Purchase price	×	Effective yield rate	×	Number of days T-bill held / Number of days in the year sold	=	Interest to be included in income
$49,000	×	8.19%	×	44 / 365	=	$ 483.77

Jesse calculates his capital gain as follows:

Proceeds of disposition		$ 49,500.00
Minus: Interest	–	483.77
Net proceeds of disposition		$ 49,016.23
Minus: Adjusted cost base	–	49,000.00
Capital gain	=	$ 16.23

Bad debts

If a debt is owed to you (other than a debt under a mortgage or a debt resulting from a conditional sales agreement), and it remains unpaid after you have exhausted all means to collect it, it becomes a bad debt. The debt will be a capital loss if you acquired it:

- to earn income from a business or property; or
- as consideration or payment for the sale of capital property in an arm's length transaction.

In most cases, the capital loss is equal to the adjusted cost base of the debt.

To claim a capital loss on a bad debt, you have to file an election with your return. To make this election, write and sign a letter stating that you want subsection 50(1) of the *Income Tax Act* to apply to the bad debt. Attach this letter to your tax return.

If the debt is from the sale of personal-use property to a person with whom you deal at arm's length, the situation is different. You can claim the capital loss in the year that the debt becomes a bad debt. However, the capital loss cannot be more than the capital gain you previously reported on the sale of the property that created the debt.

The recovery of any bad debt claimed as a capital loss will be treated as a capital gain in the year of recovery.

> **Note**
> If the bad debt involves a small business corporation, see "Allowable business investment loss (ABIL)" on page 37.

Foreign exchange gains and losses

Foreign exchange gains or losses from capital transactions in foreign currencies are considered to be capital gains or losses. However, you only have to report the amount of your net gain or loss for the year that is **more than $200**. If the net amount is $200 or less:

- there is no capital gain or loss; and
- you do not have to report it on your return.

Other mortgage foreclosures and conditional sales repossessions

Report dispositions on lines 154 and 155 of Schedule 3.

You may have held a mortgage on a property but had to repossess the property later because you were not paid all or a part of the amount owed under the mortgage. In this case, you may have to report a capital gain or a capital loss.

The following rules also apply when property is repossessed under a conditional sales agreement. For clarity, a mortgagee is a person who **lends** money under a mortgage. A mortgagor is a person who **borrows** money under a mortgage.

If, as a mortgagee, you repossess a property because the mortgagor failed to pay you the money owed under the mortgage, you are considered to have purchased the property. At the time of repossession, you do not have a capital gain or a capital loss. Any gain or loss will be postponed until you sell the property.

If you are the mortgagor and your property is repossessed because you did not pay the money owed under the mortgage, you are considered to have sold the property. Depending on the amount you owed at the time of repossession, you may have a capital gain, a capital loss, or, in the case of depreciable property, a terminal loss. However, if the property is personal-use property, you cannot deduct the loss.

For more information, see Interpretation Bulletin IT-505, *Mortgage Foreclosures and Conditional Sales Repossessions*.

Note
If the capital gain or loss is from the disposition of qualified farm property, report the capital gain or loss on line 124 in the "Qualified farm property" section of Schedule 3.

Other tax implications

Capital gains from a mortgage foreclosure or a conditional sales repossession will be excluded from net income when calculating your claim for the goods and services tax/harmonized sales tax credit, the Canada Child Tax Benefit, certain related provincial or territorial programs, and the age amount. You should also exclude this income when calculating your social benefits repayment.

Personal-use property

Report dispositions on line 158 of Schedule 3.

When you dispose of personal-use property, you may have a capital gain or loss. To calculate this gain or loss, follow these rules:

- if the adjusted cost base (ACB) of the property is less than $1,000, its ACB is considered to be $1,000;
- if the proceeds of disposition are less than $1,000, the proceeds of disposition are considered to be $1,000; and
- if both the ACB and the proceeds of disposition are $1,000 or less, you do not have a capital gain or a capital loss. Do not report the sale on Schedule 3 when you file your return.

Note
If you acquire personal-use property for donation to a qualified donee (as defined in the Glossary), as part of an arrangement, plan, or scheme promoted by another person or partnership, the above rules do not apply. If this situation applies to you, calculate your capital gain or loss using the actual ACB and proceeds of disposition as discussed in "Calculating your capital gain or capital loss" on page 10.

When you dispose of personal-use property that has an ACB or proceeds of disposition of **more than $1,000**, you may have a capital gain or loss. You have to report any capital gain from disposing of personal-use property. However, if you have a capital loss, you usually **cannot** deduct that loss when you calculate your income for the year. In addition, you cannot use the loss to decrease capital gains on other personal-use property. This is because if a property depreciates through personal use, the resulting loss on its disposition is a personal expense.

These loss restrictions **do not** apply:

- if you disposed of personal-use property that is listed personal property (see the next section); or
- to a bad debt owed to you from the sale of a personal-use property to a person with whom you deal at arm's length. For more information, see "Bad debts" on page 17.

Example
Jane sold the following personal-use properties in 2001.

Property sold	Proceeds of disposition	Adjusted cost base	Outlays and expenses
China cabinet	$ 900	$ 500	$ 0
Boat	$ 1,200	$ 850	$ 50
Personal computer	$ 1,500	$ 3,200	$ 30

Jane calculates the capital gain or loss for each transaction as follows:

Calculation of capital gain (or loss)	China cabinet ($)	Boat ($)	Personal computer ($)
Proceeds of disposition (**greater of** selling price and $1,000)	1,000	1,200	1,500
Minus: ACB (**greater of** cost and $1,000) **plus** outlays and expenses	– 1,000	– 1,050	– 3,230
Capital gain (loss)	= 0	= 150	= (1,730)

China cabinet – For the proceeds of disposition and the ACB, use $1,000, as both were less than that amount. As a result, there is no capital gain or loss for this transaction and Jane **does not** have to report it on Schedule 3.

Boat – Because the cost of the boat is less than $1,000, the ACB is considered to be $1,000. Jane reports $150 as a capital gain.

Personal computer – Jane's capital loss is not deductible. She also cannot use the loss to decrease any other capital gains realized in the year.

Listed personal property

Report dispositions on line 159 of Schedule 3.

Listed personal property (LPP) is a type of personal-use property. The principal difference between LPP and other personal-use properties is that LPP usually increases in value over time. LPP includes all, or any part of any interest in or any right to the following properties:

- prints, etchings, drawings, paintings, sculptures, or other similar works of art;
- jewellery;
- rare folios, rare manuscripts, or rare books;
- stamps; and
- coins.

To determine the value of many of these items, you can have them appraised by a dealer. You can also refer to catalogues for the value of these properties.

Note
LPP gains do not include gains from selling or donating certified Canadian cultural property to a designated institution. For more information, see "Selling or donating certified Canadian cultural property" on page 28.

Because LPP is personal-use property, the $1,000 minimum proceeds of disposition and adjusted cost base rules apply. For more information about these rules, see "Personal-use property" on page 18.

Note
If you acquire listed personal property for donation to a qualified donee (as defined in the Glossary), as part of an arrangement, plan, or scheme promoted by another person or partnership, the $1,000 minimum proceeds of disposition and adjusted cost base rules do not apply. If this situation applies to you, calculate your capital gain or loss using the actual ACB and proceeds of disposition as discussed in "Calculating your capital gain or capital loss" on page 10.

If your 2001 gains from dispositions of LPP are more than your 2001 losses from such dispositions, you can use unapplied LPP losses from 1994 and later years to reduce your 2001 gains. If you want to do this, **do not** enter these losses on line 253 of your return. Instead, subtract the unapplied LPP losses of previous years from your 2001 LLP gains. You should only complete the "Listed personal property" area of Schedule 3 if, after doing these calculations, you still have a net LPP gain in 2001.

If your 2001 losses from dispositions of LPP are more than your 2001 gains from such dispositions, the difference represents your LPP loss for the year. Keep a record of your LPP losses that have not expired so you can apply these losses against LPP gains in other years. An unapplied LPP loss expires when you do not use it by the end of the seventh year after you incurred it.

For more information on applying LPP losses, see page 36.

Information slips – Capital gains (or losses)

Most capital gains and capital losses reported on Schedule 3 come from amounts shown on information slips.

Although you report most of these amounts on line 174 or line 176 (in the case of T3 slips) of Schedule 3, there are exceptions. For example, capital gains from qualified small business corporation shares and qualified farm property are eligible for the $250,000 capital gains deduction. Therefore, you have to report those gains on lines 107 or 110, whichever applies.

The following chart explains how to report the capital gains (or losses) and other amounts shown on certain information slips.

Chart 1 – Reporting capital gains (or losses) and other amounts from information slips

Please read the instructions on the back of your slips to ensure that you claim all deductions and credits that you may be entitled to.

Type of slip	Description of amounts to report	Line on Schedule 3	Other information
T3	**Box 21, Capital gains** – This is your total capital gain from a trust. Report the difference between this amount and the amount in box 30. The "Footnotes" area will indicate if the amount is from a disposition in Periods 1, 2, or 3. **This is provided for information purposes only.** The "Footnotes" area may also show that all or part of the amount in box 21 is foreign non-business income. Enter the footnoted amount on line 433 of Schedule 1, and use it to calculate your foreign tax credit. If you receive a T3 slip from a testamentary trust that has a non-calendar year end, you may have to adjust the capital gains before completing Schedule 3 if the trust has not done the adjustment for you. Contact your slip issuer to see if an adjustment is required. Note that capital gains from a mutual fund trust do **not** have to be adjusted.	Line 176	See note 1
	Box 26, Other income – If there is an asterisk in this box, the "Footnotes" area may show that all or part of the amount in box 26 is income from eligible capital property/qualified farm property. This amount is eligible for the capital gains deduction.	Line 173	See note 3
	Box 30, Capital gains eligible for deduction – If there is an amount in this box, the "Footnotes" area will show that all or part of your gain is from dispositions of:		
	▪ qualified small business corporation shares; or	Line 107	See note 2
	▪ qualified farm property.	Line 110	See note 2
	Box 37, Insurance segregated fund capital losses	Line 176	See note 4

(continued on next page)

Chart 1 – Reporting capital gains (or losses) and other amounts from information slips (continued)			
Type of slip	**Description of amounts to report**	**Line on Schedule 3**	**Other information**
T4PS	**Box 34, Capital gains (or losses)**	Line 174	See note 5
T5	**Boxes 18, 40, and 41, Capital gains dividends** – Total the amounts shown in these boxes and enter the result on Schedule 3.	Line 174	See note 1
T5013	**Box 18, Canadian and foreign net business income (loss)** – This is your total business income (loss) from the partnership. The "Details" area may show that box 18 includes:		
	■ business income from disposing of eligible capital property (other than the recapture of annual allowances deducted in previous years); or	N/A	See note 6
	■ farming income eligible for the capital gains deduction from disposing of eligible capital property that is qualified farm property.	Line 173	See note 3
	Box 23, Capital gains (losses) – This is your total capital gains from the partnership. The "Details" area may also indicate that all or part of your gains are from:		
	■ disposing of qualified small business corporation shares;	Line 107	See note 2
	■ disposing of qualified farm property;	Line 110	See note 2
	■ a security the partnership donated; or	N/A	See note 8
	■ a reserve allocated to you from the partnership in 2000.	N/A	See note 7
	Other capital gains (or losses) – To calculate this amount, you may need to do two calculations. If there is an amount in box 23, subtract from this amount, the amount of the previous year's reserve, capital gains from securities donated in 2001, and the amounts in this box that are reported on lines 107 and 110 of Schedule 3. The "Details" area may also show that all or part of the amount in box 23 is foreign capital gains. Report the footnoted amount on line 433 of Schedule 1, and use it to calculate your foreign tax credit.	Line 174	See note 1
	Box 24, Capital gains reserve – This is your 2001 capital gains reserve from the partnership.	N/A	See note 7

Notes

1. You may be able to reduce all or part of any capital gains. For more information, see Chapter 4, beginning on page 28.
2. These amounts are eligible for the $250,000 capital gains deduction. For more information, see page 11.
3. Complete line 173 if you want to claim a capital gains deduction. If the amount is from a T5013 slip, reduce the amount on line 173 by any business income reduction that you claim for the partnership income (see note 6). Use Form T657, *Calculation of Capital Gains Deduction for 2001*, to calculate your capital gains deduction.
4. If this is your only entry on line 176, put brackets around the amount. If it is not your only entry, subtract it from the total of all other amounts you enter on line 176.
5. If the amount is in brackets, it is a capital loss. If you have a capital loss and it is your only entry on line 174, put brackets around it. Otherwise, subtract the amount from the total of all other amounts you have to enter on line 174.
6. You may be able to reduce all or part of your share of the partnership's business income. For more information, see "Business income reduction" on page 29.
7. Enter the reserve on Form T2017, *Summary of Reserves on Dispositions of Capital Property*. The "Details" area should identify the type of property to which the reserve applies.
8. Complete Form T1170, *Capital Gains on Gifts of Certain Capital Property*, if the "Details" area shows that part or all of the gains are from a donation of the following securities:
   - a share, debt obligation, or right listed on a prescribed stock exchange;
   - a share of a mutual fund corporation;
   - a unit of a mutual fund trust;
   - an interest in a related segregated fund trust; or
   - a prescribed debt obligation.

For more information, get the pamphlet called *Gifts and Income Tax*.

Chapter 3 – Special rules and other transactions

This chapter explains some of the special rules that may apply when you calculate your capital gain or loss. It also explains how to report some of the less common capital transactions.

Adjusted cost base (ACB)

In some cases, special rules may apply that will allow you to consider the cost of a property to be an amount other than its actual cost. This section explains these rules.

Identical properties

Properties of a group are considered to be identical if each property in the group is the same as all the others. The most common examples of identical properties are shares of the same class of the capital stock of a corporation or units of a mutual fund trust.

You may buy and sell several identical properties at different prices over a period of time. If you do this, you have to calculate the average cost of each property in the group at the time of each purchase to determine your ACB. The average cost is calculated by dividing the total cost of identical properties purchased (this is usually the cost of the property plus any expenses involved in acquiring it) by the total number of identical properties owned.

Note
Generally, the following properties are not considered identical properties:

- securities acquired under an employee stock option agreement that are subject to the benefit deferral or are designated and disposed of within 30 days; and
- certain employer shares received by an employee as part of a lump sum payment upon withdrawal from a deferred profit sharing plan.

As a result, the ACB averaging rule described above does not apply to these types of securities. Each of these securities will have its own ACB determined in the usual way (see the definition of "adjusted cost base" in the Glossary on page 6).

You also use this method to calculate the average cost of identical bonds or debentures you bought after 1971. However, the average cost is based on the principal amount for each identical property, that is, the amount before any interest or premiums are added.

A bond, debenture, or similar debt obligation that a debtor issues is considered to be identical to another if:

- the same debtor issues both; and
- all the attached rights are the same.

The principal amount of individual debt obligations being the same is not enough for such debts to be considered identical properties. They must still meet the two conditions listed above.

Example 1
Over the years, Cathy has bought and sold common shares of STU Ltd. The following chart shows how, after each purchase, the ACB of her shares changes.

Transaction	A Cost ($)	B Number of shares	A÷B ACB ($)
Purchase in 1993: $15.00/share	1,500	100	**15.00**
Purchase in 1994: $20.00/share	+ 3,000	+ 150	
New average cost	= 4,500	= 250	**18.00**
Sale in 2001	– 3,600	– 200	
Average cost	= 900	= 50	**18.00**
Purchase in 2001: $21.00/share	+ 7,350	+ 350	
New average cost	= 8,250	= 400	**20.63**

Example 2
In 1996, Pearl bought units of a mutual fund trust. When she bought them, Pearl chose to reinvest her annual income distributions in more units. The following chart shows how the ACB of her units changes after each purchase.

Transaction	A Cost ($)	B Number of units	A÷B ACB ($)
Purchase in 1996: $18.00/unit	15,000.00	833.3333	**18.00**
Reinvested distributions in 1996: $19.55/unit	+ 1,170.00	+ 59.8466	
New average cost	= 16,170.00	= 893.1799	**18.10**
Reinvested distributions in 1997: $20.63/unit	+ 1,455.30	+ 70.5429	
New average cost	= 17,625.30	= 963.7228	**18.29**
Sale in 2001	– 7,316.00	– 400.0000	
Average cost	= 10,309.30	= 563.7228	**18.29**
Reinvested distributions in 2001: $19.89/unit	+ 721.65	+ 36.2821	
New average cost	= 11,030.95	= 600.0049	**18.38**

Property for which you filed Form T664 or T664(Seniors)

Special rules also apply to determine the adjusted cost base (ACB) of a property for which you filed Form T664 or T664(Seniors), *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*.

In most cases, if you filed Form T664 or T664(Seniors), you are considered to have sold your capital property at the end of February 22, 1994, and to have immediately reacquired it on February 23, 1994. The ACB of your property on

February 23, 1994, depends on the type of property for which you filed an election. For example, if you filed an election for your interest in, or your shares of, a flow-through entity (see Chapter 4), in most cases the ACB of your interest or shares will not change. If you filed an election for capital property, other than a flow-through entity, your ACB is usually the amount you designated as proceeds of disposition on Form T664 or T664(Seniors). If the property is a cottage, rental property, or other non-qualifying real property, your ACB is your designatedproceeds of disposition **minus** the reduction for non-qualifying real property.

Also, if your designated proceeds of disposition were **more than** the fair market value of the property at the end of February 22, 1994, your ACB on February 23, 1994, may be reduced. In this case, complete Chart 2 or 3 to determine your ACB on February 23, 1994.

Chart 2 – Calculating the revised adjusted cost base (ACB) of a flow-through entity

Complete this chart to calculate the ACB of your shares of, or interest in, the flow-through entity **only** if the proceeds of disposition you designated on Form T664 for the property were **more** than its fair market value (FMV) at the end of February 22, 1994. If the flow-through entity is a trust (other than a mutual fund trust), do not complete this chart as you do not have to reduce the ACB of your interest.

Step 1 – Reduction of the ACB

1.	Designated proceeds of disposition (column 2, Chart A of Form T664)		$	1
2.	FMV at the end of February 22, 1994 (Step 1 of Form T664)	$	2	
3.	Amount from line 2 $ × 1.1		–	3
4.	Line 1 **minus** line 3 (if negative, enter "0")		= $	4

If the amount on line 4 is zero, do not complete the rest of this chart.

5.	ACB at the end of February 22, 1994 (column 1, Chart A of Form T664)	–	5
6.	Line 2 **minus** line 5	= $	6

If you indicated an amount in column 4, Chart A of Form T664, complete line 7. Otherwise, enter the amount from line 6 on line 8.

7. (Amount from column 4, Chart A of Form T664 $ / Amount from column 3, Chart A of Form T664 $) × line 6 $ ▸ – 7

8.	Line 6 **minus** line 7	= $ ▸	–	8
9.	Reduction (line 4 **minus** line 8)		= $	9

If the amount on line 9 is negative, do not complete the rest of this chart.

Step 2 – Revised ACB

10.	ACB at the end of February 22, 1994 (line 5)	$	10
11.	Reduction (line 9)	–	11
12.	**Revised ACB on February 23, 1994** (line 10 **minus** line 11; if negative, enter "0")	= $	12

Use the amount on line 12 to calculate the capital gain or capital loss when you sell your shares of, or interest in, the flow-through entity.

Chart 3 – Calculating the revised adjusted cost base (ACB) of capital property (other than a flow-through entity)

Complete this chart to calculate the ACB of the property **only** if the proceeds of disposition you designated on Form T664 or T664(Seniors) for the property were **more** than its fair market value (FMV) at the end of February 22, 1994.

1.	FMV of the property at the end of February 22, 1994 [from Step 1 of Form T664 or T664(Seniors)]			$ ________	1
2.	Designated proceeds of disposition [column 2, Chart B of Form T664, or column 2, Step 2 of Form T664(Seniors)]	$ ________	2		
3.	Amount from line 1 .... $ ________ × 1.1 ▶ –	________	3		
4.	Line 2 **minus** line 3 (if negative, enter "0") .... =	$ ________	▶ –	________	4
5.	Line 1 **minus** line 4 (if negative, enter "0")			= $ ________	5
6.	If the property is non-qualifying real property, enter the amount from column 4, Chart B of Form T664, or column 4, Step 2 of Form T664(Seniors). Otherwise, enter "0."			– ________	6
7.	**Revised ACB on February 23, 1994** (line 5 **minus** line 6; if negative, enter "0")			= $ ________	7

Use the amount on line 7 to calculate the capital gain or capital loss when you sell the property.

Property you inherit or receive as a gift

If you receive property as a gift, you are generally considered to have acquired the property at its fair market value (FMV) on the date you acquired it. Similarly, if you win property in a lottery, you are considered to have acquired this prize at its FMV at the time you won it.

Generally, when you inherit property, the property's cost to you is equal to the deemed proceeds of disposition for the deceased. Usually, this amount is the FMV of the property right before the person's death. However, there are exceptions to this rule. For example, property that you inherit because your spouse or common-law partner died, or farm property transferred on death to a child, may be treated differently. See the chapter called "Deemed disposition of property" in the guide called *Preparing Returns for Deceased Persons* to find out which rules apply to your situation.

Selling a building in 2001

You may need to refer to the Glossary which starts on page 6 for the definition of certain terms used in this chapter.

If you sold a building in 2001, special rules may make the selling price an amount other than the actual selling price. This happens when you meet **both** of the following conditions:

- you, or a person with whom you do not deal at arm's length, own the land on which the building is located, or the land adjoining the building if you need the land to use the building; and
- you sold the building for less than its **cost amount** and its capital cost.

Calculate the **cost amount** as follows:

- If the building was the only property in the class, the cost amount is the undepreciated capital cost (UCC) of the class before the sale.
- If more than one property is in the same class, you have to calculate the cost amount of each building as follows:

$$\frac{\text{Capital cost of the building}}{\text{Capital cost of all properties in the class that have not been previously disposed of}} \times \text{UCC of the class} = \text{Cost amount of the building}$$

Note
You may have to recalculate the capital cost of a property to determine its cost amount if:

- you acquired a property directly or indirectly from a person or partnership with whom you did not deal at arm's length; or
- you acquired the property for some other purpose and later began to use it, or increased its use, to earn rental or business income.

For more information, contact us.

If you sold a building under these conditions, this may restrict the terminal loss on the building and reduce the capital gain on the land. For more information, see the guide called *Rental Income*, or Interpretation Bulletin IT-220, *Capital Cost Allowance – Proceeds of Disposition of Depreciable Property*, and its Special Release.

Selling part of a property

When you sell only part of a property, you have to divide the adjusted cost base (ACB) of the property between the part you sell and the part you keep.

Example
Luba owns 100 hectares of vacant land. She decides to sell 25 hectares of this land. Since 25 is one quarter of 100, Luba calculates one quarter of the total ACB as follows:

Total ACB	$	100,000
Minus: The ACB of the part she sold ($100,000 × 1/4)	–	25,000
The ACB of the part she kept	= $	75,000

Therefore, Luba's ACB is $25,000 for the 25 hectares she sold.

For more information on selling part of a property, see Interpretation Bulletin IT-264, *Part Dispositions*, and its Special Release.

Capital gains deferral for investment in small business

Individuals (other than trusts) may defer capital gains incurred on certain small business investments disposed of in 2001. This deferral applies to dispositions where you use the proceeds to acquire another small business investment. The adjusted cost base of the new investment is reduced by the capital gain deferred from the initial investment.

You may acquire shares from a related individual due to circumstances such as a death or the breakdown of a marriage or common-law relationship. For the purposes of the capital gains deferral, we consider you to have acquired such shares at the time and under the same circumstances that the related individual originally acquired them.

The capital gains deferral is also available to individuals in partnerships involved in pooling their investments. If you are part of such a qualifying pooling arrangement, contact your tax services office for more information.

To qualify for the capital gains deferral for investment in small business, the investment must be in an eligible small business corporation. There is also a limit to the adjusted cost base you can use to calculate the amount of the capital gain you can defer. As well, there is a limit to the amount invested in a particular corporation on which you can calculate and apply the deferred capital gain. We discuss these restrictions below.

Eligible small business corporation shares

The capital gains deferral applies only to eligible small business corporation shares. Eligible small business corporation shares have the following characteristics:

- They consist of common shares issued by the corporation to you, the investor.
- The issuing corporation must be an **eligible small business corporation** at the time the shares were issued. Generally, this is a Canadian-controlled private corporation, where all or substantially all of the fair market value (FMV) of its assets are used principally in an active business that is carried on primarily in Canada by the corporation or an eligible small business corporation related to it. It can also be shares of, and/or debt issued by other related eligible small business corporations or a combination of such assets, shares, or debt.
- The total carrying value of the assets of the corporation (that is, the amount at which the assets would be valued for the purpose of the corporation's balance sheet if it was prepared in accordance with generally accepted accounting principles used in Canada at that time) and related corporations cannot exceed $50 million immediately before, and immediately after the investment.
- While you hold the shares, the issuing corporation is an **eligible active business corporation**. Generally, this is a taxable Canadian corporation, where all or substantially all of the FMV of its assets are used principally in an active business carried on primarily in Canada by the corporation or by a related active business corporation while the investor holds the shares, **or for at least 730 days of the ownership period**. It can also be shares of, and/or debt issued by other related active business corporations or a combination of such assets, shares, or debt.

Note
An eligible small business corporation and an eligible active business corporation do **not** include:

a) a professional corporation;

b) a specified financial institution;

c) a corporation whose principal business is leasing, renting, developing or selling real property that it owns or any combination of these activities; and

d) a corporation where more than 50% of the FMV of its property (net of debts incurred to acquire the property) is attributable to real property.

To be able to defer the capital gain, you must have held the eligible small business corporation shares for more than 185 days from the date you acquired them.

You must purchase the replacement shares after the beginning of the year of disposition of the original investment or in the following year. However, you must acquire the replacement shares no later than the earlier of the following two dates:

- the 120th day following the disposition; and
- the 60th day after the end of the year of disposition.

For example, you acquire eligible small business corporation shares in October 1999 and dispose of them on June 9, 2001. You may acquire the replacement shares any time after January 1, 2001, which is the beginning of the year of disposition. However, you **must** acquire the replacement shares by October 7, 2001 (120 days following the disposition), which is the earlier of that date and March 1, 2002 (60 days after the end of the year).

Adjusted cost base (ACB) and eligible capital gains

The capital gains deferral is available for dispositions of eligible small business corporation shares made in 2001. The investment can be made by an individual in any particular corporation (or related group). The maximum amount that you can use in calculating the capital gains deferral is $2,000,000 of your investment, based on the ACB (as defined in the Glossary on page 6).

You may have an ACB greater than $2,000,000, but you calculate the qualifying portion of the gain only on the first $2,000,000, which is the maximum investment limit. Report any remaining capital gain on Schedule 3 in the year you dispose of the shares. If your ACB is over $2,000,000, use

the following formula to determine the percentage of your capital gain that is a qualifying gain:

$$\frac{\text{Maximum investment limit}}{\text{ACB of original investment}} = \text{Qualifying gain fraction}$$

The **qualifying portion of the capital gain** is determined by multiplying this fraction by the total capital gain from the disposition.

Note
If the ACB of the original investment is $2,000,000 or less, the total capital gain will be eligible for deferral (total capital gain = qualifying portion of the capital gain).

Capital gains deferral investment limit

There is no limit to the amount of the proceeds of disposition that you can reinvest in replacement shares. However, a maximum of $2,000,000 of the cost in one particular small business investment (or related group) qualifies for the capital gains deferral. For example, you may have received $3,000,000 from the disposition of eligible small business corporation shares, which resulted in a capital gain. If you choose to reinvest and purchase $2,800,000 worth of other eligible small business corporation shares, only $2,000,000 of this new investment will qualify in the calculation of your capital gains deferral.

Calculation of the qualifying portion of the proceeds of disposition

Before you can calculate the amount of the capital gain that you can defer from disposing of eligible small business corporation shares, you must first determine the portion of the proceeds of the disposition that qualifies. Use the following formula:

Qualifying portion of the proceeds of disposition = A × (B/C)

where

A = the proceeds of disposition from the original sale

B = the qualifying portion of the capital gain from the original sale

C = the total capital gain from the original sale

Calculation of the capital gains deferral

The permitted deferral of the capital gain from the disposition of eligible small business corporation shares is determined by the following formula:

Capital gains deferral = B × (D/E)

where

B = the qualifying portion of the capital gain from the original sale

E = the qualifying portion of the proceeds of disposition

D = the lesser of E and the total cost of all replacement shares (to a maximum of $2 million for any particular corporation or related group)

For dispositions in 2001, report the total capital gain on the appropriate line of Schedule 3 and the capital gains deferral on line 161 of Schedule 3. The capital gain you must report in the year of disposition will be determined by subtracting the capital gain deferral from the total capital gain realized from the disposition.

ACB reduction

You must use the capital gains deferral to reduce the ACB of **each** of the eligible replacement shares by the amount determined by the following formula:

ACB reduction = F × (G/H)

where

F = capital gains deferral

G = the cost of replacement shares (to a maximum of $2 million)

H = the total cost of all the replacement shares (to a maximum of $2 million for any particular corporation or related group)

Example
Robert has shares in corporation A, which are eligible small business corporation shares. The ACB of these shares is $4,000,000. Robert sells the shares on November 9, 2001, for $7,000,000 and realizes a capital gain of $3,000,000. Robert buys replacement shares in corporation B on September 10, 2001, for $4,000,000 and in corporation C on December 15, 2001, for $3,000,000. Robert does the following calculations to determine his capital gains deferral.

Robert's original investment, based on the ACB of the shares, exceeds the maximum investment limit of $2,000,000. He must determine the qualifying portion of the capital gain. He does this by first dividing the maximum investment limit by the ACB of the original investment.

$$\frac{\text{Maximum investment limit}}{\text{ACB of original investment}} = \frac{\$2,000,000}{\$4,000,000} = \frac{1}{2}$$

In this case, the qualifying portion of the capital gain is $1,500,000 (1/2 of $3,000,000). Robert then uses this amount to calculate the qualifying portion of the proceeds of disposition and the capital gains deferral.

Robert now calculates the qualifying portion of the proceeds of disposition as follows:

A	= the proceeds of disposition from the original sale		= $7,000,000
B	= the qualifying portion of the capital gain from the original sale		= $1,500,000
C	= the total capital gain from the original sale		= $3,000,000
Qualifying portion of the proceeds of disposition		= A × (B/C)	
		= $7,000,000 × ($1,500,000/$3,000,000)	
		= $3,500,000	

Robert can now calculate his capital gains deferral:

B	= the qualifying portion of the capital gain from the original sale		= $1,500,000
E	= the qualifying portion of the proceeds of disposition (calculated above)		= $3,500,000
D	= the lesser of E and the total cost of all replacement shares (to a maximum of $2,000,000 for any particular corporation or related group)		= $3,500,000
Capital gains deferral		= B × (D/E)	
		= $1,500,000 × ($3,500,000/$3,500,000)	
		= $1,500,000	

Robert reports the total capital gain from the disposition ($3,000,000) on line 132 of Schedule 3, and the capital gains deferral ($1,500,000) on line 161 of Schedule 3. Finally, Robert must reduce the ACB of both of his replacement shares. He does this by calculating the ACB reduction for each of the replacement shares. He calculates the ACB reduction for corporation B as follows:

F	= the capital gains deferral		= $1,500,000
G	= the cost of replacement shares in corporation B (to a maximum of $2,000,000)		= $2,000,000
H	= the total cost of all replacement shares (to a maximum of $2,000,000 for any particular corporation or related group)		= $4,000,000
ACB reduction		= F × (G/H)	
		= $1,500,000 × ($2,000,000/$4,000,000)	
		= $750,000	

He determines the ACB reduction for corporation C in the same way and with the same result of $750,000.

Robert then calculates the ACB of corporation B as $3,250,000 ($4,000,000 – $750,000) and of corporation C as $2,250,000 ($3,000,000 – $750,000).

Other transactions

The remaining sections in this chapter give information on less common transactions.

Eligible capital property

If you disposed of eligible capital property (as defined in the Glossary on page 7) that is qualified farm property, you may be able to claim the capital gains deduction, up to a maximum of $250,000.

For details on how to report the disposition of this type of property and what amounts are eligible for the capital gains deduction, see the *Farming Income* or the *Farming Income and NISA* guides. Read the chapter called "Eligible Capital Expenditures" in those guides.

Election on dispositions of eligible capital property

If you disposed of property from your cumulative eligible capital account, you may qualify to make an election for tax years ending after February 27, 2000. The election allows qualified individuals to treat dispositions of this type of property as capital gains instead of business income. Use the "Real estate, depreciable property, and other properties" section of Schedule 3 to report the capital gain. For details on how to calculate the capital gain as well as the conditions that must be met in order to qualify to make this election, see the chapter called "Eligible Capital Expenditures" in one of the following guides:

- *Farming Income*;
- *Farming Income and NISA*;
- *Business and Professional Income;* or
- *Fishing Income.*

Partnerships

A partnership does not pay tax on its capital gains or losses and it does not report them on a return. Instead, members of the partnership report their share of the partnership's capital gains or losses on their own return.

Certain partnerships may have to file a T5013 Summary, *Partnership Information Return*, and T5013, *Statement of Partnership Income*, to report amounts flowed out to its members.

If you receive a T5013 slip, see Chart 1 beginning on page 19 to find out how to report your share of the capital gain or loss from the partnership.

However, if you are a member of a partnership that does not have to file Form T5013 Summary for 2001, you have to report your share of any capital gain or loss from each disposition of capital property in the appropriate area of Schedule 3. For example, if the capital gain is from disposing of depreciable property, report the gain in the "Real estate, depreciable property, and other properties" section.

If the partnership disposed of eligible capital property that is qualified farm property, part of the business income from this transaction may be a taxable capital gain. This amount qualifies for the capital gains deduction, up to a maximum of $250,000. The chapter called "Eligible Capital Expenditures" in the *Farming Income* and the *Farming Income and NISA* guides, explains how to calculate and report this amount.

Capital gains reduction (flow-through entity)

Because a partnership is considered a flow-through entity, you may be able to reduce all or part of the partnership income you have to report. For more information, see Chapter 4, beginning on page 28.

Capital gains deduction

You may be eligible for the capital gains deduction, up to a maximum of $250,000, if you are reporting any of the following amounts:

- a capital gain from disposing of qualified small business corporation shares;
- a capital gain from disposing of qualified farm property; or
- farming income from the disposition of eligible capital property that is qualified farm property.

For more information, see "Claiming a capital gains deduction" on page 11.

Purchase of replacement property

In certain situations, you can elect to postpone or defer reporting the capital gain, recapture of capital allowance, or business income from disposing of property. Provided you meet certain conditions, you may want to do this when you use the proceeds of disposition of the property to purchase a replacement property. The election may defer the tax consequences on the above amounts until you sell the replacement property. You can make this election when you sell a business property, or a property you own is expropriated, destroyed, or stolen.

For more information on the election, see Interpretation Bulletin IT-259, *Exchanges of Property*, and its Special Release, and Interpretation Bulletin IT-491, *Former Business Property*, and its Special Release.

Transfers of property to your spouse or common-law partner or to a trust for your spouse or common-law partner

Before reading this section, you may want to read the definitions of "spouse" and "common-law partner" on page 8.

If you give capital property to your spouse or common-law partner, or to a spousal or common-law partner trust, or a joint spouse or common-law partner trust or alter ego trust (for definitions of these trusts, refer to the *T3 Trust Guide*), you generally do not have a capital gain or capital loss at that time. At the time you give the gift, depending on the type of property you give, you are considered to receive an amount equal to:

- the undepreciated capital cost for depreciable property; or
- the adjusted cost base for other types of capital property.

Your spouse or common-law partner, or the trust for your spouse or common-law partner or for yourself, is considered to have bought the capital property for the same amount that you are considered to have sold it for.

You may have transferred property to your spouse or common-law partner, a person who has since become your spouse or common-law partner, or a trust for your spouse or common-law partner. If that person or the trust sells the property during your lifetime, you usually have to report any capital gain or loss from the sale. You usually have to do this if, at the time of the sale:

- you are both residents of Canada; and
- you are both still married or living in a common-law relationship.

If you are living apart because of a breakdown in the relationship, you may not have to report the capital gain or loss when your spouse or common-law partner sells the property. In such a case, you have to file an election with your return.

For transfers of property made **after May 22, 1985**, you can file this election with your return for any tax year ending after the time you separated. However, for the election to be valid, you have to file it no later than the year your spouse or common-law partner disposes of the property. To make this election, attach to your return a letter signed by you and your spouse or common-law partner. State that you do not want section 74.2 of the *Income Tax Act* to apply.

For transfers of property made **before May 23, 1985**, you have to file the election with your return for the tax year in which the separation occurred. To make this election, attach to your return a letter signed by you and your spouse or common-law partner. State that you do not want subsection 74(2) of the *Income Tax Act* to apply.

If you sold the property to your spouse or common-law partner or a trust for your spouse or common-law partner and you were paid an amount equal to the fair market value (FMV) of the property, there is another way to report the sale. You can list the sale at the property's FMV, and report any capital gain or loss for the year you sold the property. To do this, you have to file an election with your return. To make this election, attach to your return a letter signed by you and your spouse or common-law partner. State that you are reporting the property as being sold to your spouse or common-law partner at its FMV, and that you do not want subsection 73(1) of the *Income Tax Act* to apply.

If your spouse or common-law partner or the trust later sells the property, your spouse or common-law partner or the trust has to report any capital gain or loss from the sale.

A special situation exists if all of the following apply to you:

- you owned capital property (other than depreciable property or a partnership interest) on June 18, 1971;
- you gave the property to your spouse or common-law partner after 1971; and

- your spouse or common-law partner later sold the property.

In this case, certain rules apply when calculating your and your spouse's or common-law partner's capital gain or loss to remove any capital gains accrued before 1972. For more information, see Interpretation Bulletin IT-209, *Inter-Vivos Gifts of Capital Property to Individuals Directly or Through Trusts*, and its Special Release.

Other transfers of property

If you give capital property as a gift, you are considered to have sold it at its FMV at the time you give the gift. Include any taxable capital gain or allowable capital loss on your income tax return for the year that you give the gift.

If you sell property to someone with whom you do not deal at arm's length and the selling price is **less** than its FMV, your selling price is considered to be the FMV. Similarly, if you buy property from someone with whom you do not deal at arm's length, and the purchase price is **more** than the FMV, your purchase price is considered to be the FMV.

Special rules allow you to transfer property at an amount other than the property's FMV. If these rules apply to you, you may be able to postpone paying tax on any capital gains you had from the transfer. We note some of the more common transfers below.

Farm property

When you sell or transfer farm property, you may have a capital gain. Many special rules apply to these types of capital gains. For example, if you transfer farm property to a spouse, common-law partner, or child, these rules may apply. For more information on these types of transfers and other rules that apply to farm property, see the *Farming Income* or the *Farming Income and NISA* guides.

Elections

You can postpone reporting a capital gain when you transfer property:

- from an individual or partnership to a Canadian corporation; or
- from an individual to a Canadian partnership.

For information on transfers to a Canadian corporation, see Information Circular 76-19, *Transfer of Property to a Corporation Under Section 85*, and Interpretation Bulletin IT-291, *Transfer of Property to a Corporation Under Subsection 85(1)*.

For information on transfers to a Canadian partnership, see Interpretation Bulletin IT-413, *Election by Members of a Partnership Under Subsection 97(2)*.

Selling or donating certified Canadian cultural property

You do not have to report a capital gain when you sell or donate certified Canadian cultural property (national treasures) to an institution or public authority designated by the Minister of Canadian Heritage. The Canadian Cultural Property Export Review Board certifies this property as cultural property and will give you a certificate for tax purposes. Cultural property can include paintings, sculptures, books, manuscripts, or other objects.

If you sell or donate certified cultural property to a designated institution, you may have a capital loss. The tax treatment of the loss will depend on what type of property you sold or donated. For example, the certified cultural property may be listed personal property. If this is the case, the rules for listed personal property losses will apply. For information on how to apply capital losses, see Chapter 5, beginning on page 30.

For more information, see Interpretation Bulletin IT-407, *Dispositions of Cultural Property to Designated Canadian Institutions*, or get our pamphlet called *Gifts and Income Tax*.

Gifts of ecologically sensitive land

If you make a gift of ecologically sensitive land and you realize a capital gain, you will have to include the gain in income for the year of disposition.

For gifts (other than gifts to a private foundation) made in 2001, multiply the capital gain by 1/4 (50% of your inclusion rate of 1/2) and include this amount in your income. To qualify for this tax treatment, you must meet certain conditions. For further information, see the pamphlet called *Gifts and Income Tax*.

Chapter 4 – Flow-through entities

The information in this chapter applies to you if, for the 1994 tax year, you filed Form T664, *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*, for your shares of, or interest in, a flow-through entity. This chapter provides information on the deductions you may be able to claim for the income flowed out to you from certain trusts and corporations, and from a partnership.

What is a flow-through entity?

You are a member of, or investor in, a flow-through entity if you own shares or, units of, or an interest in, one of the following:

1. an investment corporation;
2. a mortgage investment corporation;
3. a mutual fund corporation;
4. a mutual fund trust;
5. a related segregated fund trust;
6. a partnership;
7. a trust governed by an employees' profit-sharing plan;
8. a trust created to hold shares of the capital stock of a corporation for the benefit of its employees;
9. a trust established for the benefit of creditors in order to secure certain debt obligations; or

10. a trust established to hold shares of the capital stock of a corporation in order to exercise the voting rights attached to such shares.

Exempt capital gains balance (ECGB)

When you filed Form T664 for your shares of, or interest in, a flow-through entity, the elected capital gain you reported created an exempt capital gains balance (ECGB) for that entity. You can use your ECGB to reduce capital gains and certain business income flowed out to you by that entity.

Generally, your ECGB will expire after the year 2004. If you do not use all of your ECGB by the end of 2004, you can add the unused balance to the adjusted cost base of your shares of, or interest in, the flow-through entity.

Capital gains reduction

You can use your ECGB to claim a capital gains reduction on line 195 of Schedule 3 and reduce the following capital gains:

- capital gains flowed out to you by the flow-through entity after February 22, 1994; and
- capital gains realized by you on the disposition of your interest in, or your shares of, the flow-through entity after February 22, 1994.

Do not include on line 195 of Schedule 3, the capital gains reduction for capital gains you realize from a donation, after February 18, 1997, and before 2002 to a qualified donee other than a private foundation, of shares or units of the following flow-through entities:

- a mutual fund corporation;
- a mutual fund trust; and
- a related segregated fund trust.

Instead, claim the capital gains reduction at line 6826 of Form T1170, *Capital Gains on Gifts of Certain Capital Property*.

Note
For the 1994 to 2004 tax years, you might realize a capital gain on the disposition of all your remaining shares of, or interests in, a flow-through entity described in items 1 to 6 of the section called "What is a flow-through entity?" on page 28. If you also have an unused ECGB for the entity at the time of disposition, **do not claim** a capital gains reduction. For more information, see page 30.

Business income reduction

If the flow-through entity is a partnership, you can also use the ECGB to reduce your share of the partnership's business income. This applies to the disposition of eligible capital property, other than the recapture of annual allowances deducted in previous years.

You can reduce your share of the partnership's business income by claiming a business income reduction. Claim the reduction by completing the chart called "Other amounts deductible from your share of net partnership income (loss)" on the following forms:

- T2032, *Statement of Professional Activities*;
- T2124, *Statement of Business Activities*;
- T2042, *Statement of Farming Activities*; or
- T2121, *Statement of Fishing Activities*.

You can find these forms in the guides called *Business and Professional Income*; *Farming Income*; *Farming Income and NISA*; and *Fishing Income*.

If you are a member of a partnership that has to file a T5013 Summary, *Partnership Information Return*, this income is in the details area of box 18 of Form T5013, *Statement of Partnership Income*.

However, if you are a member of a partnership that does not have to file a T5013 Summary, see the chapter called "Eligible Capital Expenditures" in the income tax guide that applies to your business. These chapters have information on how to calculate your share of the business income of the partnership from the disposition of eligible capital property (other than the recapture of annual allowances deducted in previous years).

Note
You cannot use a business income reduction to create or increase a business loss.

Tax tip
You can claim any amount you want to in a year, up to the maximum of your ECGB.

Elections to increase the cost of property you received from a trust

For 1994 and later tax years, you might own an interest in a flow-through entity described in items 7 to 10 of the section called "What is a flow-through entity?" on page 28. If you receive property from the trust in satisfaction of all or a part of your interest in the trust, you can elect to use the ECGB for the entity to increase the cost of property you received from the trust. For more information, contact us.

Keeping track of your ECGB

Depending on your situation, you can use Chart 4 on page 30 or Chart 7 on page 45, to keep track of your ECGB.

Use Chart 4 to determine your capital gains reduction and the ECGB carry forward for a flow-through entity described in items 1 to 5 of the section called "What is a flow-through entity?" on page 28.

Use Chart 7 to track your ECGB if the flow-through entity is:

- a partnership;
- a trust governed by an employees' profit-sharing plan;
- a trust created to hold shares of the capital stock of a corporation for the benefit of its employees;
- a trust established for the benefit of creditors in order to secure certain debt obligations; or
- a trust established to hold shares of the capital stock of a corporation in order to exercise the voting rights attached to such shares.

Chart 4 – Calculating your 2001 exempt capital gains balance (ECGB) and capital gains reduction

If you disposed of your remaining shares of, or interests in, the flow-through entity ("the entity") in the year and realized a capital gain, **do not claim** a capital gains reduction. For more information, see the following section.

Do a separate calculation for each entity.

1.	ECGB carry forward – Enter the ECGB carry forward you calculated the last time you claimed a capital gains reduction for the entity. If you have never claimed a capital gains reduction for the entity, see the Note below			$ ______	1
2.	Capital gains flowed out to you by the entity in 2001	$ ______	2		
3.	Capital gains from the disposition of shares or units of the entity in 2001	+ ______	3		
4.	Line 2 **plus** line 3	= $ ______	4		
5.	**Capital gains reduction** – The maximum you can claim is the **lesser of** line 1 and line 4. However, you can claim an amount that is less than the maximum. Enter this amount on line 195 of Schedule 3 or line 6826 of Form T1170, whichever applies			– ______	5
6.	**ECGB available to carry forward to 2002** (line 1 **minus** line 5). If you disposed of all your remaining shares or units of the entity, enter "0"			= $ ______	6

Note
If you have never claimed a capital gains reduction for the entity, see Chart 8 on page 46 to determine the amount you have to enter on line 1.

Example
Andrew filed Form T664 for his 800 units in a mutual fund trust with his 1994 return. He designated the fair market value of the units at the end of February 22, 1994, as his proceeds of disposition. Andrew claimed capital gains reductions of $500 in 1996 and $600 in 1997. His 2000 exempt capital gains balance available to carry forward was $2,250. In 2001, he had a $935 capital gain from the sale of 300 units. Andrew completes Chart 4 as follows (we have not reproduced the entire chart):

1.	ECGB carry forward			$ 2,250	1
2.	Capital gains flowed out	$ ______	2		
3.	Capital gains from dispositions	+ 935	3		
4.	Line 2 **plus** line 3	= $ 935	4		
5.	Capital gains reduction			– 935	5
6.	ECGB available to carry forward to 2002 =			$ 1,315	6

Disposing of your shares of, or interest in, a flow-through entity

When you dispose of your shares of, or interest in, a flow-through entity, calculate the capital gain or loss in the same way as with any other disposition of capital property (that is, proceeds of disposition minus the adjusted cost base (ACB) and outlays and expenses).

Report these dispositions on Schedule 3 as follows:

- for shares of a flow-through entity, use the "Mutual fund units and other shares including publicly traded shares" section; or
- for an interest in a flow-through entity, use the "Bonds, debentures, promissory notes, and other similar properties" section.

For more information, see Chapter 2, beginning on page 12.

If you filed Form T664 for your shares of, or interest in, a flow-through entity, and the proceeds of disposition from the form were more than the fair market value, the ACB of your investments may be affected. For information, see "Property for which you filed Form T664 or T664(Seniors)" on page 21.

Certain circumstances may create a special situation for a flow-through entity described in items 1 to 6 of the section called "What is a flow-through entity?" on page 28. This happens if you dispose of your remaining shares of, or interests in, such an entity in the 1994 to 2004 tax years and have filed Form T664. If this is the case, in the year you dispose of the shares, use the ECGB available for the entity immediately before the disposition to increase the ACB of the shares or interests. Do this instead of claiming a capital gains reduction on line 195 of Schedule 3, or on line 6826 of Form T1170, *Capital Gains on Gifts of Certain Capital Property*.

The ACB adjustment will either reduce your capital gain or will create or increase your capital loss from disposing of the shares or interest in the flow-through entity.

Chapter 5 – Capital losses

You have a capital loss when you sell, or are considered to have sold, a capital property for less than its adjusted cost base plus the outlays and expenses involved in selling the property. This chapter explains how to:

- determine your adjustment factor;
- report your 2001 net capital losses;
- apply your unused 2001 net capital losses to other years; and
- apply your unused net capital losses of other years against your 2001 taxable capital gains.

It also explains the special rules that apply to listed personal property losses, superficial losses, restricted farm losses, and allowable business investment losses.

You will find a summary of the loss application rules on page 39.

If you had an allowable capital loss in a year, you have to apply it against your taxable capital gain for that year. If you still have a loss, you can use it to reduce your taxable capital gain in any of the three preceding years or in any future year.

Example 1
In 2001, Leah sold two different securities which resulted in a taxable capital gain of $300 (1/2 × $600) and an allowable capital loss of $500 (1/2 × $1,000). After applying her allowable capital loss against her taxable capital gain, Leah has a net capital loss of $200 ($500 – $300).

While she cannot deduct the $200 from other sources of income in 2001, she can apply the loss against her taxable capital gains in any of the three preceding years, or in any future year.

Leah completes Schedule 3 and attaches it to her 2001 return. This will ensure that her loss is updated on our records.

Note
When determining your capital losses, special rules apply if you disposed of:

- depreciable property (for more information, see page 15); or
- personal-use property (for more information, see page 18).

Inclusion rate (IR)

The rate used to determine "taxable capital gains" and "allowable capital losses" (as defined in the Glossary beginning on page 6), called an **inclusion rate**, has changed over the years. As a result, the amount of net capital losses of other years that you can claim against your taxable capital gain depends on the inclusion rate that was in effect when the loss and the gain were incurred. Also, the way you apply these losses may differ if you incurred them before May 23, 1985. For more information, see "How do you apply your net capital losses of other years to 2001" on page 32.

Period net capital loss incurred	Inclusion rate
Before May 23, 1985	1/2 (50%)
After May 22, 1985, and before 1988	1/2 (50%)
In 1988 and 1989	2/3 (66.6666%)
From 1990 to 1999	3/4 (75%)
In 2000	IR*
In 2001	1/2 (50%)

* This rate was determined on line 16 in Part 4 of Schedule 3 for 2000.

If you had a capital loss or gain in 2001, you should have completed Schedule 3, *Capital Gains (or Losses) in 2001*.

Adjustment factor

You will need to determine your adjustment factor in order to adjust the amount of the net capital loss to match the inclusion rate in effect for the year to which you are applying the loss. To determine the adjustment factor, divide the inclusion rate for the year to which the loss is applied by the inclusion rate for the year in which the loss arose.

$$\textbf{Adjustment factor} = \frac{\text{Inclusion rate for year to which loss is applied}}{\text{Inclusion rate for originating year}}$$

You then multiply the adjustment factor by the amount of the net capital loss.

How do you apply your 2001 net capital loss to previous years?

You can carry your 2001 net capital loss back to 1998, 1999, and 2000 and use it to reduce your taxable capital gains in any of these years. When you carry back your net capital loss, you can choose the year(s) to which you apply the loss.

If you have a net capital loss in 2001, you must adjust the amount of the net loss to match the inclusion rate in effect in the previous year. The inclusion rate in effect for 1998 and 1999 was 75%. However, for 2000, the inclusion rate was determined on line 16 of Part 4 of Schedule 3 for that year. You determine the adjustment factor by dividing the inclusion rate for the year to which the loss is applied by the inclusion rate for 2001.

Example 2
In Example 1, Leah had a net capital loss for 2001 of $200. Her inclusion rate is 50%. She wishes to carry back this loss to apply against a taxable capital gain of $1,000 in 1999. She calculates her adjustment factor as follows:

$$\frac{\text{Inclusion rate for year to which loss is applied}}{\text{Inclusion rate for originating year}} = \frac{75\%}{50\%} = 150\%$$

To determine the net capital loss she can carry back to 1999, she multiplies the adjustment factor by the net capital loss for 2001:

Net capital loss for carry back = Adjustment factor × net capital loss
= 150% × $200
= $300

Leah is entitled to apply $300 against her 1999 taxable capital gain.

To apply a 2001 net capital loss to 1998, 1999, or 2000, complete "Area III – Net capital loss for carryback" on Form T1A, *Request for Loss Carryback*. It will also help you determine the amount you have left to carry forward to future years. You can get Form T1A from us (see "Forms and publications" on page 2).

Note
If you apply a 2001 net capital loss to a previous year, any capital gains deduction that you claimed in that year, or a following year, may be reduced.

How do you apply your net capital losses of other years to 2001?

You can apply your net capital losses of other years to your taxable capital gains in 2001. To do this, claim a deduction on line 253 of your return. However, the amount you claim depends on when you incurred the loss. This is because the inclusion rate used to determine taxable capital gains and allowable capital losses has changed over the years. The different inclusion rates are listed on page 31.

You have to apply net capital losses of earlier years before you apply net capital losses of later years. For example, if you have net capital losses in 1992 and 1994, and want to apply them against your taxable capital gains in 2001, you have to follow a certain order. First, apply your 1992 net capital loss against your taxable capital gain. Then apply your 1994 net capital loss against it. Keep separate balances of unapplied net capital losses for each year. This will help you keep track of your capital losses.

You can use a net capital loss of a previous year to reduce a taxable capital gain in 2001. If the inclusion rates for the two years are different, you must adjust the amount of the net capital loss to match the inclusion rate for 2001. Determine the adjustment factor by dividing the inclusion rate for 2001 by the inclusion rate for the year in which the loss arose.

Use Chart 5 on page 33 to determine your net capital losses of other years that you can apply to 2001, and to determine your unapplied balance that you can carry forward to future years.

Example
Andrew realized a capital gain of $5,000 in 2001. Andrew's taxable capital gain for 2001 is $2,500 ($5,000 × 50%).

Andrew has a net capital loss of $1,000 from 1997 to apply against his taxable capital gain of $2,500. Since the inclusion rate in 1997 was 75%, he calculates the adjustment factor as follows:

$$\frac{\text{Inclusion rate for year to which loss is applied}}{\text{Inclusion rate for originating year}} = \frac{50\%}{75\%} = 66.6666\%$$

To determine the net capital loss he can carry forward to 2001, Andrew multiplies the adjustment factor by the net capital loss for 1997.

Net capital loss for carry forward = Adjustment factor × net capital loss for 1997
= 66.6666% × $1,000
= $666.66

Andrew reports the adjusted net capital loss of $666.66 on line 253 against his taxable capital gain of $2,500 reported on line 127 of his 2001 return.

Losses incurred before May 23, 1985

Special rules apply to losses you incurred before May 23, 1985. This also includes losses you incurred after May 22, 1985, on any disposition of capital property made under an agreement of sale you entered into before May 23, 1985.

Usually, you can apply net capital losses of other years only against taxable capital gains. However, if you incurred the losses before May 23, 1985, you may use them to offset other income. Once you have applied your net capital losses of other years against taxable capital gains, you can use any excess to offset other income. The amount you can use is limited to the **least** of the excess amount, $2,000, or your **pre-1986 capital loss balance** available for 2001.

Your **pre-1986 capital loss balance** available for 2001 is:

- the unapplied balance of your total net capital losses that you had at any time before May 23, 1985;

  minus

- the total adjusted amount of capital gains deductions that you claimed before 2001.

If you had a net capital loss during the period January 1, 1985, to May 22, 1985, and you had taxable capital gains later in 1985, your taxable capital gains will reduce your pre-1986 capital loss balance.

Chart 5 – Applying net capital losses of other years to 2001

Use this chart to apply your net capital losses of other years to 2001, and to calculate your balance of unapplied losses you can carry forward to a future year.

When you complete this chart, replace "**IR**" with your inclusion rate for 2000. This rate was determined on line 16 in Part 4 of Schedule 3 for 2000.

Step 1 – Pre-1986 capital loss balance available for 2001
Complete this step **only** if you have a balance of unapplied net capital losses from before May 23, 1985. Otherwise, enter "0" on line 3 and go to Step 2.

1. Balance of unapplied net capital losses you had before May 23, 1985 .... $ ________ **1**
2. Capital gains deductions you claimed:

   Before 1988 .... $ ________

   In 1988 and 1989 .... $ ________ × 3/4 = + ________

   In 1990 to 1999 .... $ ________ × 2/3 = + ________

   In 2000 .... $ ________ × [1 ÷ (2 × IR)] = + ________

   Total capital gains deductions after adjustment .... = $ ________ ▶ – $ ________ **2**
3. Pre-1986 capital loss balance available for 2001 (line 1 **minus** line 2) .... = $ ________ **3**

Step 2 – Applying net capital losses of other years to 2001
Complete lines A to C of the table in Step 3 before proceeding.

4. Total unapplied adjusted net capital losses of other years (total from line C in Step 3) .... $ ________ **4**
5. Taxable capital gains from line 127 of your 2001 return .... $ ________ **5**
6. Enter the amount from line 4 or line 5, **whichever is less** .... $ ________ **6**
7. You can apply all, or part of, the amount on line 6 against your taxable capital gains in 2001. Enter on line 7 the amount of losses you want to claim .... – $ ________ **7**

   If you did not complete Step 1, enter the amount from line 7 on line 253 of your 2001 return. This is your deduction in 2001 for net capital losses of other years. Enter this same amount on line 16 in Step 3. Do not complete lines 8 to 15. **If you completed Step 1**, complete lines D to G of the table in Step 3 and lines 8 to 16 below.

8. Balance of unapplied adjusted net capital losses of other years not used to reduce taxable capital gains (line 4 **minus** line 7) .... = $ ________ **8**
9. Amount from line 8 .... $ ________ **9**
10. Amount from line 3 .... $ ________ **10**
11. Pre-1986 deductible amount .... $ **2,000** **11**
12. Line 9, 10, or 11, **whichever is less** .... + $ ________ **12**
13. Deduction in 2001 for net capital losses of other years (line 7 **plus** line 12). Enter this amount on line 253 of your 2001 return and complete the rest of the chart on the next page to determine your balance of unapplied net capital losses available to carry forward .... = $ ________ **13**

(continued on next page)

Chart 5 – Applying net capital losses of other years to 2001 (continued)

Step 3 – Calculating your balance of unapplied net capital losses of other years available to carry forward

14. Amount from line 7 .... $________ **14**

15. Amount from line 12 .... + $________ **15**

16. Total adjusted net capital losses of other years applied in 2001 (line 14 **plus** line 15) .... = $________ **16**

When you complete this table, replace "**IR**" with your inclusion rate for 2000. This rate was determined on line 16 in Part 4 of Schedule 3 for 2000.

(Do not complete the shaded areas)	**Before May 23, 1985**	**After May 22, 1985, and before 1988**	**In 1988 and 1989**	**After 1989 and before 2000**	**In 2000**	**Total**
A Amount of your unapplied net capital losses						
B Adjustment factor	**1**	**1**	$\frac{3}{4}$	$\frac{2}{3}$	$\frac{1}{2 \times IR}$	
C (Line A x line B)						
D Total adjusted net capital losses applied against taxable capital gains in 2001 (the total must equal the amount on line 16)						
E (Line C – line D)						
F Adjustment factor	**1**	**1**	$\frac{4}{3}$	$\frac{3}{2}$	**2 × IR**	
G (Line E x line F) – Net capital losses available to carry forward to future years						

Example

Jerry has unapplied net capital losses of $6,000 he incurred before May 23, 1985. He claimed a capital gains deduction of $500 in 1986, and of $300 in 2000 (Jerry's inclusion rate in 2000 was 2/3 or 66.6666%). Jerry also has the following unapplied net capital losses: $4,000 from 1988; and $6,000 from 1990. He reported a taxable capital gain of $10,000 on line 127 of his 2001 return. He completes Chart 5 to calculate the maximum deduction he can claim for his unapplied net capital losses of other years in 2001, and to determine the loss balance that he can carry forward to a future year. Because of space limitations, we have not reproduced the entire chart.

Step 1 – Pre-1986 capital loss balance available for 2001

1. Balance of unapplied net capital losses you had before May 23, 1985 .... $ 6,000 **1**
2. Capital gains deductions you claimed:
   - Before 1988 .... $ 500
   - In 1988 and 1989 .... $______ × 3/4 = + ______
   - In 1990 to 1999 .... $______ × 2/3 = + ______
   - In 2000 .... $ 300 × [1 ÷ (2 × 2/3)] = + 225
   - Total capital gains deductions after adjustment .... = $ 725 ▸ – $ 725 **2**
3. Pre-1986 capital loss balance available for 2001 (line 1 **minus** line 2) .... = $ 5,275 **3**

Step 2 – Applying net capital losses of other years to 2001

4. Total unapplied adjusted net capital losses of other years (total from line C in Step 3) .... $ 13,000 **4**
5. Taxable capital gains from line 127 of your 2001 return .... $ 10,000 **5**
6. Enter the amount from line 4 or line 5, **whichever is less** .... $ 10,000 **6**
7. You can apply all, or part of, the amount on line 6 against your taxable capital gains in 2001. Enter on line 7 the amount of losses you want to claim .... – $ 10,000 **7**
8. Balance of unapplied adjusted net capital losses of other years not used to reduce taxable capital gains (line 4 **minus** line 7) .... = $ 3,000 **8**
9. Amount from line 8 .... $ 3,000 **9**
10. Amount from line 3 .... $ 5,275 **10**
11. Pre-1986 deductible amount .... $ **2,000** **11**
12. Line 9, 10, or 11, **whichever is less** .... + $ 2,000 **12**
13. Deduction in 2001 for net capital losses of other years (line 7 **plus** line 12) .... = $ 12,000 **13**

Step 3 – Calculating your balance of unapplied net capital losses of other years available to carry forward

14. Amount from line 7 .... $ 10,000 **14**
15. Amount from line 12 .... + $ 2,000 **15**
16. Total adjusted net capital losses of other years applied in 2001 (line 14 **plus** line 15) .... = $ 12,000 **16**

	(Do not complete the shaded areas)	**Before May 23, 1985**	**In 1988 and 1989**	**After 1989 and before 2000**	**In 2000**	**Total**
A	Amount of your unapplied net capital losses	$6,000	$4,000	$6,000	$0	
B	Adjustment factor	**1**	$\frac{3}{4}$	$\frac{2}{3}$	$\frac{1}{2 \times IR}$	
C	(Line A x line B)	$6,000	$3,000	$4,000	$0	$13,000
D	Total adjusted net capital losses applied against taxable capital gains in 2001 (the total must equal the amount on line 16)	$6,000	$3,000	$3,000	$0	$12,000
E	(Line C – line D)	$0	$0	$1,000	$0	
F	Adjustment factor	**1**	$\frac{4}{3}$	$\frac{3}{2}$	**2 × IR**	
G	(Line E x line F)	$0	$0	$1,500	$0	$1,500

Jerry has to apply his older losses first. Because the total amount of adjusted losses that he used in 2001 was $12,000 (from line 16 above), he applies $6,000 of his adjusted net capital losses incurred before May 23, 1985, and $3,000 of his adjusted net capital loss incurred in 1988. He then uses $3,000 ($12,000 – $6,000 – $3,000) of his adjusted net capital loss incurred in 1990. Jerry has unapplied net capital losses of $1,500 that he can carry forward to a future year.

Applying listed personal property (LPP) losses

You have an LPP loss if, in a particular year, your losses from dispositions of LPP are more than your gains from such dispositions. If you have an LPP loss, you need to read this section. Applying this type of loss is different from applying other capital losses because:

- you can only deduct losses from the disposition of LPP from any gains you had from selling other LPP;
- the LPP losses you deduct in the year cannot be more than your LPP gains from such dispositions for that year; and
- you cannot use this type of loss to reduce any capital gains you had from selling other types of property.

If you have an LPP loss in 2001, you can use the loss to reduce gains from dispositions of LPP you had in any of the three years before 2001 or the seven years after.

For information on how to apply a prior year LPP loss to 2001 gains from dispositions of LPP, see "Listed personal property" on page 18.

To carry back your 2001 LPP losses to reduce your LPP net gains from 1998, 1999, and 2000, complete Form T1A, *Request for Loss Carryback,* and include it with your 2001 return. You can get this form from us (see "Forms and publications" on page 2). Do not file an amended return for the year to which you want to apply the loss.

Example
Walter bought some jewellery in 1985 for $5,800. In 2001, he sold it for $6,000. He ended up with a gain of $200. He also sold a coin collection for $2,000 in 2001. Walter had originally bought this collection in 1988 for $1,700. He ended up with a gain of $300 when he sold the coin collection. In addition, he sold a painting in 2001 for $8,000. However, Walter bought the painting in 1989 for $12,000. Therefore, he had a loss of $4,000. He had no outlays and expenses for these three transactions.

Walter's loss from selling LPP in 2001 was more than his gain: his loss was $4,000; his total gain was $500 ($200 + $300). As a result, his net loss was $3,500 ($4,000 – $500). Walter cannot use the difference to offset his capital gain on the sale of a property other than on LPP in the year. In addition, he cannot offset any income he had from other sources. However, he can apply his LPP loss against his gains from dispositions of LPP in any of the three preceding years, or the seven years following 2001.

Walter should not complete Schedule 3 for 2001. However, he should keep a record of his LPP loss in case he wants to apply the loss against LPP gains in another year.

Superficial loss

For dispositions that occur after April 26, 1995 (other than dispositions that occur before 1996 according to a written agreement made on or before April 26, 1995), a superficial loss can occur when you dispose of capital property for a loss, and:

- you, or a person affiliated with you, buys, or has a right to buy, the same or identical property (called "substituted property") during the period starting 30 calendar days before the sale and ending 30 calendar days after the sale; and
- you, or a person affiliated with you, still owns, or has a right to buy, the substituted property 30 calendar days after the sale.

Some examples of affiliated persons are:

- you and your spouse or common-law partner;
- you and a corporation that is controlled by you or your spouse or common-law partner; and
- a partnership and a majority-interest partner of the partnership.

If you have a superficial loss in 2001, you cannot deduct it when you calculate your income for the year. However, if you are the person who acquires the substituted property, you can usually add the amount of the superficial loss to the adjusted cost base of the substituted property. This will either decrease your capital gain or increase your capital loss when you sell the substituted property.

In certain situations, this type of loss is not considered a superficial loss. Some of the more common situations are when:

- you are considered to have sold the capital property because you became or ceased to be a resident of Canada;
- the property is considered to have been sold because the owner died;
- the disposition results from the expiry of an option;
- you are considered to have sold the property because you changed its use; or
- for dispositions that occur after April 26, 1995, you disposed of the property and within 30 calendar days after the disposition you became or ceased to be exempt from income tax.

Restricted farm loss (RFL)

If you run your farm as a business and have a reasonable expectation of making a profit, you may be able to deduct a farm loss in the year. However, if your chief source of income is neither from farming nor from a combination of farming and some other source of income, you can only deduct a portion of your farm loss for the year. The portion of the loss that you cannot deduct becomes an RFL.

You can carry an RFL back 3 years and forward up to 10 years. However, the amount you can deduct in any year cannot be more than your net farming income for that year. For more information on determining your chief source of income and how to calculate an RFL, see the *Farming Income* or the *Farming Income and NISA* guides.

You may have RFLs that you incurred in your farming operation that you could not deduct when you calculated your income for previous years. You can apply part of these RFLs against any capital gain you may have when you sell your farmland. The amount of RFLs that you can apply cannot be more than the property taxes and the interest on

money you borrowed to buy the farmland that were included in the calculation of the RFLs for each year. Reduce your capital gain by adding these amounts to the adjusted cost base (ACB) of your farmland. Also, you have to reduce your RFL balance by these amounts.

You can only use RFLs to reduce any capital gain from selling your farmland to zero. You cannot use an RFL to create or increase a capital loss from selling farmland.

Example
Fritz sold his farmland in 2001 for $200,000. The ACB of the property was $160,000. Fritz has an unapplied RFL of $20,000 from 1993. This amount includes $5,000 for property taxes, $5,000 for interest, and $10,000 for other expenses.

Fritz wants to reduce his capital gain from selling his farmland by applying his RFL against the capital gain. He calculates his capital gain as follows:

Proceeds of disposition				$ 200,000	A
Adjusted cost base		$ 160,000	B		
Plus: Property taxes	+	5,000	C		
Interest	+	5,000	D		
Total	=	$ 170,000 ▸		– 170,000	E
Capital gain (line A **minus** line E)				= $ 30,000	F

Fritz can only apply the portion of his RFL that relates to property taxes and interest on the money he borrowed to buy the farmland.

Allowable business investment loss (ABIL)

If you had a business investment loss in 2001, you can deduct 1/2 of the loss from income. The amount of the loss you can deduct from your income is called your allowable business investment loss (ABIL). Complete Chart 6 on page 38 to determine your ABIL and, if applicable, your business investment loss reduction. Claim the deduction for the ABIL on line 217 of your income tax return. Enter the gross business investment loss on line 228 of your return.

What is a business investment loss?

A business investment loss results from the actual or deemed disposition of certain capital properties. It can happen when you dispose of one of the following to a person you deal with at arm's length:

- a share of a small business corporation; or
- a debt owed to you by a small business corporation.

For business investment loss purposes, a small business corporation includes a corporation that was a small business corporation at any time during the 12 months before the disposition.

You may also have such a loss if you are deemed to have disposed of, for nil proceeds of disposition, a debt or a share of a small business corporation under any of the following circumstances:

- A small business corporation owes you a debt (other than a debt from the sale of personal-use property) that is considered to be a bad debt at the end of the year.
- At the end of the year, you own a share (other than a share you received as consideration from the sale of personal-use property) of a small business corporation that:
  - has gone bankrupt in the year;
  - is insolvent, and a winding-up order has been made in the year under the *Winding-up Act*; or
  - is insolvent at the end of the year and neither the corporation, nor a corporation it controls, carries on business. Also, at that time, the share in the corporation has a fair market value of nil, and it is reasonable to expect that the corporation will be dissolved or wound up and will not start to carry on business*.

    * You or a person that you do not deal with at arm's length will be deemed to have realized an offsetting capital gain if the corporation, or a corporation it controls, carries on business within 24 months following the end of the year in which the disposition occurred. You or that person will have to report the capital gain in the taxation year the corporation starts to carry on business. This applies if you or the person owned the share in the corporation at the time the business started.

You can elect to be deemed to have disposed of the debt or the share of the small business corporation at the end of the year for nil proceeds of disposition, and to have immediately reacquired the debt or the share after the end of the year at a cost equal to nil. To do this, you have to file an election with your return. To make this election, attach to your return a letter signed by you. State that you want subsection 50(1) of the *Income Tax Act* to apply.

What happens when you incur an ABIL?

You can deduct your ABIL from your other sources of income for the year. If your ABIL is more than your other sources of income for the year, include the difference as part of your non-capital loss for 2001. You can carry a non-capital loss back three years and forward seven years. If you choose to do this, you will need to determine your adjustment factor. See page 31 for more details.

To carry a non-capital loss back to 1998, 1999, or 2000, complete Form T1A, *Request for Loss Carryback*, and include it with your 2001 return. You can get this form from us (see "Forms and publications" on page 2). Do not file an amended return for the year to which you want to apply the loss.

If you cannot deduct your ABIL as a non-capital loss within the allowed time frame, the unapplied part becomes a net capital loss. You can use this loss to reduce your taxable capital gains in the eighth year or any year after.

For example, you had an ABIL in 1993 that became a non-capital loss and you were not able to deduct it in the three years before 1993 or the seven years after 1993. You can now use the loss to reduce your taxable capital gains in 2001 or any year after.

Note
Any ABIL that you claim for 2001 will reduce the capital gains deduction you can claim in 2001 and in future years.

Chart 6 – How to claim an allowable business investment loss.

Step 1 Business investment loss in 2001 (enter this amount on line 228 of your return) .... $______ **A**

Step 2 If you claimed a capital gains deduction in a previous year, you have to reduce your business investment loss. To determine the reduction, complete the calculation below and enter the result from line 13. Otherwise, enter "0" .... – ______ **B**

Line A **minus** line B. = $______ **C**

Step 3 Allowable business investment loss .... Amount from line C $______ × 1/2 = $______ **D**

Enter the amount from line D on line 217 of your return.

Step 4 Attach a note to your return that states the following:

- name of the small business corporation;
- number and class of shares, or the type of debt you disposed of;
- insolvency, bankruptcy, or wind-up date;
- date you bought the shares, or the date you acquired the debt;
- amount of the proceeds of disposition;
- adjusted cost base of the shares or debt;
- outlays and expenses on the disposition; and
- amount of the loss.

Calculation of the business investment loss reduction

The reduction calculated below is considered to be a capital loss for the year.

Total of all capital gains deductions claimed from 1985 to 2000

1.	For 1985 to 1987, total of the amounts from line 254 of your returns for these years	$______	×	2	▶	$______	1
2.	For 1988 and 1989 (other than for eligible capital property gains), total of the amounts from line 254 of your returns **minus** any amounts reported on lines 543 and 544 on Schedule 3; if negative enter "0"	$______ **(a)**	×	3/2	▶	+ ______	2
3.	For 1988 and 1989 for eligible capital property gains, total of the amounts from line 254 of your returns **minus** the amount calculated at line (a) above; not to exceed lines 543 and 544 on Schedule 3	$______	×	4/3	▶	+ ______	3
4.	For 1990 to 1999, total of the amounts from line 254 of your returns for these years	$______	×	4/3	▶	+ ______	4
5.	For 2000, amount from line 254 of your return	$______	×	1/IR*	▶	+ ______	5
6.	Total of lines 1 to 5					= $______	6

Total of all other business investment loss reductions for 1986 to 2000

7.	Total of amounts reported on line 535 of Schedule 3 of your 1986 to 1994 returns	$______ 7			
8.	Total of amounts reported on line 034 of Schedule 3 of your 1994 to 1996 returns	+ ______ 8			
9.	Total of amounts reported on line 178 of Schedule 3 of your 1997 to 1999 returns	+ ______ 9			
10.	Total of amounts reported on lines 293, 178, and 5668 of Schedule 3 of your 2000 return	+ ______ 10			
11.	Total of lines 7 to 10	= $______	▶	– $______	11
12.	Line 6 **minus** line 11			= $______	12

Business investment loss reduction

13. Line 12 or line A from Step 1 above, **whichever is less**.
Enter this amount on line B in Step 2 above and on line 178 of Schedule 3 .... $______ **13**

*** This inclusion rate (IR) was determined on line 16 in Part 4 of Schedule 3 for 2000.**

Summary of loss application rules

Type of loss	Application rules	Limit to annual deduction
Allowable business investment loss (see page 37)	Any unapplied portion in the year of the loss becomes a non-capital loss which can be carried back three years and forward seven years. The unapplied portion of the non-capital loss becomes a net capital loss which can be used to reduce taxable capital gains in the eighth year or any year after.	No limit Limited to taxable capital gains in the year.
Net capital loss (see page 30)	■ Carry back three years ■ Carry forward indefinitely	Limited to taxable capital gains in the year*.
Farm loss (see the *Farming Income* or the *Farming Income and NISA* guides)	■ Carry back three years ■ Carry forward ten years	No limit
Listed personal property (LPP) loss (see page 36)	■ Carry back three years ■ Carry forward seven years	Limited to net gains from LPP in the year.
Personal-use property loss (see page 18)	No loss allowed**	Not applicable
Restricted farm loss (see page 36)	■ Carry back three years ■ Carry forward ten years You can use part of any unapplied loss to reduce your capital gains from the sale of the farmland that was used in a farming business.	Limited to net farming income in the year. Cannot be more than the property taxes and the interest on money you borrowed to buy the farmland that you included in the calculation of the restricted farm losses for each year. You cannot use it to create or increase a capital loss.
Superficial loss (see page 36)	■ No loss allowed You can usually add the amount of the loss to the adjusted cost base of the substituted property.	Not applicable

* For net capital losses incurred before May 23, 1985, you may deduct an additional amount (up to $2,000) from other income. For more information, see "How do you apply your net capital losses of other years to 2001?" on page 32.

** For exceptions to this rule, see "Personal-use property" on page 18.

Chapter 6 – Principal residence

When you sell your home, you may realize a capital gain. If the property was your principal residence for every year you owned it, you do not have to report the sale on your return. However, if at any time during the period you owned the property it was not your principal residence, you may have to report all or a portion of the capital gain.

This chapter explains the meaning of a principal residence, how you designate a property as such, and what happens when you sell it. It also explains what to do in other special tax situations.

If after reading this chapter you need more information, see Interpretation Bulletin IT-120, *Principal Residence*.

What is your principal residence?

Your principal residence can be any of the following types of housing units:

- a house;
- a cottage;
- a condominium;
- an apartment in an apartment building;
- an apartment in a duplex; or
- a trailer, mobile home, or houseboat.

A property qualifies as your principal residence for any year if it meets the following four conditions:

- it is a housing unit, a leasehold interest in a housing unit, or a share of the capital stock of a co-operative housing corporation you acquire only to get the right to inhabit a housing unit owned by that corporation;

- you own the property alone or jointly with another person;
- you, your current or former spouse or common-law partner, or any of your children lived in it at some time during the year; and
- you designate the property as your principal residence.

The land on which your home is located can be part of your principal residence. Usually, the amount of land that you can consider as part of your principal residence is limited to 1/2 hectare (1.24 acres). However, if you can show that you need more land to use and enjoy your home, you can consider more than this amount as part of your principal residence. For example, this may happen if the minimum lot size imposed by a municipality at the time you bought the property is larger than 1/2 hectare.

Designating a principal residence

You designate your home as your principal residence when you sell or are considered to have sold all or part of it. You can designate your home as your principal residence for the years that you own and use it as your principal residence. However, you do not have to designate it each year. For more information, see "Form T2091(IND), *Designation of a Property as a Principal Residence by an Individual (Other Than a Personal Trust)*" on this page.

Can you have more than one principal residence?

For 1982 and later years, you can only designate one home as your family's principal residence for each year.

For 1982 to 2000, your family included:

- you;
- a person who throughout the year was your spouse (unless you were separated for the entire year under the terms of a court order or a written agreement); and
- your children (other than a child who had a spouse during the year or who was 18 or older).

If you **did not have a spouse and were not 18 or older**, your family **also** included:

- your mother and your father; and
- your brothers and sisters (who did not have spouses and were not 18 or older during the year).

For 2001, the above definition applies except that the reference to spouse is replaced by "spouse or common-law partner." These terms are defined in the Glossary on page 8.

For 1993 to 2000, a spouse included a common-law spouse. Therefore, common-law spouses could not designate different housing units as their principal residence for any of those years.

> **Note**
> If you made an election to have your same-sex partner considered your common-law partner for 1998, 1999 and/or 2000, then, for those years, your common-law partner also could not designate a different housing unit as his or her principal residence.

For years before 1982, more than one housing unit per family can be designated as a principal residence. Therefore, a husband and wife can designate different principal residences for these years. However, a special rule applies if members of a family designate more than one home as a principal residence. For more information, see Interpretation Bulletin IT-120, *Principal Residence*.

Disposition of your principal residence

When you sell your home or when you are considered to have sold it, usually you do not have to report the sale on your return and you do not have to pay tax on any gain from the sale. This is the case if the home was your principal residence for every year you owned it.

If your home was **not** your principal residence for every year that you owned it, you have to report the part of the capital gain on the property that relates to the years for which you did not designate the property as your principal residence. To do this, complete Form T2091(IND) (see the next section).

> **Note**
> Because your home is considered personal-use property, if you have a loss at the time you sell or are considered to have sold your home, you are not allowed to claim the loss.

If only a part of your home qualifies as your principal residence and you used the other part to earn or produce income, you have to split the selling price between the part you used for your principal residence and the part you used for other purposes (for example, rental or business). You can do this by using square metres or the number of rooms, as long as the split is reasonable. Report only the gain on the part you used to produce income. For more information, see "Real estate, depreciable property, and other properties" on page 15.

Form T2091(IND), *Designation of a Property as a Principal Residence by an Individual (Other Than a Personal Trust)*

Use Form T2091(IND) to designate a property as a principal residence. This form will help you calculate the number of years that you can designate your home as your principal residence, as well as the part of the capital gain, if any, that you have to report. Complete Form T2091(IND), if you:

- sold, or were considered to have sold, your principal residence, or any part of it; or
- granted someone an option to buy your principal residence, or any part of it.

You only have to include Form T2091(IND) with your return if you have to report a capital gain.

Did you or your spouse or common-law partner file Form T664 or T664(Seniors)?

Use Form T2091(IND) to calculate the capital gain if you sell, or are considered to have sold, a property for which you or your spouse or common-law partner filed Form T664 or T664(Seniors), *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*, and:

- the property was your principal residence for 1994; or
- you are designating it in 2001 as your principal residence for any tax year.

Use Form T2091(IND)-WS, *Principal Residence Worksheet*, to calculate a reduction due to the capital gains election. In this case, if the property was designated as a principal residence for the purpose of the capital gains election, you have to include those previously designated tax years as part of your principal residence designation in 2001.

> **Note**
> If, at the time of the election, the property was designated as a principal residence for any tax year other than 1994, you can choose whether or not to designate it again as your principal residence when you sell it, or are considered to have sold it. Remember, if you choose to designate it again, you have to include those previously designated tax years as part of your principal residence designation in 2001.

If the property was not your principal residence for 1994 and you are not designating it in 2001 as your principal residence for any tax year, do not use Form T2091(IND) and Form T2091(IND)-WS to calculate your capital gain. Instead, calculate your capital gain, if any, in the regular way (proceeds of disposition **minus** the adjusted cost base and outlays and expenses). For more information on how to calculate your adjusted cost base as a result of the capital gains election, see "Property for which you filed Form T664 or T664(Seniors)" on page 21.

Changes in use

You can be considered to have sold all or part of your property even though you did not actually sell it. The following are some sample situations:

- you change all or part of your principal residence to a rental or business operation; or
- you change your rental or business operation to a principal residence.

Every time you change the use of a property, you are considered to have sold the property at its fair market value and to have immediately reacquired the property for the same amount. You have to report the resulting capital gain or capital loss (in certain situations) in the year the change of use occurs.

If the property was your principal residence for any year you owned it before you changed its use, you do not have to pay tax on any gain that relates to those years. You only have to report the gain that relates to the years your home was not your principal residence. For information on how to calculate and report the gain, if any, see "Disposition of your principal residence" on page 40.

If you were using the property to earn or produce income before you changed its use, see "Real estate, depreciable property, and other properties" on page 15 for information on how to report any capital gain or capital loss.

Special situations

In certain situations, the rules stated above for changes in use do not apply. The following are some of the more common situations.

Changing all your principal residence to a rental or business operation

When you change your principal residence to a rental or business property, you can make an election not to be considered as having started to use your principal residence as a rental or business property. This means you do not have to report any capital gain when you change its use. If you make this election:

- you have to report the net rental or business income you earn; and
- you cannot claim capital cost allowance (CCA) on the property.

While your election is in effect, you can designate the property as your principal residence for up to four years, even if you do not use your property as your principal residence. However, you can only do this if you do not designate any other property as your principal residence for this time.

You can extend the four-year limit indefinitely if all of the following conditions are met:

- you live away from your principal residence because your employer, or your spouse's or common-law partner's employer, wants you to relocate;
- you and your spouse or common-law partner are not related to the employer;
- you return to your original home while you or your spouse or common-law partner are still with the same employer, or before the end of the year following the year in which this employment ends, or you die during the term of employment; and
- your original home is at least 40 kilometres (by the shortest public route) farther than your temporary residence from your, or your spouse's or common-law partner's, new place of employment.

If you make this election, there is no immediate effect on your income tax situation when you move back into your residence. However, if you change the use of the property again and do not make this election again, any gain you have from selling the property may be subject to tax.

To make this election, attach to your return a letter signed by you. Describe the property and state that you want subsection 45(2) of the *Income Tax Act* to apply.

If you started to use your principal residence as a rental or business property in the year, you may want information on how to report business or property income. If so, see the *Business and Professional Income* or the *Rental Income* guide.

Changing your rental or business operation to a principal residence

When you change your rental or business operation to a principal residence, you can elect to postpone reporting the disposition of your property until you actually sell it.

However, you cannot make this election if you, your spouse or common-law partner, or a trust under which you or your spouse or common-law partner is a beneficiary has deducted CCA on the property for any tax year after 1984, and on or before the day you change its use.

This election only applies to a capital gain. If you claimed CCA on the property before 1985, you have to include any recapture of CCA in your business or rental income. Include the income in the year you changed the use of the property. If you need more information on the recapture of CCA, see the *Business and Professional Income* or the *Rental Income* guide.

If you make this election, you can designate the property as your principal residence for up to four years before you actually occupy it as your principal residence.

To make this election, attach to your return a letter signed by you. Describe the property and state that you want subsection 45(3) of the *Income Tax Act* to apply. You have to make this election by the earlier of the following dates:

- 90 days after the date we ask you to make the election; or
- the date you are required to file your return for the year in which you actually sell the property.

Changing part of your principal residence to a rental or business operation

You are usually considered to have changed the use of part of your principal residence when you start to use that part for rental or business purposes. However, you are not considered to have changed its use if:

- your rental or business use of the property is relatively small in relation to its use as your principal residence;
- you do not make any structural changes to the property to make it more suitable for rental or business purposes; and
- you do not deduct any CCA on the part you are using for rental or business purposes.

If you meet all of the above conditions, the whole property may qualify as your principal residence, even though you are using part of it for rental or business purposes.

However, if you do not meet all of the above conditions, when you actually sell the property you have to:

- split the selling price between the part you used for your principal residence and the part you used for rental or business purposes. We will accept a split based on square metres or the number of rooms as long as the split is reasonable; and
- report any capital gain on the part you used for rental or business purposes. For more information, see "Real estate, depreciable property, and other properties" on page 15. You do not have to report any capital gain for the part you used for your principal residence.

Note
You cannot file an election under subsection 45(2) of the *Income Tax Act*, as discussed in the previous section, if there is only a partial change in use of a property.

Farm property

If you are a farmer and you sell farmland in 2001 that includes your principal residence, you can choose one of two methods to calculate your capital gain. We explain these two methods in the *Farming Income* and the *Farming Income and NISA* guides.

Example – Disposition of a principal residence partly used for earning income

In this example, we illustrate some of the topics that we discuss in this guide. We show you how to:

- treat the sale of property that was used partly as a principal residence and partly for earning income;
- report a capital gain on the disposition of property that includes land and a building (see "Real estate" on page 15); and
- calculate a recapture of capital cost allowance (CCA) or a terminal loss on the disposition of depreciable property (see "Recapture of CCA and terminal losses" on page 16).

In November 1988, John bought a duplex for $125,000. According to a municipal assessment completed just before the purchase, the entire property was valued at $100,000. The land was valued at $25,000 and the building was valued at $75,000. From the date he purchased the duplex, John lived in the lower half and rented out the upper half. Based on the property's total number of square metres, he determined that the portion he used to earn rental income was 40%.

On July 28, 2001, John sold the property for $175,000. He incurred expenses of $10,500 to make the sale. According to a recent municipal assessment, the entire property was now valued at $150,000. The land was worth $30,000 and the building was worth $120,000.

Any gain on the part of the property that John used as his principal residence will not be taxed, because he used that part of the property as his principal residence for all the years he owned it. Because John does not have to report the gain, he does not have to complete Form T2091(IND), *Designation of a Property as a Principal Residence by an Individual (Other Than a Personal Trust)*.

John has to calculate the capital gain on the portion of the property that he rented out. He also has to determine if he has a recapture of CCA or a terminal loss on the rented portion of the building. For this reason, he will break down the rental portion of the purchase price, the selling price, and the related expenses between the land and the building. Keeping in mind that 40% of the property was used for rental purposes, John completes the following calculations:

1. **He divides the rental portion of the purchase price between the land and the building, based on the municipal assessment at the time of the purchase:**

   a) Building: 40% $\times \frac{\$75{,}000}{\$100{,}000} \times \$125{,}000 = \$37{,}500$

   b) Land: 40% $\times \frac{\$25{,}000}{\$100{,}000} \times \$125{,}000 = \$12{,}500$

Because the breakdown between the land and the building was not shown on his purchase agreement, John uses the municipal assessment in effect at the time of the purchase. John would have completed this calculation at the time he purchased the property to determine the amount of CCA he could claim on the portion of the building he rented out.

2. **He divides the rental portion of the selling price between the land and the building, based on the municipal assessment at the time of the sale:**

   a) Building: 40% $\times \frac{\$120{,}000}{\$150{,}000} \times \$175{,}000 = \$56{,}000$

   b) Land: 40% $\times \frac{\$30{,}000}{\$150{,}000} \times \$175{,}000 = \$14{,}000$

The breakdown between the land and the building was not shown on John's sale agreement. Because no renovations were made to the building since the last municipal assessment, John can use the municipal assessment that was in effect at the time of the sale.

3. **He divides the rental portion of the expenses relating to the sale between the land and the building, based on the municipal assessment at the time of the sale:**

   a) Building: 40% $\times \frac{\$120{,}000}{\$150{,}000} \times \$10{,}500 = \$3{,}360$

   b) Land: 40% $\times \frac{\$30{,}000}{\$150{,}000} \times \$10{,}500 = \$840$

(continued on next page)

Example – Disposition of a principal residence partly used for earning income (continued)

John can now determine if he has a recapture of CCA or a terminal loss on the rented part of the building. The undepreciated capital cost (UCC) of the portion of the building used for rental purposes at the beginning of 2001 was $34,728. From the UCC, he subtracts one of the following amounts, whichever is less:

- the selling price of the rented part of the building minus the related outlays and expenses: $52,640 ($56,000 – $3,360); or
- the purchase price of the rented part of the building: $37,500.

UCC at the beginning of 2001	$	34,728
Minus: Purchase price	–	37,500
Recapture of CCA	= $	(2,772)

To help him complete the above calculations, John uses the CCA schedule on the back of Form T776, *Statement of Real Estate Rentals*.

John can now calculate his capital gain. To do this, he completes the section called "Real estate, depreciable property, and other properties" in Schedule 3, *Capital Gains (or Losses) in 2001*. He reports the sale of the rental property as follows:

Real estate, depreciable property, and other properties

Address or legal description									Gain (or loss)	
Street, City, Province (building)	1988		56,000	00	37,500	00	3,360	00	15,140	00
Street, City, Province (land)	1988		14,000	00	12,500	00	840	00	660	00
	Total	136	70,000	00		Gain (or loss)	138	+	15,800	00

Chart 7 – Calculating your 2001 exempt capital gains balance (ECGB) and your capital gains and business income reductions

The flow-through entities ("the entity") that this chart applies to are listed on page 29. Do a separate calculation for each entity.

If you disposed of your remaining interest in a partnership in the year and realized a capital gain, **do not** claim a capital gains reduction. For more information, see "Disposing of your shares of, or interest in, a flow-through entity" on page 30.

Step 1 – ECGB available for the year

If you claimed a capital gains or business income reduction in 1994 to 2000, or adjusted the ECGB of the entity in 1995 to 2000, because of an election to increase the cost of property you received from a trust (see page 29), enter on line 1 the ECGB to carry forward from the last time you claimed a reduction or filed an election. In all other cases, see Chart 8 on page 46 to determine the amount to enter on line 1.

1. ECGB carry forward .... $______ **1**
2. Portion of the amount at line 1 that you elected to add to the cost of property you received in 2000 (for more information, see page 29) .... – ______ **2**
3. ECGB available for 2001 (line 1 **minus** line 2) .... = $______ **3**

Step 2 – Capital gains reduction

Complete this step if, during the year, the entity flowed any capital gains out to you, or you sold your shares or interest in, the entity. Otherwise, go to Step 3.

4. Capital gains flowed out to you by the entity in 2001 .... $______ **4**
5. Capital gains from the disposition of shares of, or interest in, the entity in 2001 .... + ______ **5**
6. Total capital gains (line 4 **plus** line 5) .... = $______ **6**
7. **Capital gains reduction** – The maximum capital gains reduction you can claim is the **lesser of** the amounts on lines 3 and 6. However, you may claim less than the maximum. Enter this amount on line 195 of Schedule 3 .... – ______ **7**
8. Exempt capital gains balance before the business income reduction (line 3 **minus** line 7) .... = $______ **8**

Step 3 – Business income reduction

Complete all of this step if the entity is a partnership that disposed of eligible capital property. Otherwise, enter "0" on line 12.

9. Amount from line 8 .... $______ × 1/2 = $______ **9**
10. Your share of the partnership's business income (including your share of any farming income) from disposing of eligible capital property (other than the recapture of annual allowances deducted in previous years) .... $______ **10**
11. **Business income reduction** – Your maximum claim is the **lesser of** the amounts on lines 9 and 10. However, you can claim less than the maximum. You **cannot** use a business income reduction to create or increase a business loss. Claim the amount at line 12 in the chart "Other amounts deductible from your share of net partnership income (loss)" on Form T2032, T2042, T2121, or T2124, whichever applies... $______ **11**
12. Amount from line 11 .... $______ × 2 = ... ▶ – $______ **12**

Step 4 – Exempt capital gains balance available to carry forward

13. Line 8 **minus** line 12. If you disposed of all your shares of, or your entire interest in, the entity in 2001, enter "0." .... = $______ **13**

Chart 8 – Calculation of line 1 of Chart 4 and line 1 of Chart 7

Use this chart to determine the exempt capital gains balance for your shares of, or interest in, a flow-through entity ("the entity") if you have never:

- claimed a capital gains deduction;
- claimed a business income reduction; and
- where the entity is a trust (other than a mutual fund trust or a related segregated fund trust), filed an election to increase the cost of property you received from the trust, in satisfaction of all or a part of your interest in the trust.

Where the entity is:	Exempt capital gains balance
▪ a trust (other than a mutual fund trust), such as a related segregated fund trust or a trust governed by an employee profit-sharing plan;	Enter the elected capital gain from column 5, Chart A of Form T664 on line 1 of Chart 4 on page 30, or on line 1 of Chart 7 on page 45.
▪ an investment corporation; ▪ a mortgage investment corporation; ▪ a mutual fund corporation; ▪ a mutual fund trust; or ▪ a partnership.	If the proceeds of disposition you designated on Form T664 **are not more than** the fair market value of the entity at the end of February 22, 1994, enter the elected capital gain from column 5, Chart A of Form T664 on line 1 of Chart 4 on page 30, or on line 1 of Chart 7 on page 45. If the proceeds of disposition you designated on Form T664 are **more** than the fair market value of the entity at the end of February 22, 1994, complete the calculation below. Enter the amount from line 10 on line 1 of Chart 4 on page 30, or on line 1 of Chart 7 on page 45.

1. Designated proceeds of disposition (column 2, Chart A of Form T664) .... $________ **1**
2. Fair market value at the end of February 22, 1994 (Step 1 of Form T664) .... $________ **2**
3. Line 2 **multiplied** by 1.1 .... $________ × 1.1 ▸ – ________ **3**
4. Line 1 **minus** line 3 (if negative, enter "0") ....= $________ **4**
5. Adjusted cost base (column 1, Chart A of Form T664) ....+ ________ **5**
6. Line 4 **plus** line 5 .... = $________ ▸ – ________ **6**
7. Exempt capital gains balance before the reduction for non-qualifying real property (line 2 **minus** line 6. If negative, enter "0") .... = $________ **7**

   If you entered an amount in column 4, Chart A of Form T664, complete lines 8 and 9. Otherwise, enter the amount from line 7 on line 10.

8. The amount from column 4, Chart A of Form T664 **divided by** the amount from column 3, Chart A of Form T664 .... $________ **8**
9. Non-eligible portion of line 7 (line 7 **multiplied** by line 8) .... – ________ **9**
10. Exempt capital gains balance (line 7 **minus** line 9) .... = $________ **10**

Index

In addition to listing topics, this index provides references to any Interpretation Bulletin (IT) and Information Circular (IC) related to each topic mentioned. If after reading the explanations provided in this guide, you still need more information, get a copy of these publications. We provide a complete list of references on page 48.

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References

The following publications are available from your tax services office and can be ordered by calling 1-800-959-2221 toll free. Most of our publications are available on our Web site at **www.ccra.gc.ca**.

Forms

T1A *Request for Loss Carryback*

T123 *Election on Disposition of Canadian Securities*

T657 *Calculation of Capital Gains Deduction for 2001*

T936 *Calculation of Cumulative Net Investment Loss (CNIL) to December 31, 2001*

T1105 *Supplementary Schedule for Dispositions of Capital Property Acquired Before 1972*

T1170 *Capital Gains on Gifts of Certain Capital Property*

T2017 *Summary of Reserves on Dispositions of Capital Property*

T2091(IND) *Designation of a Property as a Principal Residence by an Individual (Other Than a Personal Trust)*

T2091(IND)-WS *Principal Residence Worksheet*

Information Circulars

IC 76-19 *Transfer of Property to a Corporation Under Section 85*

IC 78-10 *Books and Records Retention/Destruction*

Interpretation Bulletins

IT-78 *Capital Property Owned on December 31, 1971 – Identical Properties*

IT-84 *Capital Property Owned on December 31, 1971 – Median Rule (Tax-Free Zone)*

IT-95 *Foreign Exchange Gains and Losses*

IT-96 *Options Granted by Corporations to Acquire Shares, Bonds, or Debentures and by Trusts to Acquire Trust Units*

IT-113 *Benefits to Employees – Stock Options*

IT-120 *Principal Residence*

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IT-139 *Capital Property Owned on December 31, 1971 – Fair Market Value*

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IT-209 *Inter-Vivos Gifts of Capital Property to Individuals Directly or Through Trusts, and its Special Release*

IT-213 *Prizes From Lottery Schemes, Pool System Betting and Giveaway Contests*

IT-217 *Depreciable Property Owned on December 31, 1971*

IT-218 *Profit, Capital Gains and Losses From the Sale of Real Estate, Including Farmland and Inherited Land and Conversion of Real Estate From Capital Property to Inventory and Vice Versa*

IT-220 *Capital Cost Allowance – Proceeds of Disposition of Depreciable Property*, and its Special Release

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IT-232 *Losses – Their Deductibility in the Loss Year or in Other Years*

IT-236 *Reserves – Disposition of Capital Property*

IT-239 *Deductibility of Capital Losses From Guaranteeing Loans for Inadequate Consideration and From Loaning Funds at Less Than a Reasonable Rate of Interest in Non-Arm's Length Circumstances*

IT-259 *Exchanges of Property*

IT-264 *Part Dispositions*, and its Special Release

IT-291 *Transfer of Property to a Corporation Under Subsection 85(1)*

IT-332 *Personal-Use Property*

IT-391 *Status of Corporations*

IT-405 *Inadequate Considerations – Acquisitions and Dispositions*

IT-407 *Dispositions of Cultural Property to Designated Canadian Institutions*

IT-413 *Election by Members of a Partnership Under Subsection 97(2)*

IT-419 *Meaning of Arm's Length*

IT-456 *Capital Property – Some Adjustments to Cost Base*, and its Special Release

IT-458 *Canadian-Controlled Private Corporation*

IT-459 *Adventure or Concern in the Nature of Trade*

IT-478 *Capital Cost Allowance – Recapture and Terminal Loss*

IT-479 *Transactions in Securities*, and its Special Release

IT-481 *Timber Resource Property and Timber Limits*

IT-484 *Business Investment Losses*

IT-491 *Former Business Property*, and its Special Release

IT-505 *Mortgage Foreclosures and Conditional Sales Repossessions*

IT-511 *Interspousal and Certain Other Transfers and Loans of Property*

Notes

Notes

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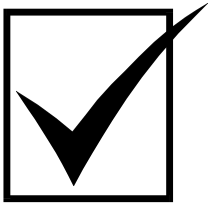

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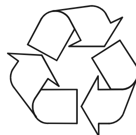

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