



Capital Gains

1993

Your
Guide



- Capital gains
- Capital losses
- Reserves
- Capital gains deduction
- Principal residence

Cette publication existe aussi en français.

Before You Start

Is this guide for you?

This guide is for you if you had a capital gain or a capital loss in 1993. You generally have a capital gain or loss whenever you dispose of capital property. Capital property is defined in Chapter 2 on page 7. This guide will show you how to calculate this type of gain or loss. It will also show you how to calculate your capital gains deduction.

Use Schedule 3, *Summary of Dispositions of Capital Property in 1993*, to record your capital gain or capital loss. This schedule comes with your *General Income Tax Guide* and returns package.

Forms and publications

In the middle of this guide, you will find two copies of some of the forms you may have to complete. Throughout the guide, we also refer to other forms and publications. If you need any forms or publications, see the section called "How to order forms and publications" on the last page of this guide.

What's New for 1993?

Outlined below are the major changes we have made to this guide. For more details on these changes, see the areas highlighted in yellow throughout the guide.

Changes

Spouse — The term spouse used throughout this guide applies to a legally married spouse and to a common-law spouse as defined on page 4 in Chapter 1.

Leaving or entering Canada — We have deleted former Chapter 8 called "Leaving or Entering Canada." The information that was in this chapter is now covered in the income tax guides called *Emigrants* and *New Canadians*.

New form — We have developed a new form you can use if you dispose of capital property you acquired before 1972. Form T1105, *Supplementary Schedule for Dispositions of Capital Property Acquired before 1972*, will help you to calculate your capital gain or loss from the disposition of capital property you owned before 1972. This form is not included in this guide. You can get this form from your Revenue Canada income tax office.

The *Capital Disposition Supplementary Schedules*, Forms T2080 to T2090, inclusive, have been cancelled with the introduction of Form T1105.

Proposed Changes

This guide includes announced tax changes that were not law at the time of printing. However, we are getting ready to apply these proposed changes.

This guide uses plain language to explain the most common income tax situations. If you need help after reading this guide, please contact your income tax office. You can find the address and telephone numbers in your income tax package.

You can get this publication in braille, large print, audio cassette, and computer diskette. For details, please call 1-800-267-1267 weekdays between 8:15 a.m. and 5:00 p.m. (Eastern Time).

Table of Contents

	Page		Page
Chapter 1 — General Information	4	Chapter 6 — Reserves	28
Did you sell personal-use property or your home? ...	4	What is a reserve?	28
Do you have a capital transaction or an income transaction?	4	Who can claim a reserve?	28
When do you have a capital gain or a capital loss? ..	4	How do you calculate a reserve?	28
When do you report a capital gain or a capital loss? ..	5	Property sold on or before November 12, 1981	28
Do you own a business?	5	Property sold after November 12, 1981	28
Are you a member of a partnership?	5	A — Other property	29
How do you calculate a capital gain or a capital loss? ..	5	B — Family farm property or small business corporation shares sold to your child	29
How do you report a capital gain or a capital loss? ..	5	Chapter 7 — Capital Gains Deduction	30
Did you sell capital property in 1993 that you owned before 1972?	5	What is a capital gains deduction?	30
What records do you have to keep?	5	When can you claim the capital gains deduction?	30
Chapter 2 — Definitions	6	Who is eligible to claim the capital gains deduction? ..	30
Chapter 3 — Common Transactions	10	What are the capital gains deduction limits?	30
Information slips	10	Disposition of non-qualifying real property	30
T3 slip	10	Calculating the portion of your capital gain not eligible for the deduction	31
T4PS slip	10	How do you calculate your capital gains deduction? ..	32
T5 slip	10	Step 1 — Calculating your cumulative net investment loss (CNIL) to December 31, 1993	32
T5013 slip	10	Step 2 — Calculating your annual gains limit	35
Real estate and depreciable property	11	Step 3 — Calculating your cumulative gains limit ..	35
Real estate	11	Step 4 — Calculating your capital gains deduction available for 1993	37
Depreciable property	11	Step 5 — Figuring out your maximum claim	37
Selling a building in 1993	12	Chapter 8 — Principal Residence	38
Selling part of a property	12	What is your principal residence?	38
Canadian securities and prescribed securities	12	How do you designate your home as your principal residence?	38
Other securities and properties	13	Can you have more than one principal residence? ...	38
Shares	13	Did you sell all or part of your principal residence? ..	38
Bonds, debentures, promissory notes, and other properties	14	Special situations	39
Treasury bills (T-Bills)	14	Changing your property's use to a rental or business operation	39
Identical properties	14	Election	39
Average cost calculation	14	Using part of your principal residence for a rental or business operation	39
Personal-use property	15	Changing your rental or business operation to a principal residence	40
Listed personal property (LPP)	16	Election	40
Employees' stock options	16	Farms	40
Chapter 4 — Other Transactions	18	Index	43
Eligible capital property	18		
Mortgages	18		
Bad debts	18		
Foreign exchange gains and losses	18		
Qualified small business corporation shares	19		
Qualified farm property	19		
Inheriting property	19		
Common transfers of property	19		
To persons other than your spouse	19		
To your spouse or a trust for your spouse	19		
Other transfers	20		
Farm property	20		
Elections	20		
Selling or donating certified Canadian cultural property	20		
Chapter 5 — Capital Losses	21		
When do you have a capital loss?	21		
1993 Capital losses	21		
Allowable business investment loss (ABIL)	21		
Reduction in business investment loss	22		
Applying listed personal property (LPP) losses	22		
Superficial losses	23		
Restricted farm losses	23		
Net capital losses of other years — line 253 of your General income tax return	24		
How do you apply net capital losses of other years to 1993?	24		
Net capital losses incurred before May 23, 1985	24		
Applying net capital losses of other years to 1993 ..	25		
How do you apply a 1993 net capital loss to previous years?	27		
Summary of losses	27		

Chapter 1 General Information

This section has general information you need to know before you start to calculate your capital gain or capital loss.

Throughout this guide, we use the terms "sell," "sold," "buy," or "bought." These words 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 may want to substitute the terms "disposed of" or "acquired" for "sold" or "bought," if they more clearly describe your situation.

Spouse — The term "spouse" used throughout this guide applies to a legally married spouse and, for 1993 and following years, it also applies to a common-law spouse. A common-law spouse is a person of the opposite sex who, at that particular time:

- was living with you in a common-law relationship and is the natural or adoptive parent (legal or otherwise) of your child; or
- was living with you in a common-law relationship and had been living with you for at least 12 continuous months (when you calculate the 12 continuous months, include any period of separation of less than 90 days).

Once either of these two situations applies, we consider you to have a common-law spouse, except for any period that you were separated for 90 days or more due to a breakdown in the relationship. In this guide, when we refer to "marriage" or "married," it includes a common-law relationship between two people of the opposite sex when the conditions above are met.

Did you sell personal-use property or your home?

Most people are not affected by capital gains rules because the property they own is for their personal use or enjoyment. When you sell personal-use property such as cars and boats, usually 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 a gain on the sale of personal-use property, generally you are not allowed to claim a loss. We explain the rules for personal-use property on page 15 in Chapter 3 of this guide.

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

- your home is your principal residence; and
- you did not designate any other house as your principal residence while you owned your home. For more information, see Chapter 8.

Do you have a capital transaction or an income transaction?

You have to know the answer to this question before you can continue in this guide. If you sell 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).

If you dispose of a property, you need to find out 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 (ITs):

- IT-459 — *Adventure or Concern in the Nature of Trade*
- 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-479 — *Transactions in Securities*, and its Special Release

The information in the rest of this guide deals with capital transactions. Therefore, if you have an income transaction, you **do not** have to read any further in this guide. If you have an income transaction, see the income tax 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 a 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; or
- a corporation redeems or cancels shares or other securities that you hold.*

* If a corporation redeems shares that you hold, you will usually have a deemed dividend. The amount of the dividend will be shown on a T5 slip.

There are other situations when you are considered to have sold a capital property, even though there is no change in the property's ownership. This can happen if:

- you change all or part of the property's use (see Chapter 8);
- you leave Canada (see the income tax guide called *Emigrants*); or

- the owner dies (see the income tax guide called *Preparing Returns for Deceased Persons*).

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

When you sell or are considered to have sold a capital property, you have to report the sale in the year that it takes place.

You may not have to pay tax for 1993. However, you still have to file a return:

- when you sell, or are considered to have sold, any capital property in 1993 (whether or not the sale results in a capital gain or capital loss); or
- to report the taxable part of any capital gains reserve you deducted in 1992 (see Chapter 6).

Tax Tip

If you want to claim the capital gains deduction, you have to file your 1993 return on or before April 30, 1995. For more information about the capital gains deduction, see Chapter 7.

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

Terri owns a construction firm. The fiscal year-end for her business is June 30, 1993. In November of 1993, she sold a capital property that she used in her business. As a result of the sale, she had a capital gain. Terri has to report the capital gain on her income tax return for 1993. 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, 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, report your share of any capital gain or capital loss in the calendar year in which that fiscal year ends.

How do you calculate a capital gain or a capital loss?

If you sold capital property in 1993, you will need to know the following three amounts to calculate any capital gain or capital loss:

- the proceeds of disposition;
- the adjusted cost base (ACB); and
- the outlays and expenses you incurred when selling your property.

To calculate your capital gain or capital loss, subtract the ACB of your property from the proceeds of disposition. From this new amount, subtract any outlays and expenses not already included in your ACB.

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

Use Schedule 3, *Summary of Dispositions of Capital*

Property in 1993, to calculate and report all of your taxable capital gains or allowable capital losses. You can find Schedule 3 in your *General Income Tax Guide* and returns package. Do not include any capital gains or capital losses in your business or property income, even if you used the property for your business. See Chapters 3 and 4 for information on how to complete Schedule 3.

You may have deducted a reserve in an earlier year, or you may be deducting a reserve in 1993. If either one of these apply to you, complete Form T2017, *Summary of Reserves on Dispositions of Capital Property*. This form is included with this guide and will help you report a prior year reserve or deduct a new reserve in 1993. For more information on reserves, see Chapter 6.

Did you sell capital property in 1993 that you owned before 1972?

If you did, you have to apply a special set of rules when calculating your capital gain or capital loss. You have to use these special rules because capital gains were not taxed before 1972. Therefore, you do not have to pay tax on capital gains accrued before 1972. To help you calculate your gain or loss from the sale of property you owned before 1972, use Form T1105, *Supplementary Schedule for Dispositions of Capital Property Acquired before 1972*.

For more information, see the following Interpretation Bulletins (ITs):

- 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-139 — *Capital Property Owned on December 31, 1971 — Fair Market Value*
- IT-217 — *Capital Property Owned on December 31, 1971 — Depreciable Property, and its Special Release.*

What records do you have to keep?

You will need the 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 have investment income or expenses, you should keep a record of these amounts. You may need them to calculate your cumulative net investment loss (CNIL) when you calculate your capital gains deduction. We explain the CNIL in Chapter 7.

In addition, it is a good idea to 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.

For more detailed information on keeping records, see Information Circular 78-10, *Books and Records Retention/Destruction*.

Chapter 2 Definitions

Adjusted cost base — This is usually the cost of your property plus any expenses you incurred to acquire it. These expenses may include 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.

You have to adjust the cost of your property to include 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. For more information on the difference between capital expenditures and current expenses, see Interpretation Bulletin IT-128, *Capital Cost Allowance — Depreciable Property*. For more information on additions to, and deductions from, the cost of a property, see Interpretation Bulletin IT-456, *Capital Property — Some Adjustments to Cost Base*, and its Special Release.

In some cases, special rules may apply so that the cost of a property is considered to be an amount other than its actual cost. For example, when you inherit or receive property as a gift, you are generally considered to have acquired the property at its fair market value on the date you acquired it. Similarly, when you win property as a prize from a lottery scheme, you are considered to have acquired the prize at its fair market value at that time. For more information, see Interpretation Bulletin IT-213, *Prizes from Lottery Schemes, Pool System Betting and Giveaway Contests*.

Allowable capital loss — This is the amount of your capital loss that you are entitled to deduct from your taxable capital gains. For 1987 and previous taxation years, the allowable portion was **one-half** of your capital loss. For 1988 and 1989, the allowable portion was **two-thirds**. For 1990 and following years, the allowable portion is **three-quarters**.

Arm's length transaction — This is a term used to describe a transaction between unrelated parties. Each party 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 blood relationship, marriage, or adoption. Also, a corporation and a shareholder who controls the corporation are related.

Unrelated parties may not be dealing with each other at arm's length if, for instance, one is under the influence or control of the other. For more information, see Interpretation Bulletin IT-419, *Meaning of Arm's Length*, and its Special Release.

Business investment loss — This is a capital loss that 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 incur 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 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 zero, and it is reasonable to expect that the corporation will be dissolved or wound-up and will not commence to carry on business. You have to elect in your return to be deemed to have sold the share in the corporation for nil proceeds of disposition, and to have reacquired the share immediately thereafter at a cost equal to nil.*

- * 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 the person have to report the capital gain in the taxation year the corporation commences to carry on business. The above applies if you or the person own the share in the corporation at the time the business is commenced.

For more information about business investment losses, see page 21 in Chapter 5. You can also get Interpretation Bulletin IT-484, *Business Investment Losses*.

Canadian-controlled private corporation — This is a private Canadian corporation that is not controlled directly or indirectly in any way by:

- one or more non-resident persons;
- one or more public corporations (other than a prescribed venture capital corporation); or
- any combination of the above.

For more information, see Interpretation Bulletin IT-458, *Canadian-Controlled Private Corporation*.

Canadian security — A Canadian security is:

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

Prescribed securities are not considered to be Canadian securities.

Capital cost allowance — In the year you buy a depreciable property, such as a building, you cannot deduct the 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 referred to as “capital cost allowance.”

Capital gain — You have a capital gain when you sell, or are considered to have sold, a capital property for **more** than its adjusted cost base plus the expenses or outlays incurred to sell the property. A capital gain is the difference between your proceeds of disposition and the adjusted cost base of the property less the expenses or outlays incurred to sell the property.

Capital loss — 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 expenses or outlays incurred to sell the property. The capital loss is the difference between the adjusted cost base of the property before you sold it and your proceeds of disposition less the expenses or outlays incurred to sell the property.

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. Some common types of capital property include:

- your cottage;
- securities, such as stocks and bonds; and
- land, buildings, and equipment that you use in a business or a rental operation.

Capital property **does not** include the trading assets of a business, such as stock or inventory.

Special rules apply when you dispose of certain types of property. These types of property include:

- insurance policies;
- certified cultural properties given or sold to designated institutions (see page 20 in Chapter 4);
- eligible capital properties (see page 18 in Chapter 4);
- depreciable properties sold at a loss (see page 11 in Chapter 3);
- Canadian resource properties;
- foreign resource properties; and
- timber resource properties.

For more information on resource properties, see Interpretation Bulletins IT-125, *Dispositions of Resource*

Properties, and IT-481, Timber Resource Property and Timber Limits.

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

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

Deemed proceeds of disposition — This term is used when you are considered to have received an amount for property, even though you did not actually receive that amount.

Depreciable property — This is usually capital property used to earn income from a business or property. The cost can be written off as capital cost allowance over a number of years. We define “capital cost allowance” earlier in this chapter.

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

Employees’ stock option — This is an option that a corporation grants to an employee. By using this option, the employee can buy the corporation’s shares, or the shares of a corporation with which it does not deal at arm’s length, for a price that may be less than the fair market value.

Fair market value — This is the highest dollar value that you can get for your property in an open and unrestricted market, where the parties of the transaction deal at arm’s length with each other and are not forced to buy or sell.

Listed personal property — This refers to the following personal-use properties that normally increase in value:

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

You can determine the value of many of these items by consulting with art, coin, jewellery, and stamp dealers. You can also refer to these dealers’ catalogues. All or any part of such property, any interest in it, or any right to it, is considered to be listed personal property.

Net capital loss — Generally, if your allowable capital loss is more than your taxable capital gain, the difference between the two is your net capital loss for the year. We explain how to apply net capital losses in Chapter 5.

Non-arm’s length transaction — This is a transaction between people who were not dealing with each other at arm’s length at the time of the transaction. Please see the definition of “arm’s length transaction” earlier in this chapter.

Non-qualifying real property — Generally, non-qualifying real property is real property that you or your partnership disposed of after February 1992. It also includes the following property you or your partnership disposed of after February 1992, 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 respect of any of the property described above.

The following is not included in the definition of non-qualifying real property:

- qualified farm property;
- qualified small business corporation shares; and
- real property that was owned by you or your spouse and, while you or your spouse owned it:
 - it was used principally in an **active business*** at all times in the 24-month period before you disposed of it (or if you or your spouse owned it for less than 24 months, that shorter period); or
 - it was used principally in an **active business*** throughout all or substantially all (90% or more) of the time before you disposed of it. This accommodates the sale of real property that may have been used for many years in an active business but lay idle for a period of time before you sold it.

In addition, the active business must have been carried on for the above-specified time period by:

- you, your spouse, your child, or your parent;
- a preferred beneficiary of a personal trust;
- the spouse, child, or parent of the preferred beneficiary of a personal trust; or
- a corporation, partnership, or personal trust where all or substantially all (90% or more) of the fair market value of their shares or interests are owned by one or more persons described in this list.

* For the purposes of this definition, an **active business** is:

- a business that does not derive its income principally from property;
- any business that employs more than 5 individuals on a full-time basis;
- any business that has managerial, administrative, financial, maintenance, or other similar services provided to it that would be equivalent to employing more than 5 individuals on a full-time basis;
- any business that leases property that is not real property; or
- any business carried on by a credit union.

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 when calculating your capital gain or capital loss. These types of expenses include:

- fixing-up expenses
- finders' fees
- commissions
- brokers' fees
- surveyors' fees
- legal fees
- transfer taxes
- advertising costs

You cannot reduce your other income by claiming a deduction for these outlays and expenses. Instead, use them to reduce your capital gain or increase your capital loss.

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, and other similar properties.

Prescribed security — This is not considered to be a Canadian security. A prescribed security generally includes:

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

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 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
- 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 it complied with the prescribed conditions relating to the number of its shareholders, the dispersal of ownership of its shares, the public trading of its shares, and the size of the corporation.

For more information on the meaning of public corporation, see Interpretation Bulletin IT-391, *Status of Corporations*.

Qualified small business corporation shares — See the definition of "Small business corporation" later in this chapter.

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

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;
- shares or debts of connected corporations that were small business corporations; or
- a combination of these two types of assets.

A share of a corporation is considered to be a **qualified small business corporation share** if:

- 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 a partnership of which you were a member;
- throughout the 24 months immediately before the share was disposed of, no one other than you, a partnership of which you were a member, or a person related to you owned the share*; and
- 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.

* As a general rule, when a corporation issues shares to a person or a partnership related to that person after June 13, 1988, a special situation exists. We consider the shares to have been owned, immediately before they were issued, by a person who was **not** related to the individual or the partnership. As a result, to meet the holding-period requirement, the individual or a

person or partnership related to the individual cannot dispose of the shares for 24 months after they were issued. However, this rule does not apply to shares issued:

- as payment for other shares; or
- in connection with a property that the person or the partnership disposed of to a corporation. The property disposed of has to consist of either:
 - all or most (90% or more) of the assets used in an active business operated by that person or by the members of that partnership; or
 - an interest in a partnership where all or most (90% or more) of the partnership's assets were used in an active business operated by the members of the partnership.

Taxable capital gain — This is the amount of your capital gain that you have to report as income on your return. For 1987 and previous taxation years, the taxable part of a capital gain was **one-half**. For 1988 and 1989, the taxable part was **two-thirds**. For 1990 and following years, the taxable part is **three-quarters**.

Terminal loss — This type of loss occurs when you have an undepreciated balance in a class of depreciable property at the end of the taxation year or fiscal year-end, 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, it is equal to the total capital cost of all the properties of the class minus the capital cost allowance (CCA) you claimed in prior years. If you sell depreciable property in a year, you also have to subtract from the UCC the lesser of the following two amounts:

- the proceeds of disposition of the property, minus the related outlays and expenses; and
- the capital cost of the property.

Chapter 3 Common Transactions

This chapter gives you information about some of the most common capital transactions. It also provides information about where you should report the sale of a capital property on Schedule 3, *Summary of Dispositions of Capital Property in 1993*. You can find this schedule in your *General Income Tax Guide* and returns package.

Information slips

T3 slip

Box 21 — Capital Gains — You may receive a T3 information slip with an amount in this box. If there is no asterisk (*) in this box, enter the amount on line 533 of Schedule 3.

If there is an asterisk in this box, you should have received instructions with your slip. The instructions will tell you where to report the amount on Schedule 3. You enter the amount on either line 513, "Qualified small business corporation shares," or line 516, "Qualified farm property." The reason for this is that these types of property are eligible for a higher capital gains deduction. We explain the capital gains deduction in Chapter 7.

Box 30 — Capital Gains Eligible for Deduction — If there is an amount in box 21, there must also be an amount in this box. If the amount is less than the amount in box 21, you have to enter the difference on line 536 of Schedule 3. You have to use this amount to calculate your capital gains deduction and your cumulative net investment loss. We explain this later in Chapter 7.

Example

Janet received a T3 slip with \$500 in box 21 and \$300 in box 30. Since there was no asterisk in box 21, she entered \$500 on line 533 of Schedule 3. Because the amount in box 30 was less than the amount in box 21, she entered the difference between the two amounts (\$200) on line 536 of Schedule 3.

Note

If box 30 has "nil," a zero, or a dash (-), no amount of your capital gain is eligible for the deduction. In this case, enter the full amount in box 21 on line 536 of Schedule 3. If there is no entry in box 30, contact the issuer for an amended slip.

Box 26 — Other Income — You may receive a T3 information slip with an asterisk (*) in this box. The asterisk indicates that a part of the amount in box 26 is a deemed taxable capital gain from the disposition of eligible capital property. The footnotes area of your slip will give you a description of the property and will tell you where to report the taxable capital gain on Schedule 3. Report a taxable capital gain on eligible capital property that is qualified farm property on line 543. Report a taxable capital gain on all other types of eligible capital property on line 544.

The footnotes area of your slip should also identify the amount of the taxable capital gain that is eligible for the

capital gains deduction. If the eligible amount is less than the taxable capital gain, you have to multiply the difference by $\frac{4}{3}$ and enter the result on line 536 of Schedule 3. You adjust this amount since box 26 includes **only** the taxable portion of the capital gain. Line 536 includes the total capital gain that is not eligible for the deduction before calculating the taxable portion. You have to use this amount to calculate your capital gains deduction and your cumulative net investment loss. We explain this later in Chapter 7.

Box 37 — Insurance Segregated Fund Losses — If there is an amount in this box, enter it on line 533 of Schedule 3. This amount is always a loss. If it is your only entry on line 533, put brackets around the amount. If it is not your only entry, subtract the amount in this box from the total of all other amounts you have to enter on line 533.

T4PS slip

Box 34 — Capital Gains (or Losses) — Enter this amount on line 533 of Schedule 3. If this amount has brackets around it, it is a capital loss. If the amount is a capital loss and it is your only entry on line 533, put brackets around the amount on line 533. If it is not your only entry, subtract the amount in this box from the total of all other amounts you have to enter on line 533.

Box 38 — Foreign Capital Gains (or Losses) — Do not include this amount on Schedule 3. It is already included in box 34 of your T4PS slip. Enter this amount on line 508 of Schedule 1, and use it to calculate your foreign tax credit.

Box 40 — Non-Eligible Capital Gains — If there is an amount in this box, enter it on line 536 of Schedule 3. This is the amount of your capital gain that is not eligible for the capital gains deduction. You have to use this amount to calculate your capital gains deduction and your cumulative net investment loss. We explain this later in Chapter 7. Do not subtract this amount from the amount you have already entered on line 533.

T5 slip

Box 18 — Capital Gains Dividends — Enter this amount on line 533 of Schedule 3.

Box 24 — Non-eligible portion of box 18 — If there is an amount in this box, enter it on line 536 of Schedule 3. This is the amount of your capital gain that is not eligible for the capital gains deduction. You have to use this amount to calculate your capital gains deduction and your cumulative net investment loss. We explain this later in Chapter 7. Do not subtract this amount from the amount you have already entered on line 533.

T5013 slip

Box 27 — Capital Gains (Losses) — Enter this amount on line 533 of Schedule 3 unless you have received additional details. For instance, the footnotes area of your slip may indicate that your gain is for qualified small business

corporation shares or qualified farm property. If this is the case, enter your gain on line 513 or line 516 of Schedule 3.

The footnotes area of your slip could also identify amounts included in box 27 that are not eligible for the capital gains deduction. If this is the case, enter the amount that is not eligible on line 536 of Schedule 3. You have to use this amount to calculate your capital gains deduction and cumulative net investment loss. We explain this later in Chapter 7.

Box 28 — Capital Gains Reserve — Enter this amount in the appropriate area on Form T2017, *Summary of Reserves on Dispositions of Capital Property*. You will find two copies of this form in the middle of this guide.

Box 29 — Business Investment Loss — Enter this amount on line 228 of your income tax return. This amount is your business investment loss. To find out how to calculate your allowable business investment loss, see page 21 in Chapter 5.

Real estate and depreciable property

If you sold real estate or depreciable property in 1993, you have to report your capital gain or loss in the section called "Real estate and depreciable property" on Schedule 3.

If you sold real estate in 1993 that is non-qualifying real property, you have to report an amount on line 536 of Schedule 3. This is the amount of your capital gain that is not eligible for the capital gains deduction. We explain this in the section called "Disposition of non-qualifying real property" on page 30 in Chapter 7.

Real estate

A real estate transaction includes the sale of:

- vacant land;
- rental properties, including both land and buildings;
- farm property, including both land and buildings (other than qualified farm property — see page 19 in Chapter 4); and
- commercial and industrial land and buildings.

Do not use this section of Schedule 3 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 this information on Schedule 3 under "Personal-use property" and "Bonds, debentures, promissory notes and other properties."

If you sold real property in 1993 that includes land and a building, you:

- first calculate how much of the selling price is for the land, and how much is for the building; then
- 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 41 in Chapter 8.

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 from selling the building as an amount other than the actual proceeds. For more information, see the section on page 12 of this chapter called "Selling a building in 1993."

Depreciable property

When you dispose of depreciable property, you may end up with a capital gain or a loss. Usually, you will have a capital gain on depreciable property if you sell it for more than its adjusted cost base plus the expenses or outlays incurred to sell the property. 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 under the capital cost allowance (CCA) rules. See page 7 in Chapter 2 for a definition of CCA.

To calculate CCA, you have to first group depreciable properties into classes. For example, certain portable tools and some automobiles are grouped together in Class 10. Your CCA claim is based on a rate assigned to each class of property. If you want to know what class your property is in, call us.

Generally, the undepreciated capital cost (UCC) of a class is the total capital cost of all the properties of the class minus the CCA claimed in prior years. If you sell depreciable property in a year, you also have to subtract from the UCC the lesser of the following two amounts:

- the proceeds of disposition of the property, minus the related outlays and expenses; and
- the capital cost of the property.

When you sell a depreciable property for less than its original capital cost, but for more than the UCC in its class, you do not have a capital gain. However, if the UCC of a class has a negative balance at the end of the year, the negative balance is considered to be a recapture of CCA. You have to include this recapture in income for that year.

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, the positive balance is a terminal loss. Unlike a capital loss, you can deduct the full amount of the terminal loss from income in that year.

If the balance for the UCC of a class is zero at the end of the year, then you have neither a recapture of CCA, nor a terminal loss.

The rules for recapture and terminal loss do not apply to passenger vehicles that you included in Class 10.1.

Example

In 1987, Adam bought a piece of machinery for \$10,000 for his business. It is the only property in its class at the beginning of 1993. The class has a UCC of \$6,000. He sold the piece of machinery in 1993 and purchased no other property in that class. The following chart gives you three different selling prices to show you how Adam would handle a variety of situations.

Calculation of capital gain

	A	B	C
Proceeds of disposition	\$ 4,000	\$ 8,000	\$12,000
Minus: Capital cost	10,000	10,000	10,000
Capital gain	<u>00</u>	<u>00</u>	<u>\$ 2,000</u>

Calculation of terminal loss and recapture of CCA

Cost of properties acquired:	\$10,000	\$10,000	\$10,000
Minus: CCA 1987-1992:	<u>4,000</u>	<u>4,000</u>	<u>4,000</u>
UCC at beginning of 1993:	\$ 6,000	\$ 6,000	\$ 6,000
Minus the lesser of:			
- cost — \$10,000; and			
- proceeds of: (A) \$ 4,000			
(B) \$ 8,000			
(C) \$12,000	<u>4,000</u>	<u>8,000</u>	<u>10,000</u>
	\$ 2,000	\$(2,000)	\$(4,000)
	Terminal loss	Recapture	Recapture

In **example A**, Adam does not have a capital gain. However, he does have a terminal loss of \$2,000 that he can deduct from income. Remember, you cannot have a capital loss on the sale of depreciable property.

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

In **example C**, Adam has a capital gain of \$2,000 (the selling price of the property of \$12,000 minus the cost of \$10,000). He also has a recapture of CCA of \$4,000 that he has to include in his income.

For more information about the recapture of CCA and terminal losses, see Interpretation Bulletin IT-478, *Capital Cost Allowance — Recapture and Terminal Loss*. You can also see the income tax guides called *Business and Professional Income* or *Rental Income*.

Selling a building in 1993

If you sold a building in 1993, special rules may apply that 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 so that the building can be used; and
- you sell the building for an amount that is less than both its **cost amount** and its capital cost to you.

You calculate the **cost amount** as follows:

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

Capital cost of the building	×	UCC of the class	=	Cost amount of the building
Capital cost of all properties in the class				

If you sold a building under these conditions, the terminal loss on the building may be restricted and the capital gain on the land may be reduced. For more information, see the chapter called "Capital Cost Allowance" in the income tax guide called *Rental Income* or Interpretation Bulletin IT-220, *Capital Cost Allowance — Proceeds of Disposition of Depreciable Property*.

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

Sophia owns 100 hectares of vacant land. The land is all of equal quality. She decides to sell 25 hectares of this land. Since 25 is one-quarter of 100, Sophia calculates one-quarter of the total ACB as follows:

The total ACB	.....	\$100,000
Minus: The ACB of the part she sold		
(\$100,000 × 1/4)	.....	\$ 25,000
Equals: The ACB of the part she kept	.....	<u>\$ 75,000</u>

Sophia then calculates any capital gain or loss using an ACB of \$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.

Canadian securities and prescribed securities

You report a disposal of Canadian securities or prescribed securities on Schedule 3 on:

- Line 513 — "Qualified small business corporation shares"
- Line 516 — "Qualified farm property"
- Line 520 — "Shares"
- Line 528 — "Bonds, debentures, promissory notes and other properties"

Chapter 2 contains the definitions of "Canadian securities," "prescribed securities," and "qualified small business corporation shares." You will find a definition of "qualified farm property" in the income tax guide called *Farming Income*. For more information on these properties, refer to the applicable headings on pages 13, 14, and 19.

If you dispose of Canadian securities, you may have an **income** gain or loss. However, there is a special election available to you in the year that you dispose of Canadian securities. You can elect to report your gain or loss as a **capital** gain or loss. However, if you make the election for a taxation year, we will consider every Canadian security owned by you in that year and later years to be capital properties. This election is not available to traders or dealers in securities, or to anyone who was a non-resident of Canada when the security was sold.

If you are a member of a partnership, and the partnership owns Canadian securities, each partner is treated as owning

the security. When the partnership disposes of the security, each partner may elect to treat the security as capital property. An election by one partner will not result in each member of the partnership 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 1993 return. Please remember that, once you make this election, you cannot reverse your decision.

For more information, see Interpretation Bulletin IT-479, *Transactions in Securities*, and its Special Release.

Other securities and properties

These include shares, bonds, debentures, promissory notes, and other such properties. If you sold any of these items in 1993, you will receive either a T5008, *Statement of Securities Transactions*, or an account statement. Report any capital gains and capital losses in the section called "Other securities and properties" on Schedule 3. This

section is broken down into three subsections so that you can report different securities and properties separately.

Shares

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

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

The following two examples share some common information. They show you two different situations (a capital gain and a capital loss) and how you would complete part of Schedule 3 for each situation.

Example 1

In 1993, Franco sold 100 shares of ABC Public Corporation of Canada for \$8,500. He received the full proceeds at the time of the sale. He paid brokerage fees of \$500. When he bought the shares in 1985 for \$3,800, Franco paid brokerage fees of \$200.

To fill in Schedule 3, Franco needs to find out three things:

- his proceeds of disposition;
- his adjusted cost base (ACB); and
- the amount of any outlays and expenses that relate to the sale.

After he finds out these three amounts, Franco calculates his taxable capital gain as follows:

Proceeds of disposition			\$8,500
Minus: The ACB			
— Original cost	\$3,800		
— Brokerage fees on purchase	\$ 200	\$4,000	
Outlays and expenses (brokerage fees on the sale)		\$ 500	\$4,500
Capital gain			\$4,000
Taxable capital gain (3/4 × \$4,000)			\$3,000

Franco reports the sale under "Shares" in the section called "Other securities and properties." He reports his total proceeds on line 519, and his capital gain on line 520.

Other securities and properties

Shares

No. of shares	Name of corporation and class of shares						Gain (or loss)
100	ABC Public Corporation of Canada	1985	8,500 00	4,000 00		500 00	4,000 00
		Total proceeds 519	8,500 00			Gain (or loss) 520	4,000 00

If Franco has no other capital gains or capital losses in the year, he reports \$3,000 (3/4 × \$4,000) as his total taxable capital gains amount. He enters this amount on line 545 of Schedule 3, and again on line 127 of his return. Franco may also be entitled to the capital gains deduction. For more information about this deduction, see Chapter 7.

Example 2

Using the same situation in Example 1, assume that Franco had sold his shares for only \$3,700. As you can see below, Franco ends up with a capital loss of \$800 (\$3,700 - \$4,500). He could use the loss to offset any capital gains he had in 1993. If his capital losses were more than his capital gains in that year, his net capital loss for 1993 would be three-quarters of the difference between the two amounts. For more information about capital losses, see the section called "1993 Capital losses" on page 21 in Chapter 5.

Other securities and properties

Shares

No. of shares	Name of corporation and class of shares	1985	3,700 00	4,000 00	500 00	Gain (or loss)
100	ABC Public Corporation of Canada					(800 00)
Total proceeds		519	3,700 00		Gain (or loss)	520 (800 00)

Bonds, debentures, promissory notes, and other properties

Report the sale of any of these types of properties on Schedule 3 in the section called "Bonds, debentures, promissory notes and other properties." You also report the following capital gains and capital losses in this section:

- **Options** — For information on disposing of options to sell or buy shares, see Interpretation Bulletins IT-96, *Options Granted by Corporations to Acquire Shares, Bonds or Debentures*, and IT-479, *Transactions in Securities*, and its Special Release; and
- **Discounts, premiums, and bonuses** — If, in 1993, you received any of these amounts for investments that you have, see Interpretation Bulletin IT-114, *Discounts, Premiums and Bonuses on Debt Obligations*.

Treasury bills (T-Bills)

You will receive a T5008, *Statement of Securities Transactions*, or an account statement for transactions that took place in 1993. When a T-Bill is issued at a discount and you keep it until it matures, the interest deemed to accrue to you is the difference between the issue price and the amount you cash it in for. However, you may sell the T-Bill before it matures. In this case, in addition to the interest accrued at that time, you may have a capital gain or capital loss.

Example

Ralph purchased a T-Bill on December 1, 1992, for \$49,000. The maturity date was March 1, 1993. However, he sold it on February 4, 1993, for \$49,500. The effective yield rate was 5.36%.

Ralph calculates interest on the T-Bill, as follows:

$$\begin{array}{r} \text{Effective} \\ \text{yield} \\ \text{rate} \end{array} \times \frac{\text{Number of days} \\ \text{T-Bill held}}{\text{Number of days} \\ \text{in the year sold}} \times \text{Purchase} \\ \text{price} = \text{Interest} \\ \text{to be} \\ \text{included} \\ \text{in income}$$

$$5.36\% \times \frac{66}{365} \times \$49,000 = \$475$$

Ralph calculates his capital gain as follows:

Proceeds	\$49,500
Minus: Interest	\$ 475
Net proceeds	\$49,025
Minus: Adjusted cost base	\$49,000
Capital gain	\$ 25

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 example of this is when you have shares of the same class of the capital stock of a corporation.

Average cost calculation

You may buy and sell several identical properties at different prices over a period of time. If you do this, you have to figure out the average cost of each property in the group at the time of each purchase. This allows you to determine your ACB. You need to know this amount before you can calculate any capital gain or loss. The following two examples show you how to calculate the average cost.

Example

Kristi owns 100 common shares of a corporation. She bought these shares for \$15 each. She later bought another 150 shares of the same class of that corporation for \$20 each. In 1993, she sold 200 of these shares for \$24 each.

Calculation of average cost

Previously purchased shares:	100 × \$15 =	\$1,500
Newly purchased shares:	150 × \$20 =	\$3,000
Total shares:	250	Total cost: \$4,500
Average cost of each share:	\$4,500 ÷ 250 = \$ 18	

Calculation of capital gain

Selling price:	(200 × \$24) =	\$4,800
Minus: ACB of shares sold:	(200 × \$18) =	\$3,600
Capital gain:		\$1,200
Taxable capital gain:	(\$1,200 × 3/4) =	\$ 900

You have to calculate the average cost each time you buy another identical property.

Example

After selling 200 shares in the corporation, Kristi had 50 left (250 - 200). She then bought 350 more shares (which were identical properties) at \$21 each. She has to recalculate the average cost of the shares as follows:

Cost of previously purchased shares:	50 × \$18 =	\$ 900.00
Cost of newly purchased shares:	350 × \$21 =	\$7,350.00
Total shares:	<u>400</u>	Total cost: <u>\$8,250.00</u>
Average cost of each share (recalculated amount):	\$8,250 ÷ 400 =	\$ 20.63

You should also use this method to calculate the average cost for identical bonds or debentures that you bought after 1971. However, the average cost is based on the principal amount for each identical property.

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

- they are both issued by the same debtor; and
- all the attached rights are the same.

You cannot take the principal amount of individual debt obligations into account when you are figuring out if these properties are identical.

Personal-use property

You will find a definition of personal-use property on page 8 in Chapter 2. When you dispose of personal-use property, you will end up with a capital gain or a capital loss. To calculate your capital gain or loss, follow these rules:

- if the 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 capital loss. Do not report the sale on Schedule 3 when you file your return.

When you dispose of personal-use property that has an ACB or proceeds of disposition **over \$1,000**, you may end up with a capital gain or a capital loss. You have to report any capital gain in the section called "Personal-use property" on Schedule 3. However, if you end up with 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. The reason for this is that 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 which is listed personal property (LPP) — LPP is discussed on page 16 in the next section; or
- to a bad debt owed to you by a person with whom you deal at arm's length for the sale of personal-use property — for more information, see the section called "Bad debts" on page 18 in Chapter 4.

You were asking...?

- Q. In 1993, I sold an old china cabinet for \$900. The cabinet didn't cost me anything because my grandmother gave it to me 10 years ago. She had a dealer appraise it at the time, and the cabinet was valued at \$500. Do I have to report the gain on my income tax return?
- A. No. Since the china cabinet is personal-use property, the ACB and the proceeds of disposition are both considered to be \$1,000. Therefore, for income tax purposes, there is no gain or loss on the sale of the china cabinet.

Example

Samir sold his motorcycle in 1993 for \$1,200. He bought it in 1983 for \$850. The only expense he had in selling the motorcycle was \$15 for advertising. Since the ACB of the motorcycle is less than \$1,000 (\$850), it is considered to have an ACB of \$1,000. Although Samir actually had a gain of \$335 (\$1,200 minus \$850 minus \$15), the capital gain that he reports is only \$185 (\$1,200 minus \$1,000 minus \$15).

Personal-use property (full description)

<i>Motorcycle</i>	1983	1,200|00	1,000|00	15|00	185|00
				Gain only 530	185|00

Example

In 1993, Chelsea sold her lakefront property and cottage to a developer for \$100,000. She bought the property in 1981 for \$49,000, and built a cottage on it for \$30,000 in 1990. Chelsea incurred expenses of \$1,000 in connection with the sale of the land and cottage. During the period she owned the property, Chelsea paid a total of \$9,000 in property taxes and in interest on the money borrowed to buy the property and build the cottage.

When calculating her capital gain on the property and cottage, Chelsea can deduct the \$1,000 selling expenses. However, the \$9,000 in property taxes and interest is considered to be a personal expense, since she was not using the property or cottage to earn income. As a result, Chelsea cannot deduct the \$9,000 from her income for any taxation year. She also cannot use it to reduce her capital gain in 1993. In addition, when she calculates the ACB of the property, she cannot add the \$9,000 to her original cost of \$49,000 for the land.

Therefore, Chelsea has to show the sale of the property in the section called "Personal-use property" on Schedule 3. She uses this schedule to report her capital gain of \$20,000 (\$100,000 - \$49,000 - \$30,000 - \$1,000 = \$20,000).

If Chelsea had designated her cottage as her principal residence, all or part of the capital gain may have been exempted from tax. For more information on designating your principal residence, see Chapter 8.

Personal-use property (full description)

<i>Lot 119-120, Plan 2750</i>	1981	100,000|00	79,000|00	1,000|00	20,000|00
<i>City, Province, Country</i>				Gain only 530	20,000|00

Remember, if you sell personal-use property that is real property, you have to read Chapter 7 to figure out what portion of your gain is not eligible for the capital gains deduction.

For information on selling part of a personal-use property or sets of personal-use property, see Interpretation Bulletin IT-332, *Personal-Use Property*.

Listed personal property (LPP)

LPP (defined on page 7 in Chapter 2) is a type of personal-use property. Therefore, the \$1,000 minimum proceeds of disposition and adjusted cost base rules apply. For more information about these rules, see the previous section called "Personal-use property."

You can only apply LPP losses against LPP gains. Report the gain from the sale of LPP on line 531 of Schedule 3. If you have a loss from LPP in 1993, or LPP losses from a

previous year to apply against your 1993 LPP gains, see page 22 in Chapter 5 to see how to apply them.

Employees' stock options

When your employer grants you a stock option, there is no immediate effect on your tax situation. A stock option is an **opportunity** to buy stock at a certain price. It only affects your tax situation if you sell the option or exercise that option and actually buy stocks. If you decide to buy stocks and you buy them at **less-than-market value**, you will have a taxable benefit. The taxable benefit is the difference between what you paid for the stocks, and the higher fair market value at the time you exercised your option. This difference is a taxable benefit received through employment.

You have to include this taxable benefit in your income in the year you acquire the shares. Please note, however, that you can reduce the amount of the benefit by any amount

you paid to acquire the stock option. Your employer includes this taxable benefit in boxes 14 and 38 on your T4 slip.

However, if you buy stocks through an employee stock option granted to you by a Canadian-controlled private corporation with which you deal at arm's length, the situation is different. 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.

If you meet certain conditions, you may be able to claim a special deduction. This deduction is equal to one-quarter of the taxable employee stock option benefit included in your employment income. The amount of the benefit that qualifies for this deduction is shown in the "footnotes" area of your T4 slip. See line 249, "Stock option and shares deductions," in the *General Income Tax Guide*.

To calculate the ACB of your stocks, add the following two amounts:

- any amount included in your income as an employee stock option benefit; and
- the actual purchase price.

You have to do this even if you claimed a stock option deduction for these stocks.

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

In the year you exchange or sell the shares that you bought through an employee stock option agreement, report the capital gain or loss on Schedule 3. Depending on your situation, you can either use the section called "Qualified small business corporation shares" or the one called "Other securities and properties." In addition, you may be

able to claim a capital gains deduction for part, or all, of any taxable capital gain. We explain this later in Chapter 7.

Example

In 1990, Julie, an employee of ABC Corporation, received an option to buy 20 shares at \$25 each. ABC was not a Canadian-controlled private corporation.

In 1992, Julie exercised the option and bought the shares. The market value at that time was \$30.

In 1993, she sold her 20 shares for \$40 each. The tax implications for Julie are as follows:

In 1990, when Julie received the option there were no tax implications.

In 1992, when Julie purchased the shares:

Market value (20 × \$30)	\$600
Minus: Amount paid (20 × \$25)	<u>\$500</u>
Taxable benefit	<u>\$100</u>

The \$100 was included as a taxable benefit on Julie's 1992 T4 slip. An amount of \$25 was shown in the footnotes area of her T4 slip as a stock option deduction. She claimed the \$25 deduction on line 249 of her General income tax return.

In 1993, when Julie sold the shares:

Proceeds of disposition (20 × \$40)	\$800
Minus: Amount paid (20 × \$25)	\$500
Taxable benefit	<u>\$100</u> <u>\$600</u>
Capital gain	<u>\$200</u>

Julie reports a capital gain of \$200 in the section called "Other securities and properties" on Schedule 3, since these are not qualified small business corporation shares.

For more information, see Interpretation Bulletin IT-113, *Benefits to Employees — Stock Options*.

Chapter 4 Other Transactions

We explain some of the less common capital transactions in this chapter. We also explain the special rules for calculating your capital gain or capital loss and where to report the result on Schedule 3.

Eligible capital property

If you operate a business, you may buy a 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. This kind of property is called eligible capital property.

If you have these types of properties, you may have a taxable capital gain when you dispose of them. You will find details on what amount will be a capital gain in the income tax guides called:

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

Read the chapter called "Eligible Capital Expenditures" in the guide that applies to your type of business. You may also want to read Interpretation Bulletin IT-123, *Transactions Involving Eligible Capital Property*.

If you have a taxable capital gain on eligible capital property that is qualified farm property, enter it on line 543 of Schedule 3. If you have a taxable capital gain on any other type of eligible capital property, enter it on line 544 of Schedule 3.

If you have a capital gain from the sale of eligible capital property, you are eligible for the capital gains deduction. If the eligible capital property was also qualified farm property, you are eligible for the higher capital gains deduction. We explain the capital gains deduction in Chapter 7.

Mortgages

The person who holds a mortgage on a property is the **mortgagee**. The person who owes the money is the **mortgagor**.

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

If you are the mortgagor, your property may be repossessed. If this happens, you are considered to have sold the property. Usually, when your property is repossessed, you will have a capital loss or a terminal loss. However, if the property is personal-use property, you cannot deduct the loss.

These rules also apply when property is repossessed under a conditional sales agreement.

Report any capital gain or capital loss on Schedule 3 in the section called "Bonds, debentures, promissory notes and other properties."

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

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 situation.*

The capital loss is equal to the adjusted cost base of the debt.

* 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.

Report any capital loss on Schedule 3 in the section called "Bonds, debentures, promissory notes and other properties."

There are times when a bad debt involves a **small business corporation**. We explain what to do in this situation under "Allowable business investment loss (ABIL)" on page 21 in Chapter 5.

For more information about bad debts, see Interpretation Bulletins IT-159, *Capital Debts Established to be Bad Debts*, and IT-239, *Deductibility of Capital Losses from Guaranteeing Loans for Inadequate Consideration and from Lending Funds at less than a Reasonable Rate of Interest in Non-Arm's Length Circumstances*.

Foreign exchange gains and losses

Foreign exchange gains or losses from capital transactions in foreign currencies are considered to be capital gains or capital 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 capital loss; and
- you do not have to report it on your tax return.

If you have a capital gain or a capital loss, report it on line 528 of Schedule 3.

For more information, see Interpretation Bulletin IT-95, *Foreign Exchange Gains and Losses*.

Qualified small business corporation shares

We define "qualified small business corporation shares" on page 9 in Chapter 2. Report the sale of these types of shares on Schedule 3 in the section called "Qualified small business corporation shares."

Do not report the following transactions in this section:

- the sale of other shares, such as publicly traded shares or shares of a foreign corporation; and
- losses you have when you sell any shares of small business corporations to a person with whom you deal at arm's length.*

* For more information on losses you may have when selling these type of shares, see the section called "Allowable business investment loss (ABIL)" on page 21 in Chapter 5.

If you have a capital gain when you sell qualified small business corporation shares, you are eligible for the higher capital gains deduction. To calculate this deduction, get Form T657, *Calculation of Capital Gains Deduction for 1993 on All Capital Property*, from us.

Qualified farm property

Generally, when you dispose of qualified farm property, you report any capital gain or capital loss on Schedule 3 in the section called "Qualified farm property." To find out what is considered to be qualified farm property, see the income tax guide called *Farming Income*.

If you have a taxable capital gain from selling eligible capital property that is also qualified farm property, report the gain on line 543 of Schedule 3. For more information, see the section called "Eligible capital property" at the beginning of this chapter.

If you have a capital gain when you sell qualified farm property, you are eligible for the higher capital gains deduction. To calculate this deduction, get Form T657, *Calculation of Capital Gains Deduction for 1993 on All Capital Property*, from us.

If you dispose of **non-qualified** farm property, report it on Schedule 3 in the section called "Real estate and depreciable property." You will find more details about this section on page 11 in Chapter 3.

Inheriting property

If you inherit property and later sell it, you may have a capital gain or a capital loss in the year of the sale. Generally, when you inherit property from a person, the property's cost to you is an amount equal to the deemed proceeds of disposition for the deceased. Usually, this amount is the fair market value of the property on the date of that person's death. However, there are exceptions to this rule. For example, property that you inherit because your spouse died, or farm property transferred on death to a child, may be treated differently. See the chapter called

"Deemed Disposal of Property" in the income tax guide called *Preparing Returns for Deceased Persons* to find out what rules apply to your situation.

Common transfers of property

When reading this section, please remember that the meaning of the terms "spouse," "married," and "marriage" have changed. Refer to the explanation on page 4 in Chapter 1.

To persons other than your spouse

If you give capital property as a gift, you are considered to have sold it at its fair market value (FMV) at the time you give the gift. You include any taxable capital gain or allowable capital loss in your income for the year that you gave the gift.

If you receive capital property as a gift, you are considered to have purchased it at its FMV at the time you received it. If you sell the property later, this same purchase price will be your cost when you calculate any capital gain or capital loss for the year.

To your spouse or a trust for your spouse

If you give capital property to your spouse, or to a trust for your spouse, 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 the trust for your spouse, 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, a person who has **since** become your spouse, or a trust for your spouse. If this is the case, and your spouse or the trust sells the property during your lifetime, you usually have to report any capital gain or capital loss from the sale.

You will **have to** report the capital gain or capital loss when your spouse, a person who has since become your spouse, or the trust sells the property if, at the time of the sale:

- you are a resident of Canada; and
- you and your spouse are married (if you are living in a common-law situation, you may be considered to be married — see the definition of "spouse" on page 4 in Chapter 1).

If you are living apart because of a marriage breakdown, you may not have to report the capital gain or capital loss when your spouse sells the property. To do this, you have to file an election with your tax return.

For transfers of property made **after May 22, 1985**, you can file this election with your income tax return for any taxation year ending after the time you separated. However, in order for the election to be valid, it has to be

filed no later than the year your spouse disposes of the property. The election has to 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**, the election has to be filed with your income tax return for the taxation year in which the separation occurred. The election has to state that you do not want subsection 74(2) of the *Income Tax Act* to apply.

In both situations, you and your spouse have to sign the election.

If you sold the property to your spouse or trust, and you were paid an amount equal to the 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 capital loss for the year that you sold the property. You also have to attach a note to your tax return. The note should say that you are reporting the property as being sold to your spouse at its FMV.

If your spouse or the trust later sells the property, your spouse or 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 it to your spouse after 1971.
- Your spouse later sold the property.

For more information about this subject, see Interpretation Bulletin IT-209, *Inter-Vivos Gifts of Capital Property to Individuals Directly or Through Trusts*.

If you need more information about transferring property to your spouse, see Interpretation Bulletins IT-511, *Interspousal Transfers and Loans of Property made after May 22, 1985*, and IT-258, *Transfer of Property to a Spouse*, and its Special Release.

Tax Tip

As you read about transfers, remember the capital gains deduction that we explain in Chapter 7. The deduction may be more useful in your situation than any of these transfers.

Other transfers

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.

For more information, see Interpretation Bulletin IT-405, *Inadequate Considerations — Acquisitions and Dispositions*.

There are special rules that allow you to transfer property

at an amount other than the property's FMV. If these rules apply to your situation, you may be able to postpone paying tax on any capital gains that you realize from the transfer. Some of the more common transfers are noted below.

Farm property

When you sell or transfer farm property, you may end up with a capital gain. There are many special rules for these types of capital gains. For example, if you transfer farm property to a spouse or child these rules may apply. For more information about these types of transfers and other rules that apply to farm property, see the income tax guide called *Farming Income*.

Elections

If you have a capital gain, you may elect to postpone reporting it when you transfer property:

- **from an individual to a Canadian corporation** (use Form T2057, *Election on Disposition of Property by a Taxpayer to a Taxable Canadian Corporation*);
- **from a partnership to a Canadian corporation** (use Form T2058, *Election on Disposition of Property by a Partnership to a Taxable Canadian Corporation*); or
- **from an individual to a Canadian partnership** (use Form T2059, *Election on Disposition of Property by a Taxpayer to a Canadian Partnership*).

For information on making a transfer 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 a transfer 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 that you have when you sell or donate certified Canadian cultural property (national treasures) to an institution or public authority designated by the Minister of Communications. The Canadian Cultural Property Export Review Board, which operates under Communications Canada, certifies this property to be cultural property and provides certificates 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 end up with a capital loss. The 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 (LPP). If this is the case, the rules regarding LPP losses will apply. See Chapter 5 for details on how to apply a capital loss.

For more information, see Interpretation Bulletin IT-407, *Disposition after 1987 of Canadian Cultural Property*, and its Special Release, or see our pamphlet called *Gifts in Kind*.

Chapter 5 Capital Losses

In this chapter, we explain what you do if you disposed of any capital property in 1993 or a prior year, and ended up with a capital loss.

When do you have a capital loss?

You generally 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 expenses or outlays incurred to sell the property. However, special rules apply when you dispose of:

- depreciable property (see page 11 in Chapter 3); or
- personal-use property (see page 15 in Chapter 3).

If you sold listed personal property and ended up with a loss, see the section called "Applying listed personal property (LPP) losses" on page 22 in this chapter.

1993 Capital losses

You can only apply a capital loss against a capital gain. This means that, if you had a capital gain in 1993, you can use your capital loss to reduce the amount of the gain.

The amount of your capital loss is further reduced to what we call your **allowable capital loss**. An allowable capital loss is three-quarters of your capital loss.

When your allowable capital losses in 1993 are greater than your taxable capital gains, the difference between the two is your **net capital loss** for 1993. Report your loss on Schedule 3 and file it with your 1993 return. This will ensure your losses are on our records, in case you want to apply the losses to other years.

You can carry your 1993 net capital loss back three years (1992, 1991, and 1990) and apply it against your taxable capital gains in any of those years. For details, see the section called "How do you apply a 1993 net capital loss to previous years?" on page 27 in this chapter.

You can also apply your net capital loss against a taxable capital gain in any future year. If you are going to do this, make sure you keep a record of the amount you have available to carry forward. We explain how to apply these losses in the section called "How do you apply net capital losses of other years to 1993?" on page 24 in this chapter.

Example

In 1993, Rosemary sold some securities that she owned. As a result, she had a capital loss of \$800 and a capital gain of \$400.

Allowable capital loss ($\$800 \times 3/4$)	.....	\$(600)
Taxable capital gain ($\$400 \times 3/4$)	.....	\$ 300
Net capital loss	.....	<u>\$(300)</u>

The difference between her allowable capital loss (\$600) and her taxable capital gain (\$300) is Rosemary's net capital loss for 1993. She can apply her net capital loss of \$300 against taxable capital gains

that she had in any of the three previous years, or in any future year.

You were asking...?

- Q. I owned some shares in a Canadian public corporation and sold them in 1993 at a loss. I had no capital gains in 1993. How do I show my capital loss on my tax return?
- A. Report this loss on Schedule 3. Enter the proceeds of disposition on line 519 of Schedule 3, and enter your capital loss on line 520. Three-quarters of your capital loss is your allowable capital loss for 1993. Since you have no taxable capital gains in 1993, your allowable capital loss becomes a net capital loss for 1993. You cannot deduct the net capital loss in 1993 because you did not have any taxable capital gains. You can, however, carry the loss back three years, or forward to any future year, and apply it against taxable capital gains. Make sure you attach Schedule 3 to your income tax return for 1993, so we have a record of your loss.

Allowable business investment loss (ABIL)

If you had a business investment loss (defined on page 6 in Chapter 2) in 1993, you can deduct three-quarters of the loss from income. We call this amount your ABIL.

You have to reduce your business investment loss by any capital gains deduction you claimed in a previous year. We explain this in the next section called "Reduction in business investment loss."

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 1993. You can carry back a non-capital loss three years and forward seven years.

To carry back a non-capital loss to 1990, 1991, or 1992, complete Form T1A, *Request for Loss Carry-Back*, and file it with your income tax return for 1993. Do not file an amended income tax return for the year you want the loss applied to. For more information on non-capital losses, see Interpretation Bulletin IT-232, *Non-Capital Losses, Net Capital Losses, Restricted Farm Losses, Farm Losses and Limited Partnership Losses — Their Composition and Deductibility in Computing Taxable Income*.

You may not be able to deduct your ABIL as a non-capital loss within the allowed time frame. The unapplied part becomes a net capital loss which you can use to reduce your taxable capital gains in the eighth year or any year after.

For example, let's say you had an ABIL in 1985 that became a non-capital loss and you were not able to deduct it in the three years before 1985 or the seven years after 1985. The loss can now be used to reduce your taxable capital gains in 1993 or any year after.

Claim your ABIL by entering:

- on line 228 of your General income tax return, your business investment loss before reducing this loss (see the next section);
- on line 535 of Schedule 3, any reduction in business investment loss (see the next section); and
- on line 217 of your General income tax return, your **allowable** business investment loss.

You also have to attach a note that states the:

- 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 that you bought the shares, or the date that you acquired the debt;
- amount of the proceeds of disposition;
- adjusted cost base of the shares or debt;
- outlays or expenses on the disposition; and
- amount of the loss (enter this amount on line 228 of your return).

Any ABIL that you claim for 1993 will reduce the capital gains deduction you can claim in 1993 and in future years. See Chapter 7 for more information.

Reduction in business investment loss

If you claimed a capital gains deduction in a previous year, you have to reduce your business investment loss in 1993.

The following chart will help you calculate the reduction. If you had more than one business investment loss in 1993, you can use this chart to calculate your total reductions for 1993.

Looking at the chart, you will notice that we adjust the amount of the capital gains deductions that you claimed in previous years. We do this because capital gains were included in income at different rates in those years.

Total capital gains deductions claimed in 1985, 1986, and 1987 (from line 254 of your 1985, 1986, and 1987 returns)	\$ _____ × 2 = \$ _____ (1)
Total capital gains deductions claimed in 1988 and 1989 excluding amounts claimed for taxable capital gains from eligible capital property (line 254 of your 1988 and 1989 returns minus any amounts reported on lines 543 and 544 on Schedule 3 for 1988 and 1989 — if negative, enter zero)	\$ _____ (a) × 3/2 = \$ _____ (2)
Total capital gains deductions claimed in 1988 and 1989 for eligible capital property (total of amounts on line 254 of your 1988 and 1989 returns minus the amount on line (a) above — not to exceed lines 543 and 544 on Schedule 3 for 1988 and 1989)	\$ _____ × 4/3 = \$ _____ (3)
Total capital gains deductions claimed in 1990, 1991, and 1992 (from line 254 of your 1990, 1991, and 1992 returns)	\$ _____ × 4/3 = \$ _____ (4)
Line 1 plus lines 2, 3, and 4	\$ _____ (5)
Total reduction(s) in business investment losses for 1986 to 1992 (from line 535 of Schedule 3 of your 1986 to 1992 returns)	\$ _____ (6)
Line 5 minus line 6	\$ _____ (7)
Business investment loss(es) for 1993 (before reducing the loss(es): from line 228 of your 1993 return)	\$ _____ (8)
Reduction(s) in business investment loss(es) for 1993: Line 7 or line 8, whichever amount is less	\$ _____ (9)
Business investment loss(es) for 1993: Line 8 minus line 9	\$ _____ (10)
Allowable business investment loss(es) for 1993 (3/4 of line 10)	\$ _____ (11)

Enter this reduced amount on line 217 of your tax return.

The amount from line 9 becomes a capital loss for 1993. Enter this amount on line 535 of Schedule 3.

Applying listed personal property (LPP) losses

If you dispose of LPP in 1993, you need to read this section since applying an LPP loss is different from applying other capital losses. This is because:

- you can only deduct LPP losses from any gains you had from selling other LPP;
- the total amount of LPP losses that you deduct in the year cannot be more than the total LPP gains for that year; and

- you cannot use this loss to reduce any capital gains you had from selling other types of property.

To figure out how much of an LPP loss you can apply, you have to calculate each LPP disposition separately.

First, determine if you have any LPP gains in 1993. Do not include LPP gains from selling or donating certified Canadian cultural property to a designated institution (see the section called "Selling or donating certified Canadian cultural property" on page 20 in Chapter 4). Next,

determine if you have any LPP losses in 1993. If you do, use your 1993 LPP losses to reduce as much of your gain as you can.

If you have not reduced your gain to zero, check to see if you have any unapplied LPP losses from 1986 and later years. You can use these losses to reduce your LPP gain in 1993. Do not enter these losses on line 253 of your return. Instead, reduce your 1993 gain by the amount of the loss. If you have reduced your LPP gain to zero, you can carry forward any loss that is left that has not expired. An LPP loss expires when it is not used by the end of the seventh year after it was incurred. If you have not reduced your gain to zero, enter the remaining gain on line 531 of Schedule 3.

If your 1993 LPP losses are more than your LPP gains in 1993, you can use the difference to reduce LPP gains of other years. You can reduce a gain you had in any of the three years before 1993 or the seven years after.

If you would like to carry back your 1993 LPP losses to reduce your LPP net gains from 1990, 1991, and 1992, complete Form T1A, *Request for Loss Carry-Back*. File one copy with your 1993 tax return. Do not file an amended return for the year you would like the loss applied to.

Remember, only complete the "Listed personal property" area of Schedule 3 if you end up with a gain in 1993. If you do not have a gain, keep a record of your LPP losses so you can apply these losses against future LPP gains.

Example

Marina bought some jewellery in 1981 for \$5,800. In 1993, she sold it for \$6,000. She ended up with a gain of \$200. She also sold a coin collection for \$2,000 in 1993. Marina had originally bought this collection in 1985 for \$1,700. She ended up with a gain of \$300 when she sold the coin collection. In addition, she sold a painting in 1993 for \$8,000. However, Marina bought the painting in 1980 for \$12,000. Therefore, she had a loss of \$4,000. She had no outlays or expenses for these three transactions.

Marina's loss from selling LPP in 1993 was more than her gain: her loss was \$4,000; her total gain was \$500 (\$200 + \$300). As a result, her net loss was \$3,500 (\$4,000 - \$500). Marina cannot use the difference to offset her capital gain on the sale of a property other than on LPP in the year. In addition, she cannot offset any income she had from other sources. However, she can apply her LPP loss against her LPP gains in any of the three previous years, or the seven years following 1993.

Marina should not complete Schedule 3 for 1993. However, she should keep a record of her LPP loss in case she wants to apply the loss against LPP gains in another year.

Superficial losses

A superficial loss can occur when you dispose of capital property for a loss and, during the period starting 30 days before the sale and ending 30 days after the sale:

- you, your spouse, or a corporation you control directly or indirectly buys the same or identical property (called "substituted property"); and
- you, your spouse, or a corporation you control directly or indirectly still owns the substituted property 30 days after the sale.

If you have a superficial loss in 1993, 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.

However, this rule **does not apply** if:

- you are considered to have sold the capital property because you 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; or
- you are considered to have sold the property because you changed its use.

Restricted farm losses

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 farming is not your chief 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 a restricted farm loss (RFL). You can carry an RFL back three years and you can carry it forward up to ten 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 chief source of income and how to calculate a restricted farm loss, see the income tax guide called *Farming Income*.

You may have restricted farm losses (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 you can apply cannot be more than the total of the property taxes and the interest on money borrowed to buy the farmland. 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 this type of loss to create or increase a capital loss from selling farmland.

Example

Bob sold his farmland in 1993 for \$200,000. The ACB of the property was \$160,000. Bob has an unapplied RFL of \$20,000 from 1992. This amount includes \$5,000 for property taxes, \$5,000 for interest, and \$10,000 for other expenses.

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

Proceeds of disposition:	\$200,000
ACB:	\$160,000
Plus: Property taxes: ..	\$ 5,000
Interest:	\$ 5,000
	<u>\$170,000</u>
Capital gain:	<u>\$ 30,000</u>
Taxable capital gain ($\$30,000 \times 3/4$):	<u>\$ 22,500</u>

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

For more information, see Interpretation Bulletin IT-232, *Non-Capital Losses, Net Capital Losses, Restricted Farm Losses, Farm Losses and Limited Partnership Losses — Their Composition and Deductibility in Computing Taxable Income*.

Net capital losses of other years — line 253 of your General income tax return

Usually, when your allowable capital losses are **more** than your taxable capital gains for a year, the difference is your **net capital loss**. You can carry your net capital loss back three years and apply it against your net taxable capital gains for those years. You can also carry it forward indefinitely to a future year and apply it against your net taxable capital gains.

Tax Tip

If you had a taxable capital gain in 1993, you may decide to take advantage of the capital gains deduction. You can do this instead of using your net capital losses from another year. See Chapter 7 for more information about the capital gains deduction.

The taxable part of a capital gain and the allowable part of a capital loss are not the same for every year. We refer to these amounts as their inclusion rates. The inclusion rates are as follows:

- **one-half** for 1987 and years before that;
- **two-thirds** for 1988 and 1989; and
- **three-quarters** for 1990 and years after that.

Since there are different inclusion rates for certain years, you may have to adjust your net capital loss. You have to adjust your net capital loss when you apply it against a taxable capital gain in a year that has a different inclusion rate.

How do you apply net capital losses of other years to 1993?

To apply net capital losses of other years to 1993, you

have to separate the losses into groups, depending on when the losses occurred. You do this because there are different inclusion rates for certain years. Also, the way you apply these losses may differ. You break down your losses as follows:

- losses incurred before May 23, 1985;
- losses incurred after May 22, 1985, and before 1988;
- losses incurred in 1988 and 1989; and
- losses incurred after 1989 and before 1993.

Losses that occurred before May 23, 1985, are subject to special rules. If you have unapplied net capital losses from before May 23, 1985, see the next section.

Make sure you apply net capital losses of earlier years before you apply net capital losses of later years. For instance, if you have a net capital loss in 1987 and in 1991, and you would like to apply these losses against your taxable capital gains in 1993, you have to follow a certain order. First, apply your 1987 net capital loss against your taxable capital gain. Then you apply your 1991 net capital loss against it.

Net capital losses incurred before May 23, 1985

This includes losses you incurred after May 22, 1985, if you disposed of capital property in accordance with an agreement you entered into before May 23, 1985.

Usually, you can only apply net capital losses of other years against taxable capital gains. However, if the losses were incurred before May 23, 1985, they may be used 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 1993.

Your **pre-1986 capital loss balance** available for 1993 is:

- the balance of your total **unapplied** 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 1993.

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. For more information, see Interpretation Bulletin IT-232, *Non-Capital Losses, Net Capital Losses, Restricted Farm Losses, Farm Losses and Limited Partnership Losses — Their Composition and Deductibility in Computing Taxable Income*.

Applying net capital losses of other years to 1993

Use the following chart to apply your net capital losses of other years to 1993, and to calculate your loss balance that is available for you to carry forward to a future year.

Step 1 — Pre-1986 capital loss balance available for 1993

Complete this step only if you have a balance of unapplied net capital losses from before May 23, 1985. Otherwise, enter zero on line 3 and start at Step 2.

Balance of unapplied net capital losses you had before May 23, 1985 \$ _____ (1)

Capital gains deductions you claimed:

Before 1988 \$ _____

In 1988 & 1989 \$ _____ × 3/4 = \$ _____

In 1990, 1991, & 1992 \$ _____ × 2/3 = \$ _____

Total capital gains deductions after adjustment \$ _____ (2)

Pre-1986 capital loss balance available for 1993 (line 1 minus line 2) \$ _____ (3)

Step 2 — Applying net capital losses of other years to 1993

Complete the following table to apply your net capital losses of other years to 1993.

Line A — Enter the amount of your unapplied net capital losses of other years for each period indicated.

Line B — Adjustment factor.

Line C — Multiply the amount on line A by the amount on line B for each period, and enter the result on line C.

	Before May 23, 1985	After May 22, 1985, and before 1988	In 1988 and 1989	After 1989 and before 1993
A				
B	3/2	3/2	9/8	1
C				

Total unapplied adjusted net capital losses of other years (total of amounts in C above) \$ _____ (4)

Taxable capital gains reported on line 127 of your 1993 return \$ _____ (5)

Line 4 or line 5, whichever is less \$ _____ (6)

You can apply all, or part of, the amount on line 6 against your taxable capital gains in 1993.

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 1993 income tax return. This is your **maximum deduction in 1993 for net capital losses of other years**. Enter this same amount on line 16 in Step 3. Do not complete lines 8 to 15, inclusive.

If you completed Step 1, complete lines 8 to 16, inclusive.

Balance of unapplied adjusted net capital losses of other years not used to reduce taxable capital gains (line 4 minus line 7) \$ _____ (8)

Amount from line 8 \$ _____ × 2/3 \$ _____ (9)

Amount from line 3 \$ _____ (10)

Pre-1986 deductible amount \$ 2,000 (11)

Line 9, 10, or 11, whichever is less \$ _____ (12)

Maximum deduction in 1993 for net capital losses of other years (line 7 plus line 12) \$ _____ (13)

Report the amount from line 13 on line 253 of your 1993 return.

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

You may still have a balance of unapplied net capital losses of other years after you have applied these losses to 1993. If this is the case, complete this step to calculate your balance.

Amount from line 7 \$ _____ (14)

Amount from line 12 \$ _____ × 3/2 \$ _____ (15)

Total adjusted net capital losses of other years applied in 1993 (line 14 plus line 15) \$ _____ (16)

The following table will help you calculate any net capital losses of other years that are available to carry forward.

Line D — Enter the amount of your unapplied adjusted net capital losses for each period at the beginning of 1993 (from line C, Step 2).

Line E — Enter the total net capital losses of other years applied in 1993. The total on line E has to equal the amount of losses on line 16 above. Remember, you have to apply the oldest losses first.

Line F — Subtract the amount on line E from the amount on line D for each period, and enter the difference on line F.

Line G — Adjustment factor.

Line H — Multiply the amount on line F by the amount on line G for each period, and enter the result on line H. The amounts on line H are your net capital losses of other years that are available to carry forward to a future year.

	Before May 23, 1985	After May 22, 1985, and before 1988	In 1988 and 1989	After 1989 and before 1993
D				
E				
F				
G	2/3	2/3	8/9	1
H				

Example

Jack has unapplied net capital losses of \$4,000 incurred before May 23, 1985. He claimed capital gains deductions of \$500 in 1986, and \$300 in 1989. Jack also has an unapplied net capital loss of \$100,000 from 1990. He reported a taxable capital gain of \$30,000 on line 127 of his 1993 return. He completes the following steps to calculate the maximum deduction he can claim for his unapplied net capital losses of other years in 1993, and to figure out the loss balance that is available for him to 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 1993

Complete this step **only** if you have a balance of unapplied net capital losses from before May 23, 1985. Otherwise, enter zero on line 3 and start at Step 2.

Balance of unapplied net capital losses you had before May 23, 1985		\$ 4,000	(1)
Capital gains deductions you claimed:			
Before 1988		\$ 500	
In 1988 & 1989 \$ 300 × 3/4 =		\$ 225	
In 1990, 1991, & 1992 \$ × 2/3 =		\$	
Total capital gains deductions after adjustment		\$ 725	(2)
Pre-1986 capital loss balance available for 1993 (line 1 minus line 2)		\$ 3,275	(3)

Step 2 — Applying net capital losses of other years to 1993

	Before May 23, 1985	After May 22, 1985, and before 1988	In 1988 and 1989	After 1989 and before 1993
A	\$4,000			\$100,000
B	3/2	3/2	9/8	1
C	\$6,000			\$100,000

Total unapplied adjusted net capital losses of other years (total of amounts in C above)		\$ 106,000	(4)
Taxable capital gains reported on line 127 of your 1993 return		\$ 30,000	(5)
Line 4 or line 5, whichever is less		\$ 30,000	(6)
You can apply all, or part of, the amount on line 6 against your taxable capital gains in 1993.			
Enter on line 7 the amount of losses you want to claim		\$ 30,000	(7)
Balance of unapplied adjusted net capital losses of other years not used to reduce taxable capital gains (line 4 minus line 7)		\$ 76,000	(8)
Amount from line 8 $\$ 76,000 \times 2/3$		\$ 50,666	(9)
Amount from line 3		\$ 3,275	(10)
Pre-1986 deductible amount		\$ 2,000	(11)
Line 9, 10, or 11, whichever is less		\$ 2,000	(12)
Maximum deduction in 1993 for net capital losses of other years (line 7 plus line 12)		\$ 32,000	(13)

Report the amount from line 13 on line 253 of your 1993 return.

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

Amount from line 7		\$ 30,000	(14)
Amount from line 12 $\$ 2,000 \times 3/2$		\$ 3,000	(15)
Total adjusted net capital losses of other years applied in 1993 (line 14 plus line 15)		\$ 33,000	(16)

	Before May 23, 1985	After May 22, 1985, and before 1988	In 1988 and 1989	After 1989 and before 1993
D	\$6,000			\$100,000
E	\$6,000			\$ 27,000*
F	00			\$ 73,000
G	2/3	2/3	8/9	1
H	00			\$ 73,000

* Jack has to apply his older losses first. Since the total amount of adjusted losses that Jack used in 1993 was \$33,000 (from line 16 above), he applies \$6,000 of his adjusted pre-1986 losses first. He then uses \$27,000 (\$33,000 - \$6,000) of his 1990 losses. Jack has unapplied net capital losses of \$73,000 that he can carry forward to a future year.

How do you apply a 1993 net capital loss to previous years?

You can carry a 1993 net capital loss back three years to 1990, 1991, and 1992 and use it to reduce your taxable capital gains in these years. When you carry back your net capital loss, you can choose to which year you want to apply the loss. Since the inclusion rate is the same for all these years, you do not have to adjust your 1993 loss when you carry it back.

To apply a 1993 net capital loss to 1990, 1991, or 1992, complete "Area III — Net capital loss for carry-back" on

Form T1A, *Request for Loss Carry-Back*. It will help you to determine the amount you have left to carry forward to future years.

To help you keep accurate records, make sure you keep separate balances of unapplied net capital losses for each year.

Tax Tip

If you apply a 1993 net capital loss to a previous year, any capital gains deduction that you claimed in that year, or a following year, may be reduced. For more information, see the note on page 35 in Chapter 7.

Summary of losses

The following chart summarizes some of the information we have discussed in this chapter.

Type of loss	Application of losses	Restrictions
Allowable business investment losses (ABIL) (see page 21 in this chapter)	Any unapplied portion becomes a non-capital loss in the year of the loss — carry back three years — carry forward seven years Unapplied portion becomes a net capital loss which can be used to reduce taxable capital gains in the eighth year or any year after	No restrictions Limited to taxable capital gains in the year
Net capital losses (see page 24 and this page in this chapter)	— carry back three years — carry forward indefinitely	Limited to taxable capital gains in the year*
Farm losses (see the income tax guide called <i>Farming Income</i>)	— carry back three years — carry forward ten years	No restrictions
Listed personal property (LPP) losses (see page 22 in this chapter)	— carry back three years — carry forward seven years	Limited to net gains from LPP in the year
Losses from personal-use property (see page 15, Chapter 3)	— no loss allowed**	Not applicable
Restricted farm loss (see page 23 in this chapter)	— carry back three years — carry forward ten years Part of any unapplied loss may be used to reduce your capital gains on the sale of the farmland that was used in a farming business	Limited in the year to net farming income for the year Cannot be more than the total of the property taxes and the interest on money borrowed to buy the farmland Cannot be used to create or increase a capital loss
Superficial losses (see page 23 in this chapter)	— no loss allowed; however, the amount of the loss can generally be added to the adjusted cost base of the substituted property	Not applicable

* For net capital losses incurred before May 23, 1985, an additional amount (up to \$2,000) may also be deducted from other income. See the section called "Net capital losses incurred before May 23, 1985" on page 24 in this chapter.

** For exceptions to this rule, see the section called "Personal-use property" on page 15 in Chapter 3.

Chapter 6 Reserves

In this chapter, we explain the capital gains rules that apply when you sell property and only receive part of the selling price at the time of the sale.

What is a reserve?

When you sell a capital property, you usually receive full payment at that time. However, this is not always the case. Sometimes the amount is spread over a number of years. For instance, you may sell a capital property for \$50,000 and receive \$10,000 at the time of the sale. You receive the remaining \$40,000 over a period of four years. In this type of situation, you can claim a **reserve**. Usually, a reserve allows you to defer reporting a portion of the capital gain to the year in which you receive the proceeds.

If you decide to claim a reserve, you still need to calculate your capital gain for the year. You do this in the regular way (the proceeds of disposition **minus** the adjusted cost base and the selling expenses). From this amount, you have to deduct the amount of your reserve for the year. The figure that you end up with is the part of the capital gain that you have to report in the year of sale.

If you claimed a reserve in a **previous year**, include that reserve when you calculate your capital gains for the **current year**. For instance, if you claimed a reserve in 1992, you have to include this amount in your capital gains for 1993. If you still have a reserve for 1993, you have to calculate and deduct a new reserve, and include it for the following year — 1994. Keep doing this until you have received full payment for the property. However, there is a limit to the number of years that you can do this. It depends on when you sold the property and the type of property that you sold.

A capital gain from a reserve qualifies for the **capital gains deduction** only if it is an eligible capital gain. Therefore, a reserve included in income from property you sold before 1985 is not eligible. If you are claiming a reserve on the disposition of non-qualifying real property, you will have to calculate the amount of the capital gain that is not eligible for the capital gains deduction. We explain this in the section called "Disposition of non-qualifying real property" on page 30 in Chapter 7.

To deduct a reserve in any year, you have to complete Form T2017, *Summary of Reserves on Dispositions of Capital Property*. Use this form if you are an individual (other than a trust) who is:

- reporting a reserve you claimed on your 1992 return;
- claiming a 1993 reserve in respect of a 1992 reserve; or
- claiming a reserve in respect of a disposition of capital property in 1993.

You can find two copies of this form in the middle of this guide.

Who can claim a reserve?

Most people can claim a reserve when they sell a capital property. However, you **cannot** claim a reserve if you:

- were not a resident in Canada at the end of the taxation year, or at any time in the following year;
- were exempt from paying tax at the end of the taxation year, or at any time in the following year; or
- sold a capital property to a corporation that you control in any way.

How do you calculate a reserve?

The amount of a reserve you can claim in a taxation year is limited. To figure out your maximum reserve for a year, you use one of three calculations. The one that you use depends on **when** you sold the property, and the type of property you sold.

Note

You do not have to claim the maximum reserve in the taxation year. You can claim any amount up to the maximum. However, the amount of the reserve you claim in a later year for the disposition of a particular property cannot be more than the amount you claimed for that property in the immediately preceding year.

Property sold on or before November 12, 1981

If you sold property on or before November 12, 1981, use the following formula to calculate your reserve:

$$\frac{\text{Capital gain}}{\text{Proceeds of disposition}} \times \text{Amount not due until after the end of the year}$$

You also use this formula for property that you sold **after** November 12, 1981, if:

- the sale took place under the terms of an offer or an agreement in writing; and
- the offer or agreement was made, or entered into, on or before November 12, 1981.

Property sold after November 12, 1981

If you sold property after November 12, 1981, the formula you use to calculate your maximum reserve depends on the type of property you sold. There are two formulas: one formula to use when you sell **other property**, and one formula to use when you sell **family farm property or small business corporation shares to your child**.

Your child includes:

- your natural child, your adopted child, or your spouse's child;
- your grandchild or great-grandchild;
- a person who, while under 19, was in your custody and control and was wholly dependent on you for support; or
- your child's spouse.

A — Other property

For all other property that you sell after November 12, 1981, you can spread the capital gain over a maximum of five years. Your reserve in each year cannot be more than the lesser of the following:

$$(a) \frac{\text{Capital gain}}{\text{Proceeds of disposition}} \times \text{Amount not due until after the end of the year}$$

and

$$(b) \text{Capital gain} \times \text{_____}^*$$

- * 1st year : 80% (year of sale)
 2nd year : 60%
 3rd year : 40%
 4th year : 20%
 5th year : zero

By using this calculation, you end up reporting at least one-fifth of the capital gain each year until you have reported the entire amount.

Example

Katelynn bought a sailboat in 1985. She sold it in 1993 for \$75,000. The adjusted cost base of the boat was \$50,000, and the selling expenses were \$5,000. She ended up with a capital gain of \$20,000. Katelynn received a down payment of \$30,000 at the time of the sale. She will receive \$5,000 a year for the following nine years.

Since Katelynn did not receive full payment for the sale in the year she sold the boat, she may claim a reserve. However, even though she will not receive the total selling price for nine years, she cannot spread the capital gain that she has to report over more than five years. Katelynn's maximum reserve for 1993 is the lesser of (a) and (b):

$$(a) \frac{\$20,000}{\$75,000} \times \$45,000 = \$12,000$$

and

$$(b) \$20,000 \times 80\% = \$16,000$$

* As this is the year of the sale, Katelynn uses 80% to calculate the amount of her reserve.

Katelynn enters the \$12,000 reserve on line 388 of Form T2017, *Summary of Reserves on Dispositions of Capital Property*. As Katelynn had no other capital transactions in 1993, she completes Schedule 3, *Summary of Dispositions of Capital Property in 1993*, as follows:

Line 530 — Capital gain	\$ 20,000
Line 537 — Total capital gain	\$ 20,000
Line 538 — Amount of reserve from T2017	\$(12,000)
Line 539 — Capital gain to be reported in the year	\$ 8,000
Line 540 — Taxable capital gain (3/4 × \$8,000)	\$ 6,000

Katelynn enters the taxable capital gain of \$6,000 on line 127 of her 1993 return.

In 1994, Katelynn has to report her 1993 reserve of \$12,000 as a capital gain. She will enter this amount on line 386 of Form T2017 for 1994. Since there will still be an amount due to her at the end of 1994, she may calculate a new reserve, and deduct it from the \$12,000. She shows the new reserve for 1994 on line 388 of Form T2017.

B — Family farm property or small business corporation shares sold to your child

If you sell one of these two types of property after November 12, 1981, to your child (who lived in Canada at the time of the sale), you can spread your capital gain over a maximum of 10 years. Your reserve in each year cannot be more than the lesser of the following:

$$(a) \frac{\text{Capital gain}}{\text{Proceeds of disposition}} \times \text{Amount not due until after the end of the year}$$

and

$$(b) \text{Capital gain} \times \text{_____}^*$$

- | | |
|---------------------------------|-----------------|
| * 1st year : 90% (year of sale) | 6th year: 40% |
| 2nd year: 80% | 7th year: 30% |
| 3rd year: 70% | 8th year: 20% |
| 4th year: 60% | 9th year: 10% |
| 5th year: 50% | 10th year: zero |

By using this calculation, you will end up reporting at least one-tenth of the capital gain each year until you have reported the entire amount.

Family farm property includes:

- shares of a family farm corporation;
- an interest in a family farm partnership; or
- land or depreciable property in Canada that you, your spouse, or any of your children used in a farming business. We define "child" on page 28 in this chapter.

For more information on how to calculate a capital gains reserve and details of what is considered to be a family farm property, see Interpretation Bulletin IT-236, *Reserves — Disposition of Capital Property*.

Chapter 7 Capital Gains Deduction

This chapter deals with the capital gains deduction as it applies to capital property other than qualified small business corporation shares or qualified farm property. It also explains the rules regarding non-qualifying real property and shows you how to complete Form T936, *Calculation of Cumulative Net Investment Loss (CNIL) to December 31, 1993*, and Form T657A, *Calculation of Capital Gains Deduction for 1993 on Other Capital Property*. You will find two copies of these forms in the middle of this guide.

If you disposed of qualified small business corporation shares or qualified farm property in 1993 or a prior year, use Form T657, *Calculation of Capital Gains Deduction for 1993 on All Capital Property*. If you disposed of a combination of properties that includes these types of properties, you should also use Form T657. This form includes information that will help you calculate the deduction for these types of capital gains. You can get this form from us. You will find the definition of qualified small business corporation shares on page 9 in Chapter 2. To find out what is considered to be qualified farm property, get the income tax guide called *Farming Income*.

Tax Tip

If you meet certain conditions, you may not have to complete Forms T936, T657, or T657A to claim the capital gains deduction. We explain this in more detail at line 254 in the *General Income Tax Guide*.

What is a capital gains deduction?

It is a deduction that you can claim against eligible taxable capital gains incurred from property disposed of after 1984. By claiming this deduction, you can reduce your taxable income.

When can you claim the capital gains deduction?

You can claim the capital gains deduction in a year that you have an eligible capital gain. Your claim cannot be more than your eligible taxable capital gains. Claiming a capital gains deduction is not mandatory. In other words, you can claim any amount you want to in a year, from zero up to the maximum.

An eligible capital gain does not include:

- a reserve you brought into income from capital property you disposed of **before** 1985; and
- a capital gain from the disposition of non-qualifying real property acquired **after** February 1992.

If you acquired non-qualifying real property **before** March 1992, part of the gain may be eligible for the deduction. We explain this in the section called "Disposition of non-qualifying real property" on this page.

Tax Tip

It is important that you report your capital gain on your return for the year that you had the capital gain. Otherwise, you may not be allowed to claim the capital gains deduction for these gains.

Who is eligible to claim the capital gains deduction?

Anyone who was a resident of Canada throughout 1993 is eligible to claim the capital gains deduction. For the purposes of this deduction, we will also consider you to be a resident throughout 1993 if:

- you were a resident of Canada for at least **part** of 1993; and
- you were a resident of Canada **throughout** 1992 or 1994.

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

What are the capital gains deduction limits?

There is a limit to the total amount of capital gains deductions that you can claim. This limit depends on the type of capital property that you disposed of. If you disposed of:

- **qualified farm property or qualified small business corporation shares**, you are eligible for the \$500,000 capital gains deduction. Since you only include three-quarters of a capital gain in your taxable income, your cumulative capital gains deduction is \$375,000 (three-quarters of \$500,000); or
- **any other capital properties**, you are eligible for the \$100,000 capital gains deduction. Your cumulative capital gains deduction is \$75,000 (three-quarters of \$100,000).

Note

The total of your capital gains deductions from 1985 to 1993 for **all** types of capital properties cannot be more than your cumulative deduction of \$375,000.

Disposition of non-qualifying real property

If you disposed of real property and certain other capital property in 1993, you have to determine if the property is non-qualifying real property. If the property is non-qualifying real property, the part of the gain that is applicable to the period after February 1992 is not eligible for the capital gains deduction. We define "non-qualifying real property" on page 8 in Chapter 2.

Qualified farm property and qualified small business corporation shares are not included in the description of non-qualifying real property and are still eligible for the

higher capital gains deduction. In addition, the principal residence exemption remains the same and does not fall under these rules.

You may have disposed of non-qualifying real property and ended up with a capital loss. If this is your only disposition of non-qualifying real property, it does not affect your capital gains deduction, and you do not have to read this section. You also do not have to read this section if you had more than one disposition of non-qualifying real property but the net effect of these dispositions is a capital loss.

This section will help you determine if all or a portion of your capital gain is eligible for the deduction. It will also help you calculate the portion of your capital gain that is not eligible, and provide instructions on how to complete your Schedule 3.

Calculating the portion of your capital gain not eligible for the deduction

If you disposed of any non-qualifying real property, you have to calculate the portion that is not eligible for the capital gains deduction. Even if you are not claiming a capital gains deduction this year, you should still do this calculation. This is because the taxable part of your capital gain that is not eligible for the deduction can be included as "investment income" for the year when calculating your cumulative net investment loss.

To calculate the portion that is not eligible for the deduction, use the following formula:

$$A \times B/C$$

In this formula:

- A = Your capital gain from the disposition of non-qualifying real property.*
- B = The number of months you owned the property after February 1992. Start counting with March 1992 and include the month you disposed of the property.
- C = The number of months you owned the property. If you owned the property before January 1972, start counting with that month. Otherwise, start counting with the month you purchased the property and include the month you disposed of the property.

* You may be claiming a reserve in respect of a capital gain incurred on the disposition of non-qualifying real property. If this is the case, you have to reduce the capital gain by the reserve claimed in the year to determine the amount to use in "A" of the formula. To find out how to calculate a reserve, see Chapter 6.

If you claimed a reserve in the prior year, you have to include it as a capital gain in the current year. If the reserve was for a disposition of non-qualifying real property, you have to figure out the part of the gain that is not eligible for the capital gains deduction. You do this by using the above formula. If you are claiming a new reserve

with respect to that property, you have to subtract it from the prior year reserve included in capital gains to determine the amount to be used in "A" of the formula.

You may have disposed of non-qualifying real property that was originally transferred to you. In this case, you have to consider the factors of the transfer to determine the amount to use for "C" in the formula.

If the property was transferred to you for an amount not more than the adjusted cost base to the person or the partnership who transferred it to you (the transferor), you are generally considered to have purchased the property when the transferor purchased it. However, if the property was transferred to you for more than the adjusted cost base to the transferor, you are considered to have purchased the property at the time the property was transferred to you. This will usually happen when the transferor elects to report all or part of the gain on the property at the time of the transfer.

You may have disposed of a property that was used as your or your spouse's principal residence for part of the time that you owned it. In this case, do not include any months that the property was used as your or your spouse's principal residence when determining the numbers to use in "B" or "C" of the formula. If you need more information on principal residence, see Chapter 8.

When you record your disposition on Schedule 3, enter the total gain on the line that describes the property you disposed of. For example, if you disposed of a rental property, enter the gain on line 522. If you disposed of a share of the capital stock of a corporation that was non-qualifying real property, enter the gain on line 520. If you disposed of a cottage that was not your principal residence, enter the gain on line 530. You then use the formula to determine the amount of your gain that is not eligible for the capital gains deduction. Enter this amount on line 536 of Schedule 3.

Example

Jackie bought a cottage in 1969. The cottage was not her principal residence. When she sold the cottage in November 1993, Jackie ended up with a capital gain of \$40,000. Since the cottage is non-qualifying real property, Jackie has to calculate the portion of her gain that is not eligible for the capital gains deduction. She does this as follows:

$$\begin{aligned} A &= \$40,000 \\ B &= 21 \text{ (March 1992 - November 1993)} \\ C &= 263 \text{ (January 1972 - November 1993)} \\ \$40,000 \times 21/263 &= \$3,193.92 \end{aligned}$$

On her Schedule 3 for 1993, Jackie enters \$40,000 on line 530. She does this because her cottage is real estate that is classified as personal-use property. Jackie then enters \$3,193.92 on line 536. This is the portion of her gain that is not eligible for the capital gains deduction. The eligible portion of her capital gain is \$36,806.08. This is the amount she uses to calculate her capital gains deduction.

If you are claiming a reserve for the disposition of non-qualifying real property, you have to complete

Form T2017, *Summary of Reserves on Disposition of Capital Property*. For more information on reserves, see Chapter 6. You then use the formula to determine the amount of the gain to be reported in the year that is not eligible for the capital gains deduction. Enter this amount on line 536 of Schedule 3.

Example

Leslie bought a rental property in September 1990. She sold it in December 1993 and ended up with a capital gain of \$20,000. Since Leslie did not receive the full payment for the sale in 1993, she may claim a reserve. Following the instructions in Chapter 6, Leslie figures out that her maximum reserve for 1993 is \$12,000. The amount of capital gain that she has to report in 1993 is \$8,000 (\$20,000 - \$12,000). As the property was non-qualifying real property, Leslie has to figure out the part of her gain that is not eligible for the capital gains deduction. She does this as follows:

Capital gain	\$20,000
Minus: Reserve claimed in 1993	<u>\$12,000</u>
Capital gain to be reported in 1993	<u>\$ 8,000</u>

Leslie uses the formula $A \times B/C$

$$\$8,000 \times \frac{22}{40} \text{ (March 1992 — December 1993)} = \$4,400$$

40 (September 1990 — December 1993)

The amount of the gain that is not eligible for the capital gains deduction is \$4,400. Leslie reports this amount on line 536 of Schedule 3. The eligible portion of her gain is \$3,600 (\$8,000 - \$4,400). Leslie will use \$2,700 (\$3,600 \times 3/4) when she calculates her capital gains deduction.

When completing her 1994 return, Leslie will have to include in her capital gains her 1993 reserve of \$12,000. However, since there is still an amount owing to her at the end of 1994, she will be able to claim a new reserve for this gain. Leslie will also have to calculate the amount of the gain reported in 1994 that is not eligible for the capital gains deduction. She will do this as follows:

Reserve claimed in 1993 to be included in capital gains in 1994	\$12,000
Minus: New reserve for 1994	<u>\$ 8,000</u>
Capital gain to be reported in 1994	<u>\$ 4,000</u>

$$\$4,000 \times \frac{22}{40} = \$2,200$$

The amount of the capital gain that will not be eligible for the capital gains deduction is \$2,200. Leslie will enter this amount on line 536 of Schedule 3 on her 1994 income tax return. The eligible portion of her gain is \$1,800 (\$4,000 - \$2,200). Leslie will use \$1,350 (\$1,800 \times 3/4) when she calculates her capital gains deduction for 1994.

You may have two dispositions of non-qualifying real property. One is a capital gain and the other is a capital loss. If the net effect of these two dispositions is a capital gain, you also have to determine the non-eligible portion of your capital loss. You do this because the non-eligible portion of your capital loss should be applied against the non-eligible portion of your capital gain. Use the same formula to calculate the non-eligible portion of your loss.

This will allow you to have a larger capital gains deduction. Once you have done this calculation, enter the net amount of the non-eligible capital gain on line 536 of Schedule 3.

Example

Tim had the following capital gains and capital losses in 1993.

Loss on the sale of shares — line 520	\$ (660)
Gain on the sale of real estate — line 522 ..	\$ 960
Gain on the sale of bonds — line 528	\$ 1,200

In this situation, the shares and the real estate fall within the meaning of non-qualifying real property as defined on page 8 in Chapter 2. Tim bought the shares in July 1991 and sold them in April 1993. He bought the real estate in January 1992 and sold it in April 1993.

Tim calculated the non-eligible portion of his capital loss and capital gain as follows:

Shares	$\$(660) \times 14/22 = \(420)
Real estate	$\$960 \times 14/16 = \840
Total	<u>\$ 420</u>

Tim entered \$420 on line 536 of Schedule 3.

Three-quarters of this capital gain (\$315) will become investment income. This will reduce Tim's cumulative net investment loss for 1993.

How do you calculate your capital gains deduction?

To calculate your capital gains deduction for 1993, you need to know the following amounts:

- your **cumulative net investment loss (CNIL)** to December 31, 1993;
- your **annual gains limit** for 1993;
- your **cumulative gains limit** for 1993;
- your **eligible capital gains** in 1993; and
- the total of all **capital gains deductions** you claimed in previous years.

There are five steps you have to complete to figure out your capital gains deduction for 1993. The following sections will help you complete each step.

Note

If you need help completing the following steps or if you need information on prior year amounts, call your income tax office.

Step 1 — Calculating your cumulative net investment loss (CNIL) to December 31, 1993

The first step in calculating your capital gains deduction is to figure out your CNIL to December 31, 1993. If you have a CNIL in 1993, it will reduce the amount of your capital gains deduction.

Your CNIL is the total of:

- your **investment expenses** for each year after 1987; minus
- your **investment income** for each year after 1987.

For 1992 and following years, the amount of net capital losses of other years (line 253 on your return) that is used to reduce any taxable capital gains that are not eligible for the capital gains deduction becomes an investment expense. You will use this amount when you calculate your CNIL.

For 1992 and following years, a taxable capital gain that is not eligible for the capital gains deduction becomes investment income. You will also use this amount when you calculate your CNIL.

Your CNIL will not necessarily reduce your capital gains deduction. Since the balance in your CNIL account varies each year, you could still end up claiming the maximum capital gains deduction if your CNIL is offset by investment income you earn in a future year.

To calculate your CNIL for 1993, complete Form T936, *Calculation of Cumulative Net Investment Loss (CNIL) to December 31, 1993*. However, you complete this form **only** if you had investment income or investment expenses in 1993. Keep a copy of Form T936 for your records and file one copy with your return. This will ensure that our records agree with yours.

Your 1992 *Notice of Assessment* or *Reassessment* may have shown a CNIL balance as of December 31, 1992. If this is the case, use this balance when you calculate your CNIL for 1993. If you did not have any investment income or investment expenses in 1993, your CNIL balance at the end of 1992 becomes your CNIL balance as of December 31, 1993. This is because your CNIL is a cumulative total. Enter the CNIL balance from your *Notice of Assessment* or *Reassessment* on line 16 of Form T657A.

The following example shows you how to calculate a CNIL to December 31, 1993.

Example

Jim received his *Notice of Assessment* for the 1992 taxation year indicating that he had a cumulative net investment loss (CNIL) of \$1,450 as of December 31, 1992. In 1993, Jim had the following types of income and expenses, which he reported on his 1993 return.

Line 120: Taxable dividends	\$ 100
Line 121: Interest income	\$ 500
Line 126: Net rental income (loss)	\$(2,000)
Line 127: Taxable capital gains	*\$ 3,750
Line 221: Carrying charges	\$ 600

* Jim had a \$5,000 capital gain from selling real estate in 1993. Of the \$5,000, he calculated that \$2,000 was not eligible for the capital gains deduction. He entered this amount on line 536 of his Schedule 3. The taxable portion of his capital gain **not** eligible for the deduction is \$1,500 ($\$2,000 \times 3/4$). The taxable portion of his capital gain eligible for the deduction is \$2,250 ($\$3,000 \times 3/4$).

To calculate his CNIL as of December 31, 1993, Jim completes Form T936. Since he disposed of non-qualifying real property in 1993, he completes Charts A and B first.

Chart A – Taxable capital gains not eligible for the capital gains deduction

Enter the amount from line 536 on Schedule 3	2,000 | 00	(a)
Enter the amount from line 395 on Form T2017 (if you are not reporting a reserve for the disposition of property before 1985, enter zero)	0 |	(b)
Total: Line (a) plus line (b)	2,000 | 00	(c)
Taxable capital gains not eligible for the capital gains deduction:		
Enter 3/4 of line (c)	1,500 | 00	(d)

Chart B – Additional investment income

- If you included an amount from a T3 slip on line 536 of Schedule 3, complete all steps in this chart.
- Otherwise, enter the amount from line (d) in Chart A, on line (l) in this chart.

Enter the amount from line (d) above .....	_____ | _____	(e)
Enter the amount from box 21 of all 1993 T3 slips .....	_____ | _____	(f)
Enter the amount from box 30 of all 1993 T3 slips .....	_____ | _____	(g)
Total: Line (f) minus line (g) .....	_____ | _____	(h)
Enter 3/4 of line (h) .....	_____ | _____	(i)
Enter the amount of taxable capital gains included in box 26 of all 1993 T3 slips which are not eligible for the capital gains deduction .....	_____ | _____	(j)
Total: Line (i) plus line (j) .....	_____ | _____	(k)
Additional investment income: Line (e) minus line (k)	1,500 | 00	(l)

Jim now completes the rest of Form T936. He uses the CNIL balance shown on his 1992 Notice of Assessment.

Part 1 – Investment expenses claimed on your 1993 return

Carrying charges and interest expenses (from line 221)	600 | 00	(1)	
Net rental loss (from line 126 or related schedules or statements)	2,000 | 00	(2)	
Limited or non-active partnership losses (from line 122) . . . other than allowable capital losses			(3)
Limited partnership losses of other years after 1985 (from line 251),			(4)
50% of exploration and development expenses (from line 224)			(5)
Any other investment expenses claimed in 1993 to earn property income *	958		(6)
Additional investment expenses: If you did not complete Charts A and B on the other side of this form, enter zero. Otherwise, enter the lesser of line (I) in Chart B, or the amount you claimed on line 253 of your return	0		(7)
Total investment expenses claimed in 1993 (add lines 1 to 7 inclusive)	<u>2,600 | 00</u>		<u>2,600 | 00 (A)</u>

* Refer to the list "Other investment expenses" on the other side of this form.

Part 2 – Investment income reported on your 1993 return

Investment income (from lines 120 and 121)	600 | 00	(8)	
Net rental income, including recaptured capital cost allowance (from line 126)			(9)
Net income from limited or non-active partnership (from line 122) other than taxable capital gains			(10)
Any other property income reported in 1993**, including annuity payments taxable under paragraph 56(1)(d) or 56(1)(d.1) less the capital portion deducted under paragraph 60(a),	959		(11)
50% of income from the recovery of exploration and development expenses (from line 130)	745		(12)
Additional investment income: If you did not complete Charts A and B on the other side of this form, enter zero. Otherwise, enter the amount from line (I) in Chart B	1,500 | 00		(13)
Total investment income reported in 1993 (add lines 8 to 13 inclusive),	<u>2,100 | 00</u>		<u>2,100 | 00 (B)</u>

** Refer to the list "Other property income" on the other side of this form.

Part 3 – Cumulative net investment loss (CNIL)

To be completed **only** if your 1992 Notice of Assessment or Reassessment showed a CNIL balance as of December 31, 1992. Otherwise, complete Part 4 on the other side of this form.

CNIL as of December 31, 1992, (shown on your 1992 Notice of Assessment or Reassessment)		1,450 | 00	(14)
Total investment expenses claimed in 1993 (from line (A) of Part 1)	2,600 | 00		(15)
Total investment income reported in 1993 (from line (B) of Part 2)	2,100 | 00		(16)
Line 15 minus line 16 (if negative, put in brackets)		500 | 00	(17)
Cumulative Net Investment Loss (CNIL) as of December 31, 1993 (Line 14 plus line 17. If negative, enter zero)		<u>1,950 | 00</u>	(C)

If you are claiming a capital gains deduction on your 1993 return, enter the amount from line (C) on line 16 of Form T657A or Form T657.

Step 2 — Calculating your annual gains limit

The second step in figuring out your capital gains deduction is to calculate your annual gains limit.

Your **annual gains limit** for 1993 is the total of:

- your net eligible taxable capital gains for 1993; **minus**
- the total of any allowable business investment losses for 1993;
- net capital losses of other years used to reduce eligible taxable capital gains, that you reported in 1993; and

- net capital losses incurred before May 23, 1985, used to reduce other income in 1993.

Net capital losses of other years applied against taxable capital gains not eligible for the capital gains deduction will not reduce your annual gains limit in 1993. For this purpose, net capital losses of other years are first applied against taxable capital gains that are not eligible, and then against eligible taxable capital gains.

To calculate your annual gains limit, complete Part 1 of Form T657A.

Example

Jim completes Part 1 of Form T657A as follows:

Part 1 — Calculation of annual gains limit for 1993

Total taxable capital gains from line 545 on Schedule 3	(1)	<u>3,750 | 00</u>	
Taxable capital gains not eligible for the capital gains deduction (amount from line (d) of Chart A on Form T936)	(2)	<u>1,500 | 00</u>	
Taxable capital gains eligible for the capital gains deduction (line 1 minus line 2) If negative, enter zero		<u>2,250 | 00</u>	▶ (3) <u>2,250 | 00</u>
Net capital losses of other years (to calculate this amount, complete Chart 1 on the other side of this form)	(4)	<u> |</u>	
Allowable business investment losses (from line 217 of your 1993 return)	(5)	<u> |</u>	
Total of above losses (line 4 plus line 5) . . . . .		<u> |</u>	▶ (6) <u> | 00</u>
Annual gains limit for 1993 (line 3 minus line 6. If negative, enter zero)	(7)	<u>2,250 | 00</u>	

If line 7 is zero, you cannot claim a capital gains deduction in 1993.

Step 3 — Calculating your cumulative gains limit

The third step in figuring out your capital gains deduction is to calculate your cumulative gains limit.

Your **cumulative gains limit** for 1993 is the total of your net eligible taxable capital gains from 1985 to 1993, **minus** the total of the following:

- any allowable capital loss you deducted from other income in 1985 (to a maximum of \$2,000);
- all allowable business investment losses you claimed from 1985 to 1993;
- all net capital losses of other years you claimed from 1985 to 1987 that you used to reduce eligible taxable capital gains in each of those years;
- all net capital losses of other years you claimed from 1988 to 1993 that you used to reduce eligible taxable capital gains in each of those years;
- all net capital losses incurred before May 23, 1985, you claimed in 1985 to 1993 that you used to reduce other income in each of those years;

- your CNIL to December 31, 1993; and
- all capital gains deductions you claimed from 1985 to 1992.

Under proposed legislation, your cumulative gains limit will not be reduced by net capital losses of other years applied against taxable capital gains not eligible for the capital gains deduction in 1985, 1986, and 1987.

Note

When you calculate your cumulative gains limit, you have to consider the meaning of "all net capital losses of other years." This applies to net capital losses that you carried **forward**, as well as to any net capital losses that you carried **back** to a given year. For example, if you carried a 1993 net capital loss back to 1991, that loss will reduce your cumulative gains limit for 1991 and all following years. However, your cumulative gains limit will not be reduced by any net capital losses of other years applied against taxable capital gains not eligible for the capital gains deduction.

To calculate your cumulative gains limit, complete Part 2 of Form T657A.

Example

Jim had a \$700 taxable capital gain in 1987 but he did not claim a capital gains deduction. He completes Part 2 of Form T657A as follows:

Part 2 - Calculation of cumulative gains limit for 1993

Total taxable capital gains reported after 1984 and before 1992 (from line 127 of your returns for these years. Do not include reserves reported on property disposed of before 1985)	(8)	700 | 00		
1992 taxable capital gains eligible for the capital gains deduction (from line 3 in Part 1 of Form T657A for 1992)	(9)	0 |		
1993 taxable capital gains eligible for the capital gains deduction (from line 3 in Part 1 above)	(10)	2,250 | 00		
Cumulative taxable capital gains eligible for the capital gains deduction (add lines 8 to 10 inclusive)		2,950 | 00	▶ (11)	2,950 | 00
Allowable capital losses claimed in 1985 (from line 127 on your 1985 return; maximum of \$2,000)	(12)	|		
Allowable business investment losses claimed after 1984 and before 1993 (from line 217 on your 1985 to 1992 returns)	(13)	|		
Net capital losses of other years claimed after 1984 and before 1993 (to calculate this amount, complete Chart 2 on the other side of this form)	(14)	|		
Total losses used to calculate your annual gains limit for 1993 (from line 6 of Part 1 above)	(15)	|		
Cumulative net investment loss to December 31, 1993, (from line (C) or (D) on Form T936). If you did not complete Form T936 for 1993, enter your cumulative net investment loss, if any, from your 1992 <i>Notice of Assessment</i> or <i>Reassessment</i>	(16)	1,950 | 00		
Total capital gains deductions claimed after 1984 and before 1993 (from line 254 on your 1985 to 1992 returns)	(17)	0 |		
Subtotal (add lines 12 to 17 inclusive)		1,950 | 00	▶ (18)	1,950 | 00
Cumulative gains limit for 1993 (line 11 minus line 18. If negative, enter zero)	(19)	1,000 | 00		

If line 19 is zero, you cannot claim a capital gains deduction in 1993.

Step 4 — Calculating your capital gains deduction available for 1993

The fourth step in figuring out your capital gains deduction

is to calculate the balance of your capital gains deduction limit.

To do this, complete Part 3 of Form T657A.

Example

Jim completes Part 3 of Form T657A as follows:

Part 3 — Calculation of capital gains deduction on other capital property

Maximum capital gains deduction for 1993	(20)	\$75 000	
Total capital gains deductions claimed after 1984 and before 1988 (from line 254 on your 1985 to 1987 returns)	(21)		
Adjustment of pre-1988 capital gains deductions (1/2 of amount at line 21)	(22)		
Capital gains deductions claimed in 1988 and 1989 excluding "eligible capital property" (from line 254 of your 1988 and 1989 returns minus any amounts reported on line 544 on Schedule 3 for 1988 and 1989. If negative, enter zero)	(23)		
Adjustment of 1988 and 1989 capital gains deductions (1/8 of amount at line 23)	(24)		
Capital gains deductions claimed in 1988 and 1989 for "eligible capital property" (from line 254 of your 1988 and 1989 returns minus the amount on line 23 above; not to exceed line 544 on Schedule 3 for 1988 and 1989)	(25)		
Total capital gains deductions claimed in 1990, 1991, and 1992 (from line 254 on your 1990, 1991, and 1992 returns)	(26)		
Subtotal (add lines 21 to 26 inclusive)		0	(27) 0
Capital gains deduction available for 1993 (line 20 minus line 27. If negative, enter zero)	(28)	75,000	00

If line 28 is zero, you cannot claim a capital gains deduction in 1993.

Step 5 — Figuring out your maximum claim

The final step is simple. The maximum amount you can claim is equal to the **lowest** of the following amounts:

- Line 7 of Form T657A — your annual gains limit for 1993;
- Line 19 of Form T657A — your cumulative gains limit for 1993; or
- Line 28 of Form T657A — your capital gains deduction limit available for 1993.

Remember, you do not have to claim the maximum amount. You can claim any amount, from zero to the maximum.

Enter the amount you want to claim on line 29 of Form T657A. Then, enter the same amount on line 254 of your return.

Example

Jim wants to claim the maximum capital gains deduction. He enters \$1,000 on line 29 of Form T657A and the same amount on line 254 of his 1993 return.

Part 4 — Determination of 1993 capital gains deduction on other capital property

The maximum amount you can enter on line 29 is the least of lines 7, 19, and 28. However, you may enter an amount that is less than the maximum. Enter this amount on line 254 of your 1993 return. (29) 1,000 00

Chapter 8 Principal Residence

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

Note

When reading this chapter, remember that, beginning in 1993, the meaning of the term spouse has changed. We define "spouse" on page 4 in Chapter 1.

What is your principal residence?

It is the housing unit you normally live in. Your principal residence may be:

- 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 if the share is acquired for the sole purpose of obtaining the right to inhabit a housing unit owned by that corporation;
- you own the property alone or jointly with another person;
- you, your spouse, your former spouse, 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 **one-half hectare** (approximately one acre). 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 one-half hectare.

How do you designate your home as your principal residence?

For each year that you own your home and use it as your principal residence, you can designate it as your principal residence. However, you do not have to designate it each year. You only have to do it in the year that you sell or are considered to have sold your principal residence. See the section called "Did you sell all or part of your principal residence?" later in this chapter for details.

Can you have more than one principal residence?

For years before 1982, you can designate more than one home per family as a principal residence. As a result, it is possible for a husband and wife to 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 years before 1982. For more information, see Interpretation Bulletin IT-120, *Principal Residence*.

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

For 1982 and any years after, during which you were married or were 18 or older, a **family includes**:

- 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 child (other than a child who was married during the year or who was 18 or older).

For 1982 and any years after, during which you were **not** married or 18 or older, a **family includes**:

- you;
- your mother or father; and
- your brother or sister (who was not married or 18 or older during the year).

Beginning in 1993, a common-law spouse, as defined on page 4 in Chapter 1, is considered to be a married person. Therefore, such common-law spouses are considered to be a family and may no longer designate different homes as their principal residences for taxation years after 1992.

Did you sell all or part of your principal residence?

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

If your home **was not** your principal residence for every year you owned it, there could be a capital gain that you have to include in your income. Form T2091(IND), *Designation of a Property as a Principal Residence by an Individual*, will help you calculate the number of years that you were entitled to designate your home as your principal residence **and** calculate the part of your gain, if any, that is taxable. Complete Form T2091(IND), if you:

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

- were considered to have sold your principal residence, or any part of it. For more information, see the next section called "Special situations."

You only have to include Form T2091(IND) with your tax return if you have to report a capital gain. Report this amount on line 530 of Schedule 3. Also, your taxable capital gain may be eligible for the capital gains deduction. For more information about this deduction, see Chapter 7.

Special situations

When you sell your principal residence, you may have a taxable capital gain if you:

- rented out part of the residence;
- used part of the residence to operate a business; or
- designated or chose another home as your principal residence.

Changing your property's use to a rental or business operation

You may be living in a home that you have designated as your principal residence. However, you may decide that you would like to change the use of your home. You might want to rent it out, or use it to operate a business. If you do this, we would consider that you are no longer using your home for your own personal use or enjoyment. You would be using it to earn or produce income.

At the time you change the use of your property, two things happen. You are considered:

- to have sold the property at its fair market value (FMV); and
- to have immediately repurchased the property for the same FMV.

By knowing the FMV, you will be able to tell if you have any capital gain on the property. However, if your home was your principal residence for every year you owned it before you changed its use, you do not have to pay tax on any gain when you changed its use.

If you later sell the property, you may have a capital gain. The capital gain would be the **increase** in the FMV from the time that you changed the property's use to the day you sell it.

If, at some point, you stop using the property to earn income but you do not actually sell it, you are considered to have sold it again. In this case, your capital gain would be the **increase** in the FMV during the time you used the property to earn income.

You have to report any capital gain that you make from the property on line 522 of Schedule 3. You usually have to do this in the calendar year that you changed the property's use.

Election

When you change your principal residence to a rental or business property, you can make a special election. With this election, you can choose **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.

You make this election by enclosing a signed letter with your tax return that describes the property and states that you are making your election under subsection 45(2) of the *Income Tax Act*.

You can designate the property to be your principal residence for up to four years while your election is in effect, 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:

- you are absent from your principal residence because your employer, or your spouse's employer, wants you to relocate;
- you and your spouse are not related to the employer;
- you return to your original home while still with the same employer, or before the end of the year following the year in which this employment ends; **and**
- your original home is at least 40 kilometres farther than your temporary residence from your, or your spouse's, new place of employment.

If you started to use your principal residence as a rental or business property in the year, you may want information on reporting business or property income. If you do, get the income tax guides called *Business and Professional Income* or *Rental Income*.

Using part of your principal residence for 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. You are also considered to have sold that part at its FMV at that time and to have immediately reacquired that part for the same FMV. If, before you changed its use, the property was your principal residence for every year since you owned it, there is no capital gain at the time you changed its use.

You are **not** considered to have changed its use if:

- the part you use for rental or business purposes is small in relation to the whole property;
- 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 all the previously mentioned conditions are not met, when you actually **sell** the property:

- you have to split the selling price between the part you used for the principal residence and the part you used for rental or business purposes. You can do this by using either square metres or the number of rooms, as long as the split is reasonable; and
- you do not have to report any capital gain for the part you used for the principal residence. Any capital gain on the part you used for rental or business purposes may be eligible for the capital gains deduction. See Chapter 7 for more information.

Changing your rental or business operation to a principal residence

If you buy a property to use as a rental or business property, and later begin to use it as your principal residence, you are considered to have sold the property at its FMV at the time you change its use. You may have a taxable capital gain at this time.

Election

You can elect to postpone reporting the disposition of your property until you actually sell the property. However, you **cannot** make this election if:

- you;
- your spouse; or
- a trust under which you or your spouse is a beneficiary

has deducted CCA on the property for any taxation year after 1984, and on or before the day you change its use.

To make this election, you have to attach a signed note to your return that describes the property and states that you are making your election under subsection 45(3) of the *Income Tax Act*.

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
- April 30th following the year in which you actually sell the property.

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.

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. You include the income in the year you changed the use of the property. If you need more detailed information on the recapture of CCA, get the income tax guide called *Business and Professional Income*, or the income tax guide called *Rental Income*.

Farms

If you are a farmer and you sell farmland in 1993 that includes your principal residence, you have a choice of two methods to calculate your capital gain. We explain these two methods in the income tax guide called *Farming Income*.

Example

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 property that includes land and a building (see Chapter 3);
- calculate a recapture or terminal loss on the disposition of depreciable property (see Chapter 3); and
- calculate the portion of a capital gain on non-qualifying real property that is not eligible for the capital gains deduction (see Chapter 7).

In November 1988, Paul 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, Paul lived in the lower half and rented out the upper half. Based on the total number of square metres of the property, he determined that the portion he used to earn rental income was 40%.

In February 1993, Paul sold the property for \$175,000. He incurred expenses of \$10,500 in connection with 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 Paul used as his principal residence will not be taxed. This is because he used the property as his principal residence for all the years that he owned it. Because Paul 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*.

Paul has to calculate the capital gain on the portion of the property that he rented out. He also has to figure out if he has a recapture of capital cost allowance (CCA) or a terminal loss on the building. For this reason, he will break down the 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 had been used for rental purposes, Paul completes the following calculations:

1) **He divides 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 agreement of purchase, Paul uses the municipal assessment in effect at the time of the purchase. (Paul would have completed this calculation at the time he purchased the property in order to figure out the amount of CCA he could claim on the portion of the building he rented out.)

2) **He divides 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 building was not shown on Paul's agreement for sale. Since there were no renovations to the building since the last municipal assessment, Paul can use the municipal appraisal that was in effect at the time of the sale.

3) **He divides 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:

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

Paul can now determine if he has a recapture of capital cost allowance (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 1993 was \$34,728. From the UCC, Paul subtracts the lesser of the following:

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

UCC	\$34,728
Minus: Purchase price	\$37,500
Recapture of CCA	<u>\$(2,772)</u>

To help him complete the above calculations, Paul uses the CCA schedule on the back of Form T776, *Statement of Real Estate Rentals*. He can get a copy of Form T776 in the income tax guide called *Rental Income* or from a Revenue Canada income tax office.

Paul can now calculate his capital gain. He starts by completing the section “Real estate and depreciable property” on Schedule 3, *Summary of Dispositions of Capital Property in 1993*. He reports the sale of the rental property as follows:

Real estate and depreciable property (do not include losses on depreciable property)

Address or legal description				Gain (or loss)	
Street, City, Province (Building)	1993	56,000 00	37,500 00	3,360 00	15,140 00
Street, City, Province (Land)	1993	14,000 00	12,500 00	840 00	660 00
	Total proceeds 521	70,000 00		Gain (or loss) 522	15,800 00

Because the land and the building are non-qualifying real property (defined on page 8 in Chapter 2), he has to figure out the part of the capital gain that is not eligible for the capital gains deduction. He uses the formula on page 31 in Chapter 7.

$$A \times B/C$$

$$\$15,800 \times 12/52 = \$3,646$$

The portion of the gain that is not eligible for the capital gains deduction is \$3,646. He enters this amount on line 536 of Schedule 3. He also enters \$3,646 on line (a) in Chart A of Form T936, *Calculation of Cumulative Net Investment Loss (CNIL) to December 31, 1993*. To determine his allowable capital gains deduction for 1993, Paul completes Form T936 and Form T657A, *Calculation of Capital Gains Deduction for 1993 on Other Capital Property*. He uses Form T657A because he did not dispose of qualified farm property or qualified small business corporation shares in 1993 or a prior year. Paul completes these forms by following the instructions in Chapter 7.

Index

	Page		Page
Adjusted cost base (ACB)	6	Identical properties	14
Allowable business investment loss (ABIL)	21	Income transaction	4
reduction in business investment loss	22	Information slips	10
Allowable capital loss	21	Inheriting property	19
definition	6	Investment expenses	32
Annual gains limit	35	Investment income	32
Arm's length transaction	6	Listed personal property (LPP)	7, 16
Average cost	14	Listed personal property losses	22
Bad debts	18	Losses — summary	27
Business investment loss	6	Mortgagee	18
Canadian-controlled private corporation	6	Mortgages	18
Canadian securities	12	Mortgagor	18
definition	7	Net capital losses	21
election	12	applying a 1993 loss to previous years	27
Capital cost allowance	7	applying losses of other years to 1993	24
Capital gain	4	definition	7
common transactions	10	of other years	24
definition	7	pre-1986 capital loss balance	24
capital gain not eligible for the capital gains		Non-arm's length transaction	7
deduction	30	Non-qualifying real property	8, 30
foreign exchange	18	Outlays and expenses	8
how to report	5	Personal-use property	4, 8, 15
information slips	10	Prescribed securities	8, 12
when it occurs	4	Principal residence	38
when to report	5	changing from a rental or business operation	40
Capital gains deduction	30	changing to a rental or business operation	39
calculation	32	definition	38
definition	30	designating	38
information slips	10	elections	39, 40
limits	30	selling	38
non-qualifying real property	30	using part as a rental or business operation	39
qualified farm property	30	Proceeds of disposition	8
qualified small business corporation shares	30	Public corporation	8
who can claim?	30	Qualified small business corporation shares	8
Capital losses	21	Real estate	11
1993 capital losses	21	selling a building in 1993	12
definition	7	selling part of a property	12
foreign exchange	18	Real property	8
how to report	5	Records	5
when it occurs	4	Reserves	5, 28
when to report	5	calculation of	28
Capital property	7	definition	28
Capital transaction	4	family farm property	29
Cultural property	20	non-qualifying real property	31
Cumulative gains limit	35	small business corporation shares	29
Cumulative net investment loss (CNIL)	32	who can claim?	28
Deemed acquisition	7	Restricted farm losses	23
Deemed disposition	7	Securities and properties	13
Deemed proceeds of disposition	7	bonds	14
Deemed resident	30	debentures	14
Depreciable property	7, 11	discounts, premiums, bonuses	14
Disposition (dispose of)	7	options	14
Eligible capital property	18	promissory notes	14
Employees' stock options	16	shares	13
definition	7	Small business corporation	9
Factual resident	30	Spouse	4
Fair market value	7	Superficial losses	23
Farms	20, 40	Taxable capital gain	9
capital gains deduction	30	Terminal loss	9
reserves	29	Transfers of property	19
restricted farm losses	23	Treasury bills (T-Bills)	14
transfers	20	Undepreciated capital cost (UCC)	9, 11
Foreign exchange	18		
Gifts	19		