



1995

Capital
Gains

Before You Start

Is this guide for you?

This guide is for you if you had a capital gain or a capital loss in 1995. You generally have a capital gain or a capital loss whenever you sell, or are considered to have sold, capital property. Capital property is defined on page 9. Use Schedule 3, *Capital Gains (or Losses) in 1995*, to record your capital gain or capital loss. This schedule comes with your General income tax package.

This guide uses plain language to explain the most common income tax situations. If you need help after reading this guide, please contact your Revenue Canada tax services

office or tax centre. You can find the addresses and telephone numbers under "Revenue Canada" in the Government of Canada section of your telephone book.

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, you can order them from your tax services office or tax centre by mail, by telephone, or in person.

What's New for 1995?

We have outlined the major changes to this guide below. For more details on these and other changes for 1995, see the areas highlighted in blue throughout the guide.

Changes

Form T1A, Request for Loss Carry-Back — If you would like to carry a 1995 net capital loss back to 1992, 1993, or 1994 and use it to reduce your taxable capital gains in those years, or if you would like to carry a 1995 listed personal property loss back to 1992, 1993, or 1994 and use it to reduce taxable capital gains from listed personal property in those years, you need to complete Form T1A. This form is no longer included with this guide. However, you can get a copy from us.

\$75,000 capital gains deduction — The \$75,000 capital gains deduction ($\$100,000 \times 3/4$) is no longer available for dispositions of capital property or eligible capital

property after February 22, 1994. However, if you owned this type of property at the end of February 22, 1994, and have not used all of your \$75,000 capital gains deduction, you may still be able to benefit from this deduction. If this is your situation, read the section called "Did you own capital property or eligible capital property at the end of February 22, 1994?" on page 4.

There are certain situations where you can still claim the \$75,000 capital gains deduction for 1995. For more information on capital gains eligible for the \$75,000 capital gains deduction for 1995, see the chart on page 37.

Proposed changes

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

Blind or visually impaired persons can get this publication in braille and large print, and on audio cassette and computer diskette. To order, please call 1-800-267-1267 weekdays between 8:15 a.m. and 5:00 p.m. (Eastern Time).

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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**, and **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 can substitute the terms **disposed of** or **acquired** for **sold** or **bought**, if they more accurately describe your situation.

Did you own capital property or eligible capital property at the end of February 22, 1994?

The \$75,000 capital gains deduction is no longer available for dispositions of capital property or eligible capital property after February 22, 1994. However, if you owned this type of property at the end of February 22, 1994, and you have not used all of your \$75,000 capital gains deduction, there is a special election that may be available to you.

This election allows you to report an accrued capital gain on your income tax return and to claim a capital gains deduction, even though you did not actually sell your property. To make this election, you have to complete and file Form T664, *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*.

In most cases, this election was available only for the 1994 taxation year and you had to file it by April 30, 1995. If you did not file an election by April 30, 1995, and you would like to take advantage of it for the 1994 taxation year, we will accept a late election up to April 30, 1997, if you estimate and pay a penalty at the time you actually file it.

If you sold property after February 22, 1994, and realized a capital gain, you can file this election to report the capital gain accrued up to February 22, 1994, and you can claim a capital gains deduction, on your 1994 return.

To find out more about the election and how to calculate the penalty, see the *Capital Gains Election Package*. The package includes Form T664. If you want to make a late election, do not submit an amended 1994 income tax return. Instead, complete and submit Form T664, together with payment of the estimated penalty, to the Enquiries and Adjustments Section at your tax centre.

Election available for the 1995 taxation year

The election described above is available for the 1995 taxation year if you owned eligible capital property at the end of February 22, 1994, and your **business' fiscal year that includes February 22, 1994, ends in 1995**. Note that a member of a partnership cannot make an election in respect of the eligible capital property owned by the partnership.

Generally, you have to file the election by June 15, 1996. In this case, you should attach Form T664 to your 1995 income tax return. For more information about how the election works for eligible capital property of a business, read the chapter called "Eligible Capital Expenditures" in one of the following guides that applies to your type of business:

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

Did you sell personal-use property or your home?

Most people are not affected by the 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 20.

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 determine if the transaction is a capital transaction or an income transaction. The facts surrounding the transaction determine the nature of the gain or loss.

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

- IT-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 only with capital transactions. Therefore, if you have income transactions only, 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 pamphlet called *Emigrants*);
- the owner dies (see the income tax guide called *Preparing Returns for Deceased Persons*); or
- you file Form T664 or T664(Seniors), *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*.

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 calendar year that it takes place.

You may not have to pay tax for 1995. However, you still have to file a return:

- when you sell, or are considered to have sold, any capital property in 1995 (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 1994 (see Chapter 6).

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

Colleen owns an accounting firm. The fiscal year-end for her business is June 30, 1995. In November 1995, she sold a capital property that she used in her business. As a result of the sale, she had a capital gain. Colleen has to report the capital gain on her income tax return for 1995. She does this even though the sale took place after her business' fiscal year-end date of June 30.

Are you a member of a partnership?

If you are a member of a partnership, it is possible that your partnership has a fiscal year-end other than December 31. If the partnership sells capital property during its fiscal year, 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?

You 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.

You will find the definition of **proceeds of disposition**, **adjusted cost base**, and **outlays and expenses** in Chapter 2.

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 you incurred when selling your property.

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

Use Schedule 3, *Capital Gains (or Losses) in 1995*, to calculate and report all your taxable capital gains or allowable capital losses for 1995. You can find Schedule 3 in your General income tax 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 1995. If either one of these situations 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 1995. For more information on reserves, see Chapter 6.

How do you report your share of a capital gain or a capital loss from a partnership?

If you are a member of a partnership that has to file Form T5013 Summary, *Partnership Information Return*, for 1995, you should have received two copies of Form T5013 Supplementary, *Statement of Partnership Income*, indicating your share of the capital gain or capital loss from the partnership. If this is your case, see the section called "Information slips" on page 11 to find out how to report these amounts.

On the other hand, if you are a member of a partnership that does not have to file Form T5013 Summary for 1995, see the section called "Partnerships" on page 24 to find out how to report a capital gain or capital loss from the partnership.

Did you sell capital property in 1995 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. These rules are not explained in this guide. To help you calculate your gain or loss from selling property you owned before 1972, use Form T1105, *Supplementary Schedule for Dispositions of Capital Property Acquired Before 1972*.

For more information, see the following Interpretation Bulletins:

- IT-78 — *Capital Property Owned on December 31, 1971 — Identical Properties*
- IT-84 — *Capital Property Owned on December 31, 1971 — Median Rule (Tax-Free Zone)*
- IT-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, if 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, if 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*.

Special rules also apply when determining the adjusted cost base of a property for which you filed Form T664 or T664(Seniors), *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*. If you did not file this election for your property, the rest of this definition does not apply to you.

In most cases, if you filed Form T664 or T664(Seniors), you are considered to have sold your capital property at the end of February 22, 1994, and to have immediately reacquired it on February 23, 1994. The adjusted cost base of your property on February 23, 1994, depends on the type of property for which you filed an election. For example, if you filed an election for your interest in, or your shares of, a flow-through entity, in most cases the adjusted cost base of your interest or shares does not change as a result of the election. If you filed an election for capital property, other than a flow-through entity, your adjusted cost base is usually the amount you designated as proceeds of disposition on Form T664 or T664(Seniors). If the property is a cottage, rental property, or other non-qualifying real property, your adjusted cost base is your designated proceeds of disposition **minus** the reduction for non-qualifying real property.

In addition, if your designated proceeds of disposition were **more than** the fair market value of the property at the end of February 22, 1994, your adjusted cost base on

February 23, 1994, may be reduced. If this is your case, complete the applicable chart below to calculate your adjusted cost base on February 23, 1994.

Chart 1 — Flow-through entity

Complete this chart to calculate the adjusted cost base of your interest in, or your shares of, the flow-through entity **only** if the proceeds of disposition you designated on Form T664 for the property were **more** than its fair market value at the end of February 22, 1994. If the flow-through entity is a trust (other than a mutual fund trust), such as a related segregated fund trust or a trust governed by an employees profit-sharing plan, do not complete this chart as you do not have to reduce your adjusted cost base.

Designated proceeds of disposition (column 2, Chart A of Form T664).....	\$ _____	1	
Fair market value at the end of February 22, 1994 (Step 1 of Form T664).....	\$ _____	2	
Amount from line 2 _____ x 1.1.....	\$ _____	3	
Line 1 minus line 3 (if negative, enter zero).....	\$ _____	4	
If the amount on line 4 is zero, do not complete the rest of this chart as you do not have to reduce your adjusted cost base.			
Fair market value at the end of February 22, 1994 (line 2).....	\$ _____	5	
Adjusted cost base at the end of February 22, 1994 (column 1, Chart A of Form T664) .	\$ _____	6	
Line 5 minus line 6.....	\$ _____	7	
If the property is non-qualifying real property, complete the following calculation to determine the non-eligible portion of line 7. Otherwise, enter the amount from line 7 on line 10 of this chart.			
Non-eligible portion of line 7:			
The amount from column 4, Chart A of Form T664 divided by the amount from column 3, Chart A of Form T664	= _____	8	
Non-eligible portion of line 7 (line 7 multiplied by line 8).....	\$ _____	9	
Line 7 minus line 9.....	\$ _____	➔ \$ _____	10
Reduction (line 4 minus line 10).....	\$ _____	11	
If the amount on line 11 is negative, do not complete the rest of this chart as you do not have to reduce your adjusted cost base.			
Adjusted cost base at the end of February 22, 1994 (line 6).....	\$ _____	12	
Reduction (line 11).....	\$ _____	13	
Adjusted cost base on February 23, 1994 (line 12 minus line 13; if negative, enter zero).....	\$ _____	14	

Chart 2 — Capital property other than a flow-through entity

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

Fair market value of the property at the end of February 22, 1994 (from Step 1 of Form T664 or T664(Seniors)).....	\$ _____	1	
Designated proceeds of disposition (column 2, Chart B of Form T664, or column 2, Step 2 of Form T664(Seniors)).....	\$ _____	2	
Amount from line 1 _____ x 1.1.....	\$ _____	3	
Line 2 minus line 3 (if negative, enter zero).....	\$ _____	➔ \$ _____	4
Line 1 minus line 4 (if negative, enter zero).....	\$ _____	5	
If the property is non-qualifying real property, enter the reduction for non-qualifying real property (column 4, Chart B of Form T664, or column 4, Step 2 of Form T664(Seniors)). Otherwise, enter zero.....	\$ _____	6	
Adjusted cost base on February 23, 1994 (line 5 minus line 6; if negative, enter zero).....	\$ _____	7	

Allowable capital loss — This is the amount of your capital loss 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 an expression 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 you received as consideration from the sale of personal-use property) of a small business corporation that:
 - has gone bankrupt in the year;
 - is insolvent and a winding-up order has been made in the year under the *Winding-up Act*; or
 - is insolvent at the end of the year and neither the corporation, nor a corporation it controls, carries on business. Also, at that time, the share in the corporation has a fair market value of nil, and it is reasonable to expect that the corporation will be dissolved or wound-up and will not commence to carry on business. *

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

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

For more information about business investment losses, see page 27. You can also get Interpretation Bulletin IT-484, *Business Investment Losses*, and its Special Release.

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, 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 called "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 (ACB) **plus** the outlays or expenses incurred to sell the property. To calculate your capital gain, subtract the ACB of your property from the proceeds of disposition. From this amount, subtract any outlays and expenses you incurred when selling your 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 (ACB) **plus** the outlays or expenses incurred to sell the property. To calculate your capital loss, subtract the ACB of your property from the proceeds of disposition. From this amount, subtract any outlays and expenses you incurred when selling your 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:

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

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

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

- insurance policies;
- certified cultural properties you give or sell to designated institutions (see page 26);
- eligible capital properties (see page 22);
- depreciable properties sold at a loss (see page 19);
- Canadian resource properties;
- foreign resource properties;
- timber resource properties; and
- a beneficiary's interest in a mining reclamation trust.

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

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

Deemed proceeds of disposition — This expression is used when you are considered to have received an amount for 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** 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.

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

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

Flow-through entity — A flow-through entity is:

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

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

- prints, etchings, drawings, paintings, sculptures, or other similar works of art;
- jewellery;
- rare folios, rare manuscripts, or rare books;
- stamps; and
- 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 catalogues for the value of these properties. 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 losses are more than your taxable capital gains, the difference between the two is your net capital loss for the year. We explain how to apply a net capital loss in Chapter 5.

Non-arm's length transaction — This is a transaction between persons who were not dealing with each other at arm's length at the time of the transaction. 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 are 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 that laid 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 were 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 five 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 five 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, or similar obligation of a corporation (other than a public corporation) that you do not deal with at arm's length at any time before you dispose of the security; and
- a share, bond, debenture, bill, note, mortgage, or similar obligation you acquire from a person with whom you do not deal at arm's length.

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, 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 after June 13, 1988, to a person or a partnership related to that person, 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.

Spouse — The term spouse used throughout this guide applies to a legally married spouse and a common-law spouse. A common-law spouse is a person of the opposite sex who, at that particular time, lived with you in a common-law relationship, and:

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

Once either of these two situations applies, we consider you to have a common-law spouse, except for any period that you are separated for 90 days or more because of 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.

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, UCC is equal to the total capital cost of all the properties of the class minus the capital cost allowance 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, *Capital Gains (or Losses) in 1995*. You can find this schedule in your General income tax package.

Information slips

You will notice that there are two lines on Schedule 3 called "Information slips — Capital gains (or losses)" to report certain amounts indicated on information slips. Use line 032 in Part 1 of Schedule 3 to report **non-eligible** capital gains (or losses) and line 533 in Part 2 of Schedule 3 to report **eligible** capital gains (or losses). The term **non-eligible capital gains** means not eligible for the capital gains deduction. The term **eligible capital gains** means eligible for the capital gains deduction. You can find information about the capital gains deduction in Chapter 7. If you report a non-eligible capital gain on line 032 and you filed Form T664, *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*, for the 1994 taxation year, you may be able to reduce all or part of the non-eligible capital gain. For more information on this subject, see the section called "Flow-through entity" on page 16. In the section below, you will find information on how to report capital gains and losses from information slips.

T3 slip

Box 30 — Capital gains eligible for deduction — If there is no asterisk (*) in this box, enter the amount from this box on line 533 in Part 2 of Schedule 3.

If there is an asterisk in this box, you should have received instructions with your slip. The footnotes area of your slip will indicate that all or part of your gain is from qualified small business corporation shares or qualified farm property. Enter that amount on either line 513 or line 516 in Part 2 of Schedule 3, as these types of property are eligible for the \$375,000 capital gains deduction. Enter on line 533 in Part 2 of Schedule 3, any amount from box 30 that you did not report on lines 513 or 516.

Box 21 — Capital gains — This amount is your total capital gain from a trust. Enter the difference between the amount in this box and the amount in box 30, if any, on line 032 in Part 1 of Schedule 3. The amount you report on line 032 is the non-eligible portion of your capital gain.

Example

Tony received a T3 slip with \$300 in box 30 and \$500 in box 21. Since there was no asterisk in box 30, he entered the \$300 on line 533 in Part 2 of Schedule 3 and \$200, the difference between the two amounts (\$500 - \$300), on line 032 in Part 1 of Schedule 3.

If there is an asterisk in box 21, you should have received instructions with your slip. The footnotes area of your slip will indicate that all or part of the amount in box 21 is foreign capital gains. In addition to entering the amount from box 21 on Schedule 3 as mentioned above, enter the amount identified in the footnotes area as foreign capital gains on line 508 of Schedule 1, and use it to calculate your foreign tax credit.

Box 26 — Other income — If there is an asterisk in this box, you should have received instructions with your slip. The footnotes area of your slip may indicate that all or part of the amount in box 26 is farming income eligible for the capital gains deduction or a deemed taxable capital gain from the disposition of eligible capital property. Report any farming income eligible for the capital gains deduction on line 529 of Schedule 3. Report a taxable capital gain on eligible capital property that is qualified farm property on line 543 in Part 2 of Schedule 3. Report a taxable capital gain on all other types of eligible capital property on line 544 in Part 2 of Schedule 3.

Box 37 — Insurance segregated fund capital losses — Enter this amount on line 032 in Part 1 of Schedule 3. If this is your only entry on line 032, 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 032.

T4PS slip

Box 34 — Capital gains (or losses) — This amount is your total capital gain (or loss) from an employees profit-sharing plan. Enter this amount on line 032 in Part 1 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 032, put brackets around it. 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 032.

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.

T5 slip

Box 18 — Capital gains dividends — This amount is your total capital gains dividends from a corporation. Enter this amount on line 032 in Part 1 of Schedule 3.

T5013 slip

Box 18 — Canadian and foreign net business income (loss) — The footnotes area of your slip may indicate that box 18 includes business income from the disposition of eligible capital property (other than the recapture of annual allowances deducted in previous years). If you filed Form T664, *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*, for the 1994 taxation year with respect to your interest in the partnership, you may be able to reduce all or part of this business income by claiming a **business income reduction**. For more information, see the section called "Flow-through entity" on page 16.

The footnotes area of your slip may also indicate that box 18 includes farming income eligible for the capital gains deduction. Enter this amount on line 529 of Schedule 3, if you want to take advantage of the capital gains deduction. However, the amount that you report on line 529 has to be reduced by any **business income reduction** described above that you claimed for 1995, in respect of the partnership. Use Form T657, *Calculation of Capital Gains Deduction for 1995 on All Capital Property*, to calculate your capital gains deduction. You can get this form from us.

Box 27 — Capital gains (losses) — The footnotes area of your slip may indicate that all or part of your gain is for qualified small business corporation shares or qualified farm property. If this is the case, enter that amount on line 513 or line 516 in Part 2 of Schedule 3, as these types of property are eligible for the \$375,000 capital gains deduction.

The footnotes area of your slip may also identify non-eligible capital gains included in box 27. If this is the case, enter the non-eligible amount on line 032 in Part 1 of Schedule 3.

The footnotes area of your slip may also identify your share of reserves allocated in the previous year. If you claimed a reserve from the partnership in 1994, you have to include that reserve in your capital gains for 1995. Enter the amount of any reserve you claimed from the partnership in 1994 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.

Enter on line 533 in Part 2 of Schedule 3, the capital gains eligible for the \$75,000 capital gains deduction. To calculate this amount, subtract from the amount shown in box 27 the amount identified as the previous year's reserve, if any, and the amounts from this box that you reported on lines 513, 516, and 032.

The footnotes area of your slip may also indicate that all or part of the amount in box 27 is foreign capital gains. In addition to entering the amount from box 27 on Schedule 3 as mentioned above, enter the amount identified in the footnotes area as foreign capital gains on line 508 of Schedule 1, and use it to calculate your foreign tax credit.

Box 28 — Capital gains reserve — This amount is your 1995 capital gains reserve from the partnership. The footnotes area of your slip should identify to what type of property the reserve applies. Enter the amount of the reserve 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.

The footnotes area of your slip may also indicate that all or part of the reserve in box 28 is from the disposition of capital property, other than qualified small business corporation shares or qualified farm property, after 1984 and before February 23, 1994, by a partnership that has a **fiscal period that includes February 22, 1994, and ends in 1995**. If this is the case, you have to calculate the portion, if any, that is eligible for the \$75,000 capital gains deduction. Enter the eligible amount on line 391 of Part 2 of Form T2017. We explain how to determine the eligible portion of this type of reserve in the section called "Are you reporting or claiming a reserve from the disposition of property by a partnership that has a fiscal year that includes February 22, 1994, and ends in 1995?" on page 36.

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 27.

Canadian securities and prescribed securities

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

- Lines 512 and 513 — "Qualified small business corporation shares"
- Lines 515 and 516 — "Qualified farm property"
- Lines 020 and 021 — "Shares"
- Lines 026 and 027 — "Bonds, debentures, promissory notes, and other properties"

Chapter 2 contains the definitions of **Canadian security**, **prescribed security**, and **qualified small business corporation shares**. You will find a definition of **qualified farm property** in the income tax guide called *Farming Income*.

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 you owned 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 can 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 1995 return. Please remember, 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.

Shares

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

- 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.

If you sold any of the above items in 1995, you will receive either a T5008, *Statement of Securities Transactions*, or an account statement. Report the sale in the section called "Shares" in Part 1 of Schedule 3.

Note

If you report a capital gain from the disposition of shares and securities of a flow-through entity for which you filed Form T664, *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*, for the 1994 taxation year, you may be able to reduce all or part of the gain. For more information, see the section called "Flow-through entity" later in this chapter.

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 1995, Jack sold 100 shares of XYZ 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 1986 for \$3,800, Jack paid brokerage fees of \$200. To complete Schedule 3, Jack needs to determine his proceeds of disposition, his adjusted cost base (ACB), and the amount of any outlays and expenses that relate to the sale. After he determines these three amounts, Jack calculates his taxable capital gain as follows:

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

Jack reports the sale in the section called "Shares" in Part 1 of Schedule 3. He enters his total proceeds on line 020, and his capital gain on line 021.

Shares						Gain (or loss)
No. of shares	Name of corporation and class of shares					
100	XYZ Public Corporation of Canada	1986	8,500 00	4,000 00	500 00	4,000 00
		Total proceeds 020	8,500 00			Gain (or loss) 021
						4,000 00

If Jack has no other capital gains or capital losses in the year, he reports \$3,000 ($3/4 \times \$4,000$) as his total taxable capital gains amount. He enters this amount on lines 041, 042, and 044 of Schedule 3, and again on line 127 of his return.

Example 2

Using the same situation in Example 1, assume that Jack had sold his shares for only \$3,700. As you can see below, Jack 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 1995. If his capital losses were more than his capital gains in that year, his net capital loss for 1995 would be three-quarters of the difference between the two amounts. For more information about capital losses, see the section called "1995 Capital losses" on page 26.

Shares						Gain (or loss)
No. of shares	Name of corporation and class of shares					
100	XYZ Public Corporation of Canada	1986	3,700 00	4,000 00	500 00	(800 00)
		Total proceeds 020	3,700 00			Gain (or loss) 021
						(800 00)

Bonds, debentures, promissory notes, and other properties

If you sold any of these types of properties in 1995, you will receive either a T5008, *Statement of Securities Transactions*, or an account statement. Report the sale of these types of properties in the section called "Bonds, debentures, promissory notes, and other properties" in Part 1 of Schedule 3.

You also report capital gains and capital losses from options and discounts, premiums, and bonuses on debt obligations in this section. 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.

Treasury bills (T-Bills)

You will receive a T5008, *Statement of Securities Transactions*, or an account statement for transactions that took place in 1995. 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

Robbie purchased a T-Bill on December 1, 1994, for \$49,000. The maturity date was March 1, 1995. However, he sold it on February 5, 1995, for \$49,500. The effective yield rate was 5.36%.

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

Effective yield rate	×	Number of days T-Bill held	×	Purchase price	=	Interest to be included in income
5.36%	×	$\frac{66}{365}$	×	\$49,000	=	\$475

Robbie 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 occurs 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 calculate the average cost of each property in the group at the time of each purchase. This allows you to determine your adjusted cost base (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 1

Paddy owns 250 common shares of a corporation. She bought 100 of these shares in 1991 for \$15 each and another 150 shares in 1992 for \$20 each. In 1995, she sold 200 of these shares for \$24 each.

Calculation of average cost

Shares purchased in 1991	100 × \$15	=	\$1,500
Shares purchased in 1992	150 × \$20	=	\$3,000
Total shares:	<u>250</u>	Total cost:	<u>\$4,500</u>
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			<u>\$1,200</u>
Taxable capital gain	\$1,200 × 3/4 =		<u>\$ 900</u>

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

Example 2

After selling 200 shares in the corporation, Paddy 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
Cost of newly purchased shares	350 × \$21	=	\$7,350
Total shares:	<u>400</u>	Total cost:	<u>\$8,250</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 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 determining if these properties are identical.

Flow-through entity

You will find a definition of **flow-through entity** on page 9. It is possible that you may have filed Form T664, *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*, for the 1994 taxation year with respect to your interest in, or your shares of, a flow-through entity. If this is the case, the adjusted cost base of your interest or shares does not usually change as a result of the election. Instead, your elected capital gain creates an **exempt capital gains balance** for that flow-through entity. You can use the exempt capital gains balance to reduce:

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

You can reduce the above-mentioned capital gains by claiming a **capital gains reduction** on line 039 in Part 1 of Schedule 3. We explain how to calculate your capital gains reduction in the chart called "Calculating your exempt capital gains balance and your capital gains and business income reductions for 1995," later in this chapter.

If the flow-through entity is a partnership, you can also use the exempt capital gains balance to reduce your share of the business income of the partnership from the disposition of eligible capital property (other than the recapture of annual allowances deducted in previous years).

You can reduce your share of the business income of a partnership by claiming a **business income reduction** in the chart called "Other amounts deductible from your share of net partnership income (loss)" on Forms T2032, *Statement of Professional Activities*, T2124, *Statement of Business Activities*, T2042, *Statement of Farming Activities*, or

T2121, *Statement of Fishing Activities*. You can find these forms in the related income tax guides called *Business and Professional Income*, *Farming Income*, and *Fishing Income*. Note that you cannot use a business income reduction to create or increase a business loss.

If you are a member of a partnership that does not have to file Form T5013 Summary, *Partnership Information Return*, you will find information on how to calculate your share of the business income of the partnership from the disposition of eligible capital property (other than the recapture of annual allowances deducted in previous years), in the chapter called "Eligible Capital Expenditures" in the income tax guide that applies to your type of business. However, if you are a member of a partnership that has to file Form T5013 Summary, this income is shown in the details area of box 18 of Form T5013 Supplementary, *Statement of Partnership Income*.

We explain how to calculate your business income reduction in the chart called "Calculating your exempt capital gains balance and your capital gains and business income reductions for 1995," later in this chapter.

The total amount of capital gains and business income from a flow-through entity that you can reduce is limited to the extent of your exempt capital gains balance for that flow-through entity. Your exempt capital gains balance expires after the end of the 2004 taxation year. If you did not use all of your exempt capital gains balance by the end of 2004, the unused balance may be added to the adjusted cost base of your interest in, or your shares of, the flow-through entity.

Note

Claiming a capital gains reduction or a business income reduction is not mandatory. You can claim any amount you want to in a year, from zero to the maximum.

**Calculating your exempt capital gains balance and
your capital gains and business income reductions for 1995**

This chart will help you calculate your exempt capital gains balance and your capital gains and business income reductions for 1995. In most cases, your exempt capital gains balance for a flow-through entity available for 1995 is the elected capital gain for the flow-through entity **minus** any capital gains or business income reductions claimed for the flow-through entity in 1994. See the example on the next page.

You have to calculate your exempt capital gains balance and your capital gains and business income reductions for each flow-through entity separately.

Exempt capital gains balance as a result of the capital gains election (enter the elected capital gain from column 5, Chart A of Form T664)*	\$ _____	1
1994 capital gains reduction claimed for the flow-through entity (the portion of the amount from line 039 in Part 3 of Schedule 3 for 1994 that applies to the flow-through entity)	\$ _____	2
1994 business income reduction for the flow-through entity (from the chart called "Other amounts deductible from your share of net partnership income (loss)" on Form T2032, T2042, T2121, or T2124 for 1994, whichever applies) .. \$ _____ x 4/3 =	\$ _____	3
Total capital gains and business income reductions for 1994 (line 2 plus line 3)	\$ _____	4
Exempt capital gains balance available for 1995 (line 1 minus line 4)	\$ _____	5
Capital gains flowed out to you by the flow-through entity in 1995	\$ _____	6
Capital gains from the disposition of all or part of your interest in, or your shares of, the flow-through entity in 1995	\$ _____	7
Total capital gains in 1995 (line 6 plus line 7)	\$ _____	8
1995 capital gains reduction. The maximum amount you can enter on line 9 is the lesser of the amounts on line 5 and line 8. However, you may enter an amount that is less than the maximum	\$ _____	9
Enter the amount from line 9 on line 039 in Part 1 of Schedule 3.		
Exempt capital gains balance, before the business income reduction (line 5 minus line 9)	\$ _____	10
If the flow-through entity is a partnership, complete lines 11 to 15 inclusive. Otherwise, enter zero on line 14 and complete line 15.		
Amount from line 10 \$ _____ x 3/4 =	\$ _____	11
Your share of the business income of the partnership from the disposition of eligible capital property (other than the recapture of annual allowances deducted in previous years)**	\$ _____	12
1995 business income reduction. The maximum amount that you can enter on line 13 is the lesser of the amounts on line 11 and line 12. However, you may enter an amount that is less than the maximum. Remember, you cannot use a business income reduction to create or increase a business loss.	\$ _____	13
Enter the amount from line 13 in the chart called "Other amounts deductible from your share of net partnership income (loss)" on Form T2032, T2042, T2121, or T2124, whichever applies.		
Amount from line 13 \$ _____ x 4/3 =	\$ _____	14
Exempt capital gains balance available to carry forward (line 10 minus line 14). If, however, you disposed of your entire interest in, or all your shares of, the flow-through entity in 1995, enter zero at line 15.	\$ _____	15

* If the amount you designated as proceeds of disposition on Form T664 for your interest in, or your shares of, the flow-through entity is **more than** the fair market value of your interest in, or your shares of, the flow-through entity at the end of February 22, 1994, call your tax services office before you complete this chart as your exempt capital gains balance (line 1 above) may be reduced.

** This includes your share of the farming income from the disposition of eligible capital property by the partnership (other than the recapture of annual allowances deducted in previous years).

Example

Marlo filed Form T664, *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*, for the 1994 taxation year with respect to his 500 units in a mutual fund trust. He designated the fair market value of the units at the end of February 22, 1994, as his proceeds of disposition for the purpose of this election. Marlo reported a capital gain of \$2,500 in column 5, Chart A of Form T664. He also claimed a capital gains reduction of \$1,900 at line 039 in Part 3 of Schedule 3 for 1994 in respect of his units. In 1995, Marlo received a non-eligible capital gain of \$200 from the mutual fund trust. To calculate his capital gains reduction for 1995 and his exempt capital gains balance available for carryforward, he completes the chart as follows:

Exempt capital gains balance as a result of the capital gains election (enter the elected capital gain from column 5, Chart A of Form T664)*	\$ 2,500	1
1994 capital gains reduction claimed for the flow-through entity (the portion of the amount from line 039 in Part 3 of Schedule 3 for 1994 that applies to the flow-through entity)	\$ 1,900	2
1994 business income reduction for the flow-through entity (from the chart called "Other amounts deductible from your share of net partnership income (loss)" on Form T2032, T2042, T2121, or T2124 for 1994, whichever applies) .. \$ 0 x 4/3 =	\$ 0	3
Total capital gains and business income reductions for 1994 (line 2 plus line 3)	\$ 1,900	4
Exempt capital gains balance available for 1995 (line 1 minus line 4)	\$ 600	5
Capital gains flowed out to you by the flow-through entity in 1995	\$ 200	6
Capital gains from the disposition of all or part of your interest in, or your shares of, the flow-through entity in 1995	\$ 0	7
Total capital gains in 1995 (line 6 plus line 7)	\$ 200	8
1995 capital gains reduction. The maximum amount you can enter on line 9 is the lesser of the amounts on line 5 and line 8. However, you may enter an amount that is less than the maximum	\$ 200	9
Enter the amount from line 9 on line 039 in Part 1 of Schedule 3.		
Exempt capital gains balance, before the business income reduction (line 5 minus line 9)	\$ 400	10
If the flow-through entity is a partnership, complete lines 11 to 15 inclusive. Otherwise, enter zero on line 14 and complete line 15.		
Amount from line 10 \$ _____ x 3/4 =	\$ _____	11
Your share of the business income of the partnership from the disposition of eligible capital property (other than the recapture of annual allowances deducted in previous years)**	\$ _____	12
1995 business income reduction. The maximum amount that you can enter on line 13 is the lesser of the amounts on line 11 and line 12. However, you may enter an amount that is less than the maximum. Remember, you cannot use a business income reduction to create or increase a business loss.	\$ _____	13
Enter the amount from line 13 in the chart called "Other amounts deductible from your share of net partnership income (loss)" on Form T2032, T2042, T2121, or T2124, whichever applies.		
Amount from line 13 \$ 0 x 4/3 =	\$ 0	14
Exempt capital gains balance available to carry forward (line 10 minus line 14). If, however, you disposed of your entire interest in, or all your shares of, the flow-through entity in 1995, enter zero at line 15.	\$ 400	15

* If the amount you designated as proceeds of disposition on Form T664 for your interest in, or your shares of, the flow-through entity is **more than** the fair market value of your interest in, or your shares of, the flow-through entity at the end of February 22, 1994, call your tax services office before you complete this chart as your exempt capital gains balance (line 1 above) may be reduced.

** This includes your share of the farming income from the disposition of eligible capital property by the partnership (other than the recapture of annual allowances deducted in previous years).

Real estate and depreciable property

If you sold real estate or depreciable property in 1995, you have to report your capital gain or loss in the section called "Real estate and depreciable property" in Part 1 of Schedule 3.

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 24); and
- commercial and industrial land and buildings.

Do not use the section called "Real estate and depreciable property" to report the sale of personal-use property (e.g., a cottage), or the sale of mortgages and other similar debt obligations on real property. Report this information in Part 1 of Schedule 3 under the sections called "Personal-use property" and "Bonds, debentures, promissory notes, and other properties."

If you sold real property in 1995 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 49.

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 called "Selling a building in 1995" on page 20.

Note

Special rules apply if you dispose of, or are considered to have disposed of, a property for which you or your spouse have filed Form T664 or T664(Seniors), *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*, for the 1994 taxation year and the property was your principal residence for 1994. If this is your situation, see the section called "Selling a property for which you or your spouse filed Form T664 or T664(Seniors), *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*" on page 46.

Depreciable property

When you dispose of depreciable property, you may have 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 outlays or expenses you 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 8 for a definition of CCA.

To calculate CCA, you first have to 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 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.

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 do not have a recapture of CCA and you do not have 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 1989, Ian bought a piece of machinery for \$10,000 for his business. It is the only property in its class at the beginning of 1995. The class has a UCC of \$6,000. He sold the piece of machinery in 1995 and purchased no other property in that class. The following chart gives you three different selling prices to show you how Ian 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	<u>10,000</u>	<u>10,000</u>	<u>10,000</u>
Capital gain	<u>0</u>	<u>0</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 1989-1994	<u>4,000</u>	<u>4,000</u>	<u>4,000</u>
UCC at beginning of 1995	\$ 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>
	<u>\$ 2,000</u>	<u>\$ (2,000)</u>	<u>\$ (4,000)</u>
Terminal loss			
Recapture			
Recapture			

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

In **example B**, Ian 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**, Ian 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 1995

If you sold a building in 1995, 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 sold 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 that have not been previously disposed of				

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*, and its Special Release.

Selling part of a property

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

Example

Maria 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, Maria 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)	<u>\$ 25,000</u>
The ACB of the part she kept	<u>\$ 75,000</u>

Maria 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.

Personal-use property

You will find a definition of **personal-use property** on page 10. When you dispose of personal-use property, you may have a capital gain or loss. To calculate your capital gain or loss, follow these rules:

- if the adjusted cost base (ACB) of the property is less than \$1,000, its ACB is considered to be \$1,000;
- if the proceeds of disposition are less than \$1,000, the proceeds of disposition are considered to be \$1,000; and
- if both the ACB and the proceeds of disposition are \$1,000 or less, you do not have a capital gain or 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 **more than \$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" in Part 1 of 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 that is listed personal property (LPP) — LPP is discussed 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 23.

You were asking...?

- Q. In 1995, 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 1

Johnny sold his motorcycle in 1995 for \$1,200. He bought it in 1984 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 be \$1,000. Although Johnny actually had a gain of \$335 (\$1,200 - \$850 - \$15), the capital gain that he reports is only \$185 (\$1,200 - \$1,000 - \$15).

Personal-use property (full description)

Motorcycle	1984	1,200 00	1,000 00	15 00	185 00
				Gain only 029+	185 00

Example 2

In 1995, Betty sold her lakefront property and cottage to a developer for \$100,000. She bought the property in 1982 for \$49,000, and built a cottage on it for \$30,000 in 1991. Betty incurred expenses of \$1,000 in connection with the sale of the land and cottage. During the period she owned the property, Betty 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, Betty 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, Betty cannot deduct the \$9,000 from her income for any taxation year. She also cannot use it to reduce her capital gain in 1995. 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.

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

If Betty 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 a property as your principal residence, see Chapter 8.

Personal-use property (full description)

Lot 119 - 120, Plan 2750, City, Province, Country	1982	100,000 00	79,000 00	1,000 00	20,000 00
				Gain only 029+	20,000 00

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 9) 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 030 in Part 1 of Schedule 3. If you have a loss from LPP in 1995, or LPP losses from a previous year to apply against your 1995 LPP gains, see page 28 to see how to apply them.

Employees' stock options

When your employer grants you a stock option, it does not immediately affect your tax situation. A stock option is an opportunity to buy 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 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 stocks. 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 adjusted cost base 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. Report the transaction in the section called "Qualified small business corporation shares" in Part 2 if the shares were qualified small business corporation shares. See page 10 for a definition of **qualified small business corporation shares**. Taxable capital gains from qualified small business corporation shares may be eligible for the \$375,000 capital gains deduction.

If the shares you exchanged or sold were not qualified small business corporation shares, report the transaction in the section called "Shares" in Part 1 of Schedule 3.

Example

In 1991, Anna, an employee of Widget Corporation, received an option to buy 20 shares at \$25 each. Widget was not a Canadian-controlled private corporation. In 1993, Anna exercised the option and bought the shares. The market value at that time was \$30. In 1995, she sold her 20 shares for \$40 each. The tax implications for Anna are as follows:

In 1991, when Anna received the option, there were no tax implications.

In 1993, when Anna purchased the shares:

Market value (20 × \$30).....	\$600
Minus: Amount paid (20 × \$25)	\$500
Taxable benefit	\$100

The \$100 was included as a taxable benefit on Anna's 1993 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 1995, when Anna sold the shares:

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

She reports a capital gain of \$200 in the section called "Shares" in Part 1 of Schedule 3, since these shares 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 have any of the types of properties described in the definition of eligible capital property on page 9, under certain conditions, you may be able to claim a capital gains deduction when you dispose of them. For example, if you disposed of eligible capital property that is qualified farm property, you may be eligible to claim the \$375,000 capital gains deduction. You will find details on what amount will be considered eligible for the capital gains deduction 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*.

Note

The \$75,000 capital gains deduction is no longer available for dispositions of eligible capital property after February 22, 1994. However, if you owned eligible capital property at the end of February 22, 1994, and your **business' fiscal year that includes February 22, 1994, ends in 1995**, there is a special election that may be available to you for the 1995 taxation year. If you have not used all of your

\$75,000 capital gains deduction, this election will allow you to report the capital gain accrued before February 23, 1994, on your 1995 income tax return and to claim a capital gains deduction, even though you did not actually sell your eligible capital property. Note that a member of a partnership cannot make an election in respect of the eligible capital property owned by the partnership. For more information about how the election works for eligible capital property of a business, read the chapter called "Eligible Capital Expenditures" in one of the above-mentioned guides that applies to your type of business. Generally, you have to file the election by June 15, 1996. To make this election, complete Form T664, *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*, and attach it to your 1995 return. For more information about the election, see the *Capital Gains Election Package*. The package includes two copies of Form T664.

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 a capital loss. Any gain or loss will be postponed until you sell the property.

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

The above-mentioned rules also apply when property is repossessed under a conditional sales agreement.

If you incur a capital gain as a result of a mortgage foreclosure or a conditional sales repossession, the capital gain will be excluded from net income for the purpose of calculating any social benefits repayment.

Under proposed legislation, if you incur a capital gain as a result of a mortgage foreclosure or a conditional sales repossession, the capital gain will be excluded from net income for the purpose of calculating your claim for the goods and services tax credit, the Child Tax Benefit, and the age amount.

Report any capital gain or capital loss in Part 1 of Schedule 3 in the section called "Mortgage foreclosures and conditional sales repossessions." For more information, 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.

In order to claim a capital loss on a bad debt, you have to file an election with your income tax return. You make this election by attaching a letter signed by you to your return stating that you want subsection 50(1) of the *Income Tax Act* to apply to the bad debt. Report any capital loss in Part 1 of 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 27.

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 Loaning 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 losses. However, you only have to report the amount of your net gain or loss for the year that is **more than \$200**. If the net amount is **\$200 or less**:

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

If you have a capital gain or loss, report it on line 027 in Part 1 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 10. Report the sale of these types of shares in Part 2 of 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 types of shares, see the section called "Allowable business investment loss (ABIL)" on page 27.

If you have a capital gain when you sell qualified small business corporation shares, you may be eligible for the \$375,000 capital gains deduction. To calculate this deduction, use Form T657, *Calculation of Capital Gains Deduction for 1995 on All Capital Property*. You can get this form from us.

Qualified farm property

Generally, when you dispose of qualified farm property, you report any capital gain or loss in Part 2 of 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 capital gain when you sell qualified farm property, you may be eligible for the \$375,000 capital gains deduction. To calculate this deduction, use Form T657, *Calculation of Capital Gains Deduction for 1995 on All Capital Property*. You can get this form from us.

If you dispose of farm property, other than qualified farm property, report any capital gain or loss in Part 1 of Schedule 3 in the section called "Real estate and depreciable property." You will find more details about this section of Schedule 3 on page 19.

If you dispose of eligible capital property that is qualified farm property, you may be eligible to claim the \$375,000 capital gains deduction. For more information, see the chapter called "Eligible Capital Expenditures" in the income tax guide called *Farming Income*.

Partnerships

If you are a member of a partnership that has to file Form T5013 Summary, *Partnership Information Return*, for 1995, you should receive two copies of Form T5013 Supplementary, *Statement of Partnership Income*, indicating your share of the capital gain or loss from the partnership. If this is your case, do not read this section. Instead, see the section called "Information slips" on page 11 to find out how to report a capital gain or capital loss reported on Form T5013 Supplementary.

However, if you are a member of a partnership that does not have to file Form T5013 Summary for 1995, read this section to find out how to report your share of a capital gain or capital loss from the partnership.

Report your share of any capital gain or loss from a partnership on Schedule 3. If the capital gain or loss is from the disposition of qualified small business corporation shares or qualified farm property, enter the amount on either line 513 or line 516 in Part 2 of Schedule 3, as these types of property are eligible for the \$375,000 capital gains deduction.

If the capital gain or loss is from the sale of capital property, other than qualified small business corporation shares or qualified farm property, enter the amount in the section called "Partnerships — Capital gains (or losses)." You will notice that there are two lines on Schedule 3 called "Partnerships — Capital gains (or losses)." Use line 033 in Part 1 of Schedule 3 to report non-eligible capital gains (or losses) and line 532 in Part 2 of Schedule 3 to report eligible capital gains (or losses). The term **non-eligible capital gains** means not eligible for the capital gains deduction. The term **eligible capital gains** means eligible for the capital gains deduction. You can find information about the capital gains deduction in Chapter 7. If you report a non-eligible capital gain on line 033 and you filed Form T664, *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*, for the 1994 taxation year with respect to your interest in the partnership, you may be able to reduce all or part of the non-eligible capital gain. For more information on this subject, see the section called "Flow-through entity" on page 16.

An eligible capital gain (or loss) from a partnership includes your share of a capital gain (or loss) from the disposition of property before February 23, 1994, by a partnership that has a **fiscal year that includes February 22, 1994, and ends in 1995**. If the capital gain (or loss) is from the disposition of non-qualifying real property that was acquired after February 1992, the total capital gain is not eligible for the capital gains deduction. If the capital gain (or loss) is from the disposition of non-qualifying real property that was acquired before March 1992, you have to calculate the eligible and non-eligible portion of the capital gain (or loss). We explain this in the section called "Disposition of non-qualifying real property by a partnership before February 23, 1994" on page 38. Report the non-eligible portion of the capital gain (or loss) on line 033 in Part 1 of Schedule 3 and the eligible portion of the capital gain (or loss) on line 532 in Part 2 of Schedule 3.

A non-eligible capital gain (or loss) from a partnership also includes your share of a capital gain (or loss) from the disposition of property by a partnership after February 22, 1994.

You may have farming income eligible for the \$375,000 capital gains deduction as a result of the disposition of eligible capital property that is qualified farm property. The chapter called "Eligible Capital Expenditures" in the income tax guide called *Farming Income*, explains how to calculate and how to report this amount.

Inheriting property

If you inherit property and later sell it, you may have a capital gain or 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 right before the 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 Disposition 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, remember that the meaning of the terms spouse, married, and marriage have changed since 1993. Refer to the definition of **spouse** on page 11.

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. Include any taxable capital gain or allowable capital loss in your income for the year that you give 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 usually **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 11).

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, for the election to be valid, you have to file it no later than the year your spouse disposes of the property. To make this election, attach a letter signed by you and your spouse to your return stating that you do not want section 74.2 of the *Income Tax Act* to apply.

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

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

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; and
- your spouse later sold the property.

For more information, 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.

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 have 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

It is possible to postpone reporting a capital gain 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 when you sell or donate certified Canadian cultural property (national treasures) to an institution or public authority designated by the Minister of Canadian Heritage. The Canadian Cultural Property Export Review Board, which operates under the Department of Canadian Heritage, certifies this property as 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 have 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 for 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 and Income Tax*.

In this chapter, we explain what you do if you disposed of any capital property in 1995 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 outlays or expenses you incurred to sell the property. However, special rules apply when you dispose of:

- depreciable property (see page 19); or
- personal-use property (see page 20).

If you sold listed personal property and ended up with a loss, see the section called "Applying listed personal property (LPP) losses" on page 28.

1995 Capital losses

You can only apply a capital loss against a capital gain. This means that, if you had a capital gain in 1995, 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 1995 are more than your taxable capital gains, the difference between the two is your **net capital loss** for 1995. Report your loss on Schedule 3 and file it with your 1995 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 1995 net capital loss back three years (1994, 1993, and 1992) and apply it against your taxable capital gains in any of those years. For details, see the section called "How do you apply a 1995 net capital loss to previous years?" on page 33.

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 1995?" on page 30.

Example

In 1995, Carmela sold some securities. As a result, she had a capital loss of \$800 and a capital gain of \$600.

Allowable capital loss ($\$800 \times 3/4$)	\$(600)
Taxable capital gain ($\$600 \times 3/4$)	\$ 450
Net capital loss	<u>\$(150)</u>

The difference between her allowable capital loss of \$600 and her taxable capital gain of \$450 is Carmela's net capital loss for 1995. She can apply her net capital loss of \$150 against her taxable capital gains 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 1995 at a loss. I had no capital gains in 1995. 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 020 and your capital loss on line 021 in Part 1 of Schedule 3. Three-quarters of your capital loss is your allowable capital loss for 1995. Since you have no taxable capital gains in 1995, your allowable capital loss becomes a net capital loss for 1995. You cannot deduct the net capital loss in 1995 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 1995, so we have a record of your loss.

Allowable business investment loss (ABIL)

If you had a business investment loss (defined on page 8) in 1995, you can deduct three-quarters of the loss from income. We call this amount your ABIL.

You have to reduce your business investment loss if you claimed a capital gains deduction in a previous year. We explain this in the chart called "Reduction in business investment loss" on page 28.

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 1995. You can carry a non-capital loss back three years and forward seven years.

To carry a non-capital loss back to 1992, 1993, or 1994, complete Form T1A, *Request for Loss Carry-Back*, and file it with your tax return for 1995. You can get this form from us. Do not file an amended 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*.

If you are not 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 1987 that became a non-capital loss and you were not able to deduct it in the three years before 1987 or the seven years after 1987. You can now use the loss to reduce your taxable capital gains in 1995 or any year after.

Claim your ABIL by entering:

- on line 228 of your tax return, your business investment loss before reducing this loss (see the chart on page 28);
- on line 034 in Part 1 of Schedule 3, any reduction in your business investment loss (see the chart on page 28); and
- on line 217 of your 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 you bought the shares, or the date you acquired the debt;
- amount of the proceeds of disposition;
- adjusted cost base of the shares or debt;
- outlays 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 1995 will reduce the capital gains deduction you can claim in 1995 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 1995.

The following chart will help you calculate the reduction. If you had more than one business investment loss in 1995, make sure you calculate each reduction separately.

Looking at the chart, you will notice that we adjust the amount of the capital gains deductions 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 returns for these years)	\$ _____	× 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, 1992, 1993, and 1994 (from line 254 of your returns for these years)	\$ _____	× 4/3 =	\$ _____	4
Line 1 plus lines 2, 3, and 4				\$ _____ 5
Total reduction(s) in business investment losses for 1986 to 1994 (from line 535 of Schedule 3 of your returns for these years plus line 034 in Part 3 of Schedule 3 of your 1994 return)	\$ _____	6		
Total amount already used to reduce any other business investment losses in 1995	\$ _____	7		
Line 6 plus line 7				\$ _____ 8
Line 5 minus line 8				\$ _____ 9
Business investment loss for 1995 (before reducing this loss)				\$ _____ 10
Reduction in business investment loss for 1995: Line 9 or line 10, whichever amount is less				\$ _____ 11
Business investment loss for 1995: Line 10 minus line 11				\$ _____ 12
Allowable business investment loss for 1995 (3/4 of line 12)				\$ _____ 13

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

The amount from line 11 becomes a capital loss for 1995. Enter this amount on line 034 in Part 1 of Schedule 3.

Applying listed personal property (LPP) losses

If you dispose of LPP in 1995, 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 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.

LPP gains do not include 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 26).

To determine how much of an LPP loss you can deduct, you have to calculate each LPP disposition separately. Since LPP is a type of personal-use property, the \$1,000 minimum proceeds of disposition and adjusted cost base rules apply. For more information about these rules, see the section called "Personal-use property" in Chapter 3.

If your 1995 LPP losses are more than your LPP gains in 1995, 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 1995 or the seven years after. If you would like to carry back your 1995 LPP losses to reduce your LPP net gains from 1992, 1993, and 1994, complete Form T1A, *Request for Loss Carry-Back*. You can get this form from us. File one copy with your 1995 tax return. Do not file an amended return for the year you would like the loss applied to.

If your 1995 LPP gains are more than your LPP losses in 1995, you can use unapplied LPP losses from 1988 and later years to reduce the balance of your 1995 LPP gains. Do not enter these losses on line 253 of your return. Instead, reduce your 1995 LPP gains by the amount of the unapplied LPP losses from other years.

You should only complete the "Listed personal property" area in Part 1 of Schedule 3 if you have a net LPP gain in 1995. If you do not have a net LPP gain, keep a record of your LPP losses that have not expired so you can apply these losses against future LPP gains. An unapplied LPP loss expires when you do not use it by the end of the seventh year after you incurred it.

Example

Marino bought some jewellery in 1985 for \$5,800. In 1995, he sold it for \$6,000. He ended up with a gain of \$200. He also sold a coin collection for \$2,000 in 1995. Marino had originally bought this collection in 1988 for \$1,700. He ended up with a gain of \$300 when he sold the coin collection. In addition, he sold a painting in 1995 for \$8,000. However, Marino bought the painting in 1989 for \$12,000. Therefore, he had a loss of \$4,000. He had no outlays or expenses for these three transactions.

Marino's loss from selling LPP in 1995 was more than his gain: his loss was \$4,000; his total gain was \$500 (\$200 + \$300). As a result, his net loss was \$3,500 (\$4,000 - \$500). Marino cannot use the difference to offset his capital gain on the sale of a property other than on LPP in the year. In addition, he cannot offset any income he had from other sources. However, he can apply his LPP losses against his LPP gains in any of the three previous years, or the seven years following 1995.

Marino should not complete Schedule 3 for 1995. However, he should keep a record of his LPP loss in case he wants to apply the loss against LPP gains in another year.

Superficial 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.

Under proposed legislation, for dispositions that occur after April 26, 1995 (other than dispositions that occur before 1996 according to a written agreement entered into on or before April 26, 1995), 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, or a person affiliated with you, buys, or has a right to buy, the same or identical property (called "substituted property"); and

- you, or a person affiliated with you, still owns, or has a right to buy, the substituted property 30 days after the sale.

Some examples of affiliated persons are:

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

If you have a superficial loss in 1995, 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.

There are situations where this type of loss is not considered a superficial loss. Some of the more common situations are when:

- you are considered to have sold the capital property because you became or ceased to be a resident of Canada;
- the property is considered to have been sold because the owner died;
- the disposition results from the expiry of an option; or
- you are considered to have sold the property because you changed its use.

Under proposed legislation, this type of loss is also not considered a superficial loss if you disposed of the property after April 26, 1995, and within 30 days after the disposition, you became or ceased to be exempt from income tax.

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 3 years and forward up to 10 years. However, the amount you can deduct in any year cannot be more than your net farming income for that year. For more information on 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 of RFLs that you can apply cannot be more than the property taxes and the interest on money you borrowed to buy the farmland that were included in the calculation of the RFLs for each year. Reduce your capital gain by adding these amounts to the adjusted cost base (ACB) of your farmland. Also, you have to reduce your RFL balance by these amounts.

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

Example

Desmond sold his farmland in 1995 for \$200,000. The ACB of the property was \$160,000. Desmond has an unapplied RFL of \$20,000 from 1993. This amount includes \$5,000 for property taxes, \$5,000 for interest, and \$10,000 for other expenses.

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

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

Desmond can only apply the portion of his RFL that relates to property taxes and interest on the money he 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.

The taxable part of a capital gain and the allowable part of a capital loss are not the same for every year. We call these amounts **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 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 1995?

To apply net capital losses of other years to 1995, you have to separate the losses into groups, depending on when you incurred the losses. 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 you incurred before May 23, 1985;
- losses you incurred after May 22, 1985, and before 1988;
- losses you incurred in 1988 and 1989; and
- losses you incurred after 1989 and before 1995.

Losses that you incurred 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.

You have to 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 1995, 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 also includes losses you incurred after May 22, 1985, if you disposed of capital property according to an agreement of sale you entered into before May 23, 1985.

Usually, you can only apply net capital losses of other years against taxable capital gains. However, if you incurred the losses before May 23, 1985, you may use them to offset other income. Once you have applied your net capital losses of other years against taxable capital gains, you can use any excess to offset other income. The amount you can use is limited to the least of the excess amount, \$2,000, or your **pre-1986 capital loss balance** available for 1995.

Your **pre-1986 capital loss balance** available for 1995 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 1995.

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 1995

Use the following chart to apply your net capital losses of other years to 1995, and to calculate your loss balance that is available for you to carry forward to a future year. See the example on the next page.

Step 1 — Pre-1986 capital loss balance available for 1995

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 and 1989..... \$ _____ × 3/4 = \$ _____

 In 1990, 1991, 1992, 1993, and 1994 \$ _____ × 2/3 = \$ _____

Total capital gains deductions after adjustment \$ _____ 2

Pre-1986 capital loss balance available for 1995 (line 1 minus line 2) \$ _____ 3

Step 2 — Applying net capital losses of other years to 1995

Complete the following table to apply your net capital losses of other years to 1995.

- 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 1995
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 1995 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 1995. 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 1995 income tax return. This is your deduction in 1995 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

Deduction in 1995 for net capital losses of other years (line 7 plus line 12)..... \$ _____ 13

Report the amount from line 13 on line 253 of your 1995 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 1995. 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 1995 (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 1995 (from line C, Step 2).
 Line E — Enter the total adjusted net capital losses of other years applied in 1995. 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 1995
D				
E				
F				
G	2/3	2/3	8/9	1
H				

Example

Claudio has unapplied net capital losses of \$4,000 he incurred before May 23, 1985. He claimed a capital gains deduction of \$500 in 1986, and \$300 in 1989. Claudio 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 1995 return. He completes the following steps to calculate the maximum deduction he can claim for his unapplied net capital losses of other years in 1995, and to determine 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 1995

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 and 1989.....	\$	300 × 3/4 = 225	
In 1990, 1991, 1992, 1993, and 1994	\$	_____ × 2/3 = _____	
Total capital gains deductions after adjustment.....	\$	725	2
Pre-1986 capital loss balance available for 1995 (line 1 minus line 2)	\$	3,275	3

Step 2 — Applying net capital losses of other years to 1995

	Before May 23, 1985	After May 22, 1985, and before 1988	In 1988 and 1989	After 1989 and before 1995
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 1995 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 1995. 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 × 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
Deduction in 1995 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 1995 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 × 3/2 =	\$	3,000	15
Total adjusted net capital losses of other years applied in 1995 (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 1995
D	\$6,000			\$100,000
E	\$6,000			\$ 27,000*
F	0			\$ 73,000
G	2/3	2/3	8/9	1
H	0			\$ 73,000

* Claudio has to apply his older losses first. Since the total amount of adjusted losses that Claudio used in 1995 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. Claudio has unapplied net capital losses of \$73,000 that he can carry forward to a future year.

How do you apply a 1995 net capital loss to previous years?

You can carry a 1995 net capital loss back three years to 1992, 1993, and 1994 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 1995 loss when you carry it back.

To apply a 1995 net capital loss to 1992, 1993, or 1994, complete "Area III — Net capital loss for carry-back" on Form T1A, *Request for Loss Carry-Back*. You can get this form

from us. It will help you 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 1995 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 42.

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 (see page 27)	Any unapplied portion becomes a non-capital loss in the year of the loss: <ul style="list-style-type: none"> – 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 this page and page 30)	<ul style="list-style-type: none"> – 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>)	<ul style="list-style-type: none"> – carry back three years – carry forward ten years 	No restrictions
Listed personal property (LPP) losses (see page 28)	<ul style="list-style-type: none"> – carry back three years – carry forward seven years 	Limited to net gains from LPP in the year
Losses from personal-use property (see page 20)	– no loss allowed**	Not applicable
Restricted farm loss (see page 29)	<ul style="list-style-type: none"> – 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 to net farming income in the year Cannot be more than the property taxes and the interest on money you borrowed to buy the farmland that were included in the calculation of the restricted farm losses for each year Cannot be used to create or increase a capital loss
Superficial losses (see page 29)	– 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 be deducted from other income. See the section called "Net capital losses incurred before May 23, 1985" on page 30.

** For exceptions to this rule, see the section called "Personal-use property" on page 20.

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. Sometimes, however, you receive the amount 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 in the regular way (the proceeds of disposition minus the adjusted cost base and the selling expenses). From this amount, you 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 the **previous year**, include that reserve when you calculate your capital gains for the **current year**. For instance, if you claimed a reserve in 1994, you have to include it in your capital gains for 1995. If you still have an amount that is **payable** to you after 1995, you can calculate and deduct a new reserve, which you include in your capital gains for the following year — 1996. 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.

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 1994 return; or
- claiming a reserve in 1995.

You can find two copies of this form in the middle of this guide. Attach one copy to your return.

Does a capital gain from a reserve qualify for the capital gains deduction?

A capital gain from a reserve qualifies for the capital gains deduction **only** if it is an eligible capital gain.

An eligible capital gain includes:

- a reserve brought into income from the disposition of qualified farm property after 1984 or qualified small business corporation shares after June 17, 1987; and
- a reserve brought into income from the disposition of property after 1984 and before February 23, 1994, by a personal trust or a partnership that has a **fiscal year that includes February 22, 1994, and ends in 1995.***

- * If the reserve is from the disposition of non-qualifying real property, the portion of your share of the capital gain that applies to the period after February 1992 is not eligible for the capital gains deduction (see the section called "Are you reporting a reserve from the disposition of property by a partnership that has a fiscal year that includes February 22, 1994, and ends in 1995?" on page 36).

You will find a definition of **qualified small business corporation shares** on page 10. To find out what is considered **qualified farm property**, see the income tax guide called *Farming Income*. A capital gain from a reserve brought into income from the disposition of these types of properties qualifies for the \$375,000 capital gains deduction. To calculate this deduction, use Form T657, *Calculation of Capital Gains Deduction for 1995 on All Capital Property*. You can get this form from us. For more information about the capital gains deduction, see Chapter 7.

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 the 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 calculate your maximum reserve for 1995, you use one of three calculations. The one 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 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 before November 13, 1981

If you sold property before November 13, 1981, use the following formula to calculate your reserve:

$$\text{Capital gain} \times \frac{\text{Amount payable after the end of the year}}{\text{Proceeds of disposition}}$$

You also use this formula for property that you sold, or are considered to have sold, after November 12, 1981, if the disposition took place:

- under the terms of an offer or an agreement in writing made or entered into before November 13, 1981; or
- as a result of the property having been stolen, destroyed, or expropriated before November 13, 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 property other than family farm property and small business corporation shares sold to your child, 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
- the spouse of any of the above.

A — Property other than family farm property and small business corporation shares sold to your child

For all property, other than family farm property and small business corporation shares sold to your child, that you sell after November 12, 1981, you can claim a reserve up to a maximum of 4 years. Your reserve in each year cannot be more than the lesser of the following:

$$(a) \text{ Capital gain} \times \frac{\text{Amount payable after the end of the year}}{\text{Proceeds of disposition}}$$

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

Example

Caitlin bought a sailboat in 1985. She sold it in 1995 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. Caitlin 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 Caitlin did not receive full payment for the sale in the year she sold the boat, she can 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. Caitlin's maximum reserve for 1995 is the lesser of (a) and (b):

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

and

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

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

Caitlin enters the \$12,000 reserve on lines 388 and 399 of Form T2017, *Summary of Reserves on Dispositions of Capital Property*. As Caitlin had no other capital transactions in 1995, she completes Schedule 3, *Capital Gains (or Losses) in 1995*, as follows:

Line 029 —	Personal-use property.....	\$ 20,000
Line 036 —	Total gains (or losses) before reserves.....	\$ 20,000
Line 037 —	Reserves from line 399 of Form T2017.....	\$(12,000)
Line 040 —	Total capital gains (or losses).....	\$ 8,000
Line 041 —	Total taxable capital gains (or losses) of Part 1 (\$8,000 × 3/4) ..	\$ 6,000
Line 042 —	Total taxable capital gains (or losses) of Part 1	\$ 6,000
Line 044 —	Total taxable capital gains (or net capital losses).....	\$ 6,000

Caitlin enters the taxable capital gain of \$6,000 on line 127 of her 1995 return.

In 1996, Caitlin has to report her 1995 reserve of \$12,000 as a capital gain. She will enter this amount on line 386 of Form T2017 for 1996. Since there will still be an amount payable to her after 1996, she can calculate a new reserve, and deduct it from the \$12,000. She shows the new reserve on line 388 of Form T2017 in 1996.

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 claim a reserve up to a maximum of 9 years. Your reserve in each year cannot be more than the lesser of the following:

$$(a) \text{ Capital gain} \times \frac{\text{Amount payable after the end of the year}}{\text{Proceeds of disposition}}$$

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 |

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 this page.

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*.

Are you reporting or claiming a reserve from the disposition of property by a partnership that has a fiscal year that includes February 22, 1994, and ends in 1995?

This section will help you determine the eligible and non-eligible portions of your share of reserves from the disposition of capital property, other than qualified small business corporation shares or qualified farm property, by a partnership that has a fiscal year that includes February 22, 1994, and ends in 1995. Read this section only if all the following conditions apply to your situation:

- you are a member of a partnership;
- the partnership has a fiscal year that includes February 22, 1994, and ends in 1995; and
- you are reporting or claiming a reserve from the disposition of property, other than qualified farm property or qualified small business corporation shares, after 1984 and before February 23, 1994, by the partnership.

If the reserve was from the disposition of property after 1984 and before February 23, 1994, by a partnership that has a fiscal year that includes February 22, 1994, and ends in 1995, you have to complete the appropriate area in Part 2 of Form T2017. All or part of the reserve may be eligible for the \$75,000 capital gains deduction.

If the reserve is from the disposition of capital property, other than non-qualifying real property, all of the reserve is eligible for the \$75,000 capital gains deduction. If this is your case, in addition to reporting the reserve in the appropriate area in Part 2 of Form T2017, you have to enter the amount of the reserve that is eligible for the capital gains deduction on line 391 in Part 2 of Form T2017. To calculate this amount, subtract the current year's reserve from the prior year's reserve for the particular property, and enter the difference on line 391. If the result is a negative amount, show it in brackets.

If the reserve is from the disposition of non-qualifying real property that the partnership acquired before March 1992, the portion of the reserve that applies to the period after February 1992 is not eligible for the capital gains deduction. If this is your case, see the next section to determine the eligible and non-eligible portions of the reserve. We define non-qualifying real property on page 9.

Calculating the eligible and non-eligible portion of a reserve from the disposition of non-qualifying real property by a partnership that has a fiscal year that includes February 22, 1994, and ends in 1995

To calculate the non-eligible portion of your reserve, use the following formula:

$$A \times B/C$$

In this formula:

- A = the reserve from the disposition of non-qualifying real property after 1984 and before February 23, 1994.*
- B = the number of months the partnership owned the property after February 1992 and before March 1994 (start counting with March 1992 and include the month the partnership disposed of the property).
- C = the number of months the partnership owned the property before March 1994 (if the partnership owned the property before January 1972, start counting with January 1972. Otherwise, start counting with the month the partnership purchased the property and include the month the partnership disposed of the property).

* If you are reporting a reserve that you claimed in the prior year for that property, the amount to use in A is the reserve from the prior year minus the reserve, if any, that you are claiming for the current year. If you are not reporting a reserve from the prior year, the amount to use in A is the reserve you are claiming for the current year.

In addition to entering the reserve in the appropriate area in Part 2 of Form T2017, you have to enter the amount of the reserve that is eligible for the \$75,000 capital gains deduction. In this case, the eligible portion of the reserve is the difference between the amount determined for A in the above formula and the amount you calculated as the non-eligible portion of the reserve. Enter the eligible portion on line 391 in Part 2 of Form T2017.

Chapter 7 — Capital Gains Deduction

This chapter deals with the capital gains deduction as it applies to capital property and eligible capital property, other than qualified small business corporation shares and qualified farm property. It also shows you how to complete Form T936, *Calculation of Cumulative Net Investment Loss (CNIL) to December 31, 1995*, and Form T657A, *Calculation of Capital Gains Deduction for 1995 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 1995 or a prior year, use Form T657, *Calculation of Capital Gains Deduction for 1995 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 10. To determine what is considered qualified farm property, see the income tax guide called *Farming Income*.

If, for the 1995 taxation year, you file Form T664, *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*, for eligible capital property that is qualified farm property, and you did not dispose of qualified farm property or qualified small business corporation shares in 1995 or a prior year, you should use Form T657A and not Form T657.

You will notice throughout this chapter that capital gains are often referred to as being eligible or non-eligible. The term **eligible capital gains** means eligible for the capital gains deduction and the term **non-eligible capital gains** means not eligible for the capital gains deduction.

What is a capital gains deduction?

It is a deduction that you can claim against eligible taxable capital gains you realized from the disposition of capital property. By claiming this deduction, you can reduce your taxable income. An eligible taxable capital gain is three-quarters of an eligible capital gain.

What are the capital gains deduction limits?

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

- **qualified farm property or qualified small business corporation shares**, you may be eligible for the \$500,000 capital gains exemption. 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 may be eligible for the \$100,000 capital gains exemption. Your cumulative capital gains deduction is \$75,000 (three-quarters of \$100,000).

The \$75,000 capital gains deduction is no longer available for dispositions of capital property or eligible capital property after February 22, 1994. However, there are certain situations where you can still claim the \$75,000 capital gains deduction for 1995. The chart called "Capital gains eligible for the \$75,000 capital gains deduction for 1995," on this page, lists these situations.

The total of your capital gains deductions from 1985 to 1995 for all types of capital properties cannot be more than your cumulative deduction of \$375,000.

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.

Remember, the \$75,000 capital gains deduction is no longer available for dispositions of capital property or eligible capital property after February 22, 1994. However, if you owned this type of property at the end of February 22, 1994, and you have not used all of your \$75,000 capital gains deduction, there is a special election that may be available to you. For more information, read the section called "Did you own capital property or eligible capital property at the end of February 22, 1994" on page 4.

Capital gains eligible for the \$75,000 capital gains deduction for 1995

Capital gains eligible for the \$75,000 capital gains deduction for 1995 include:

- a capital gain from an elective disposition of eligible capital property of a business that has a **fiscal year that includes February 22, 1994, and ends in 1995**, and for which you filed Form T664, *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*, for the 1995 taxation year;
- a capital gain reported in box 30 of a T3 slip;
- 4/3 of a taxable capital gain reported in box 26 of a T3 slip;
- your share of a capital gain from the disposition of property before February 23, 1994, by a partnership that has a **fiscal year that includes February 22, 1994, and ends in 1995***;
- your share of a capital gain from a reserve brought into income from the disposition of property after 1984 and before February 23, 1994, by a partnership that has a **fiscal year that includes February 22, 1994, and ends in 1995***; and
- a capital gain from the disposition of eligible capital property of a business you disposed of before February 23, 1994, that is being reported on your 1995 income tax return because of an election under subsection 25(1) of the *Income Tax Act* to extend the fiscal year-end of the business to 1995.

* If your share of the capital gain is from the disposition of non-qualifying real property, the portion of your share of the capital gain that applies to the period after February 1992 is not an eligible capital gain. For more information, see the section called "Disposition of non-qualifying real property by a partnership before February 23, 1994" on page 38, or the section called "Are you reporting or claiming a reserve from the disposition of property by a partnership that has a fiscal year that includes February 22, 1994, and ends in 1995?" on page 36, whichever applies.

Who is eligible to claim the capital gains deduction?

You have to be a resident of Canada throughout 1995 to be eligible to claim the capital gains deduction. For the purposes of this deduction, we will also consider you to be a resident throughout 1995 if:

- you were a resident of Canada for at least part of 1995; and
- you were a resident of Canada throughout 1994 or 1996.

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.

Disposition of non-qualifying real property by a partnership before February 23, 1994

Read this section only if all of the following apply:

- you are a member of a partnership that does not have to file Form T5013 Summary, *Partnership Information Return*, for 1995;*
- the partnership has a fiscal year that includes February 22, 1994, and ends in 1995; and
- the partnership has disposed of non-qualifying real property before February 23, 1994, in the above-mentioned fiscal year.

If this is your case, the portion of the capital gain or capital loss from the disposition of the non-qualifying real property that applies to the period after February 1992 is considered a non-eligible capital gain or capital loss. We define **non-qualifying real property** on page 9.

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 \$375,000 capital gains deduction. In addition, the principal residence exemption remains the same and does not fall under these rules.

* If you are a member of a partnership that has to file Form T5013 Summary for 1995, you should receive two copies of Form T5013 Supplementary, *Statement of Partnership Income*, indicating your share of the capital gain or capital loss from the partnership. If this is your case, do not read this section. Instead, see the section called "Information slips" on page 11 to find out how to report a capital gain or capital loss reported on Form T5013 Supplementary.

Calculating the non-eligible portion of your share of a capital gain or capital loss from the disposition of non-qualifying real property by a partnership before February 23, 1994

This section will help you determine the eligible and non-eligible portions of your share of a capital gain or

capital loss from the disposition of non-qualifying real property before February 23, 1994, by a partnership that has a fiscal year that includes February 22, 1994, and ends in 1995. It also provides instructions on how to complete Schedule 3.

If you are reporting or claiming a reserve from the disposition of non-qualifying real property by the partnership, see the section called "Are you reporting or claiming a reserve from the disposition of property by a partnership that has a fiscal year that includes February 22, 1994, and ends in 1995?" on page 36 to determine the eligible and non-eligible portions of your share of the reserve.

You have to determine the non-eligible portion of your share of the capital gain or capital loss for the following reasons:

- the non-eligible portion of your share of the capital gain does not qualify for the capital gains deduction; and
- the non-eligible portion of your share of the capital loss should first be applied against any non-eligible capital gains that you may be reporting in the year.

To calculate the non-eligible portion of your share of the capital gain or capital loss, use the following formula:

$$A \times B/C$$

In this formula:

- A = your share of the capital gain or capital loss from the disposition of non-qualifying real property before February 23, 1994.
- B = the number of months the partnership owned the property after February 1992 and before March 1994 (start counting with March 1992 and include the month the partnership disposed of the property).
- C = the number of months the partnership owned the property before March 1994 (if the partnership owned the property before January 1972, start counting with January 1972. Otherwise, start counting with the month the partnership purchased the property and include the month the partnership disposed of the property.).

You enter the non-eligible portion of your share of the capital gain or capital loss on line 033 in Part 1 of Schedule 3. Then enter the eligible portion of your share of the capital gain or capital loss on line 532 in Part 2 of Schedule 3. The eligible portion of your share of the capital gain or capital loss is the difference between the amount determined for A in the above formula and the amount you calculated as the non-eligible portion of the gain.

Example

XYZ Properties is a partnership with two partners, Deirdre and Alex. Each partner has a 50% interest in the partnership. The partnership's fiscal period is from February 1, 1994, to January 31, 1995. The partnership sold land on February 12, 1994 and realized a capital gain of \$80,000. The partnership purchased the land in February 1979, and it was never used in the partnership's business activities. The land is considered non-qualifying

real property. Since the partnership sold the land before February 23, 1994, Deirdre and Alex each have to calculate the eligible and non-eligible portion of their share of the capital gain. They do this as follows:

- A = \$40,000 ($\$80,000 \times 50\%$)
 - B = 24 (March 1992 to February 1994)
 - C = 181 (February 1979 to February 1994)
- $$\$40,000 \times 24/181 = \$5,303.86$$

Deirdre and Alex each complete a Schedule 3 for 1995. They enter \$5,303.86, the non-eligible portion of their share of the capital gain, on line 033 in Part 1. They then enter \$34,696.14 ($\$40,000 - \$5,303.86$), the eligible portion of their share of the capital gain, on line 532 in Part 2. Deirdre and Alex will use \$26,022.10 ($\$34,696.14 \times 3/4$) when they calculate their capital gains deduction.

How do you calculate your capital gains deduction?

To calculate your capital gains deduction for 1995, you need to know the following amounts:

- your cumulative net investment loss (CNIL) to December 31, 1995;
- your annual gains limit for 1995;
- your cumulative gains limit for 1995;
- your eligible capital gains in 1995; and
- the total of all capital gains deductions you claimed in previous years.

There are five steps you have to complete to calculate your capital gains deduction for 1995. 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 us.

Step 1— Calculating your cumulative net investment loss (CNIL) to December 31, 1995

The first step in calculating your capital gains deduction is to determine your CNIL to December 31, 1995. If you have a CNIL in 1995, 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 you use to reduce any non-eligible taxable capital gains becomes an investment expense. You will use this amount when you calculate your CNIL.

For 1992 and following years, a non-eligible taxable capital gain may become investment income. You will also use this amount when you calculate your CNIL.

To calculate your CNIL for 1995, complete Form T936, *Calculation of Cumulative Net Investment Loss (CNIL) to December 31, 1995*. 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.

The following example shows you how to calculate a CNIL to December 31, 1995.

Example

Al had a \$1,500 capital gain from selling shares in 1995. He also received a T5013 Supplementary, *Statement of Partnership Income*, for 1995 showing a capital gain of \$5,000. The non-eligible portion of this gain was \$2,000. Al completes Schedule 3 as follows:

Line 021: Shares	\$1,500
Line 032: Information slips — non-eligible capital gains (or losses).....	\$2,000
Line 042: Total taxable capital gains (or losses) of Part 1 (\$3,500 x 3/4)	\$2,625
Line 533: Information slips — eligible capital gains (or losses) (\$5,000 — \$2,000)	\$3,000
Line 547: Total taxable capital gains (or losses) of Part 2 (\$3,000 x 3/4)	\$2,250
Line 044: Total taxable capital gains (or net capital losses) (\$2,625 + \$2,250)	\$4,875

Al did not file Form T664, *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*, for the 1994 taxation year with respect to his interest in the partnership. If he had filed Form T664 with respect to his interest in the partnership, he may have been able to reduce all or part of the non-eligible capital gain from the partnership. For more information on this subject, see the section called "Flow-through entity" on page 16.

In prior years, Al reported investment income of \$600 and claimed investment expenses of \$2,600. For 1995, Al reported the following types of income and expenses on his income tax return.

Line 120: Taxable dividends	\$ 100
Line 121: Interest income	\$ 650
Line 126: Net rental income (loss).....	\$(1,550)
Line 221: Carrying charges.....	\$ 650

To calculate his CNIL as of December 31, 1995, Al completes Form T936. Since a portion of his capital gains are non-eligible, he completes Charts A and B first.

Chart A — Net non-eligible taxable capital gains

Enter the amount from line 044 in Part 3 of Schedule 3 (if negative, show it in brackets)	4,875 00	(a)
Enter the amount from line 529 of Schedule 3	00	(b)
Line (a) plus line (b) (if negative, enter zero)	4,875 00	(c)
If line (c) is zero, you do not have any additional investment income for 1995. In this case, do not complete the rest of this chart and enter zero on line (m) in Chart B below.		
Enter the amount from line 042 in Part 3 of Schedule 3 (if negative, enter zero)	2,625 00	(d)
If line (d) is zero, you do not have any additional investment income for 1995. In this case, enter zero on line (m) in Chart B below.		
Total net non-eligible taxable capital gains (line (c) or line (d), whichever is less)	2,625 00	(e)

Chart B — Additional investment income

- If line (e) in Chart A includes an amount from a T3 slip, complete all steps in this chart.
- Otherwise, enter the amount from line (e) in Chart A, on line (m) in this chart.

Enter the amount from line (e) in Chart A above	00	(f)
Enter the amount from box 21 of all 1995 T3 slips	00	(g)
Enter the amount from box 30 of all 1995 T3 slips	00	(h)
Line (g) minus line (h)	00	(i)
Enter the portion, if any, of the amount from line 039 in Part 1 of Schedule 3, used to reduce the gain on line (f) above	00	(j)
Line (f) minus line (j)	00	(k)
Enter 3/4 of line (k)	00	(l)
Additional investment income (line (f) minus line (l). If negative, enter zero.)	2,625 00	(m)

All now completes the rest of Form T936.

Part 1 – Investment expenses claimed on your 1995 return

Carrying charges and interest expenses (from line 221)	650 00	(1)	
Net rental losses (from line 126 or related schedules or statements)	1,550 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 1995 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 (m) in Chart B, or the amount you claimed on line 253 of your return.			
	0	(7)	
Total investment expenses claimed in 1995 (add lines 1 to 7 inclusive)	2,200 00	▶	2,200 00 (A)

* Refer to the list called "Other investment expenses" below.

Part 2 – Investment income reported on your 1995 return

Investment income (from lines 120 and 121)	750 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 1995**, including annuity payments taxable under paragraph 56(1)(d) or 56(1)(d.1) minus 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 (m) in Chart B.			
	2,625 00	(13)	
Total investment income reported in 1995 (add lines 8 to 13 inclusive)	3,375 00	▶	3,375 00 (B)

** Refer to the list called "Other property income" below.

Part 3 – Cumulative net investment loss (CNIL)

Total investment expenses claimed in 1995 (from line (A) in Part 1)	2,200 00	(14)	
Total investment expenses claimed in prior years (after 1987): Enter the amount from line 20 in Part 4 of Form T936 for 1994. If you did not complete Part 4 of Form T936 for 1994, report the total expense amounts as described in lines 1 to 6 in Part 1, as claimed on your 1988 to 1994 returns inclusive, and any additional investment expenses described on line 7 in Part 1 that you had in 1992, 1993, and 1994.	2,600 00	(15)	
Cumulative investment expenses (add lines 14 and 15)	4,800 00	▶	4,800 00 (16)
Total investment income reported in 1995 (from line (B) in Part 2)	3,375 00	(17)	
Total investment income reported in prior years (after 1987): Enter the amount from line 23 in Part 4 of Form T936 for 1994. If you did not complete Part 4 of Form T936 for 1994, report the total income amounts described in lines 8 to 12 in Part 2, as reported on your 1988 to 1994 returns inclusive, and any additional investment income described on line 13 in Part 2 that you had in 1992, 1993, and 1994.	600 00	(18)	
Cumulative investment income (add lines 17 and 18)	3,975 00	▶	3,975 00 (19)
Cumulative net investment loss (CNIL) to December 31, 1995 (Line 16 minus line 19. If negative, enter zero.)			825 00 (C)

If you are claiming a capital gains deduction on your 1995 return, enter the amount from line (C) on line 17 of Form T657A or line 21 of Form T657.

Step 2 — Calculating your annual gains limit

The second step in calculating your capital gains deduction is to determine your annual gains limit.

Your **annual gains limit** for 1995 is the total of:

- your net eligible taxable capital gains for 1995, **minus**:
- the total of any allowable business investment losses for 1995;
- net capital losses of other years you used to reduce your eligible taxable capital gains that you reported in 1995; and

- net capital losses you incurred before May 23, 1985, that you used to reduce other income in 1995 (maximum of \$2,000).

Net capital losses of other years applied against non-eligible taxable capital gains will not reduce your annual gains limit in 1995. For this purpose, net capital losses of other years are first applied against non-eligible taxable capital gains, and then against eligible taxable capital gains.

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

Example

Al completes Part 1 of Form T657A as follows:

Part 1 — Calculating your annual gains limit for 1995

Total taxable capital gains (or losses) from line 547 in Part 2 of Schedule 3 (if the amount is a loss, enter zero)	2,250 00	(1)	
Total taxable capital gains (or net capital losses) from line 044 in Part 3 of Schedule 3 (if the amount is a loss, enter zero)	4,875 00	(2)	
1995 eligible taxable capital gains (enter the lesser of the amounts on lines 1 and 2. If line 3 is zero, you cannot claim a capital gains deduction for 1995.)	2,250 00	▶	2,250 00 (3)
Net capital losses of other years (to calculate this amount, complete Chart 1 on the other side of this form)		(4)	
Allowable business investment losses (from line 217 of your 1995 return)		(5)	
Total of above losses (line 4 plus line 5)		▶	0 (6)
Annual gains limit for 1995 (line 3 minus line 6. If negative, enter zero.)	2,250 00	(7)	

If line 7 is zero, you cannot claim a capital gains deduction for 1995.

Step 3 — Calculating your cumulative gains limit

The third step in calculating your capital gains deduction is to determine your cumulative gains limit.

Your **cumulative gains limit** for 1995 is the total of your net eligible taxable capital gains from 1985 to 1995, **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 1995;
- all net capital losses of other years that you used to reduce eligible taxable capital gains in 1985 to 1995;
- all net capital losses you incurred before May 23, 1985, that you used to reduce other income in 1985 to 1995;

- your CNIL to December 31, 1995; and
- all capital gains deductions you claimed from 1985 to 1994.

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 1995 net capital loss back to 1992, that loss will reduce your cumulative gains limit for 1992 and all following years. However, your cumulative gains limit will not be reduced by any net capital losses of other years applied against non-eligible taxable capital gains.

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

Example

Al 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 - Calculating your cumulative gains limit for 1995

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.)	<u>700 00</u>	(8)	
1992 and 1993 taxable capital gains eligible for the capital gains deduction (from line 3 in Part 1 of Form T657A for 1992 and 1993)	_____	(9)	
1994 eligible taxable gains (from line 5 in Part 1 of Form T657A for 1994)	_____	(10)	
1995 eligible taxable capital gains (from line 3 in Part 1 above)	<u>2,250 00</u>	(11)	
Cumulative eligible taxable capital gains (add lines 8 to 11 inclusive)	<u>2,950 00</u>	▶	<u>2,950 00</u> (12)
Allowable capital losses claimed in 1985 (from line 127 on your 1985 return; maximum of \$2,000)	_____	(13)	
Allowable business investment losses claimed after 1984 and before 1995 (from line 217 on your 1985 to 1994 returns)	_____	(14)	
Net capital losses of other years claimed after 1984 and before 1995 (to calculate this amount, complete Chart 2 on the other side of this form)	_____	(15)	
Total losses used to calculate your annual gains limit for 1995 (from line 6 of Part 1 above)	_____	(16)	
Cumulative net investment loss to December 31, 1995 (from line (C) in Part 3 of Form T936 for 1995).	<u>825 00</u>	(17)	
Total capital gains deductions claimed after 1984 and before 1995 (from line 254 on your 1985 to 1994 returns)	<u>0</u>	(18)	
Subtotal (add lines 13 to 18 inclusive)	<u>825 00</u>	▶	<u>825 00</u> (19)
Cumulative gains limit for 1995 (line 12 minus line 19. If negative, enter zero.)			
If line 20 is zero, you cannot claim a capital gains deduction for 1995.			<u>2,125 00</u> (20)

Step 4 — Calculating your capital gains deduction available for 1995

The fourth step in calculating your capital gains deduction is to determine the balance of your capital gains deduction limit.

To do this, complete Part 3 of Form T657A.

Example

Al completes Part 3 of Form T657A as follows:

Part 3 — Calculating your capital gains deduction on other capital property

Maximum capital gains deduction for 1995	\$75 000	(21)
Total capital gains deductions claimed after 1984 and before 1988 (from line 254 on your 1985 to 1987 returns)		(22)
Adjustment of pre-1988 capital gains deductions (1/2 of amount at line 22)		(23)
Capital gains deductions claimed in 1988 and 1989 excluding "eligible capital property (other)" (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.)		(24)
Adjustment of 1988 and 1989 capital gains deductions (1/8 of amount at line 24)		(25)
Capital gains deductions claimed in 1988 and 1989 for "eligible capital property (other)" (from line 254 of your 1988 and 1989 returns minus the amount on line 24 above; not to exceed line 544 on Schedule 3 for 1988 and 1989)		(26)
Total capital gains deductions claimed in 1990, 1991, 1992, 1993, and 1994 (from line 254 of your returns for those years)		(27)
Subtotal (add lines 22 to 27 inclusive)		0 (28)
Capital gains deduction available for 1995 (line 21 minus line 28. If negative, enter zero.)	75,000 00	(29)

If line 29 is zero, you cannot claim a capital gains deduction for 1995.

Step 5 — Calculating 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 1995;
- Line 20 of Form T657A — your cumulative gains limit for 1995; or

- Line 29 of Form T657A — your capital gains deduction limit available for 1995.

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 30 of Form T657A. Then, enter the same amount on line 254 of your return.

Example

Al wants to claim the maximum capital gains deduction. He enters \$2,125 on line 30 of Form T657A and the same amount on line 254 of his 1995 return.

Part 4 — Determining your 1995 capital gains deduction on other capital property

The maximum amount you can enter on line 30 is the least of lines 7, 20, and 29. However, you may enter an amount that is less than the maximum. Enter this amount on line 254 of your 1995 return.	2,125 00	(30)
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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.

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 (about 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. For more information on this subject, see Interpretation Bulletin IT-120, *Principal Residence*.

Designating a 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 all or part of your principal residence. For more information, see the section called "Form T2091(IND), *Designation of a Property as a Principal Residence by an Individual (Other than a Personal Trust)*," later in this chapter.

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).

For 1993 and following years, a common-law spouse, as defined in the definition of **spouse** on page 11, 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.

Selling 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.

It is possible that the property was **not** your principal residence for every year that you owned it. If this is the case, you have to report the part of the capital gain on the property that relates to the years for which you did not designate the property as your principal residence. For more information, see the next section called "Form T2091(IND), *Designation of a Property as a Principal Residence by an Individual (Other than a Personal Trust)*."

When you actually sell the property, it is possible that part of the property does not qualify as your principal residence. In that case, you have to split the selling price between the part you used for your principal residence and the part you used for rental or business purposes. You can do this by using square metres or the number of rooms, as long as the split is reasonable. Report only the gain on the part you used for rental or business purposes. To better understand how to report the sale of a property you use partly as your principal residence and partly for rental or business purposes, see the example at the end of this chapter.

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

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

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

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

Selling a property for which you or your spouse filed Form T664 or T664(Seniors), Election to Report a Capital Gain on Property Owned at the End of February 22, 1994

When you sell, or are considered to have sold, a property for which you or your spouse filed Form T664 or T664(Seniors), and

- the property was your principal residence for 1994; or
- you are designating it in 1995 as your principal residence for any taxation year,

you have to use Form T2091(IND) to calculate the capital gain and Form T2091(IND)-WS, *Principal Residence Worksheet for 1995*, to calculate a reduction as a result of the capital gains election. If this is the case, and the property was designated as a principal residence for the purpose of the capital gains election, you have to include those previously designated taxation years as part of your principal residence designation in 1995.

If the property was not your principal residence for 1994 and you are not designating it in 1995 as your principal residence for any taxation year, do not use Form T2091(IND) and Form T2091(IND)-WS to calculate your capital gain. Instead, calculate your capital gain, if any, in the regular way (the proceeds of disposition minus the adjusted cost base and the selling expenses). For more information on how to calculate your adjusted

cost base as a result of the capital gains election, see the definition of **adjusted cost base** on page 6.

Note

If, at the time of the election, the property was designated as a principal residence for any taxation year **other than 1994**, you can choose whether or not to designate it again as your principal residence when you sell it, or are considered to have sold it. Remember, if you choose to designate it again, you have to include those previously designated taxation years as part of your principal residence designation in 1995.

Special situations

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

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

The rest of this chapter deals with more common situations where you will be considered to have sold all or part of your property. For more information on some of these special situations, see Interpretation Bulletins IT-120, *Principal Residence*, and IT-366, *Principal Residence — Transfer to Spouse, Spouse Trust or Certain Other Individuals*, and its Special Release, or contact us.

Changing all of your principal residence 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, 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 reacquired 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 024 in Part 1 of Schedule 3. You usually have to do this in the calendar year that you changed the property's use.

Election when you change the use of your principal residence

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 letter signed by you 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 as 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 the following conditions are met:

- you live away 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 you or your spouse are 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 decide to make this election, there is no immediate effect on your income tax situation when you move back into your residence. However, you might change the use of the property again. If you do not make this election again, any gain you have from selling the property may be subject to tax. See "Selling all or part of your principal residence" on page 45 to calculate the taxable part of your gain.

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

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

You are usually considered to have changed the use of part of your principal residence when you start to use that part

for rental or business purposes. 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 of the above conditions are not met, when you actually sell the property:

- you have to split the selling price between the part you used for your principal residence and the part you used for rental or business purposes. You can do this by using either square metres or the number of rooms, as long as the split is reasonable; and
- you report any capital gain on the part you used for rental or business purposes on line 024 in Part 1 of Schedule 3. You do not have to report any capital gain for the part you used for your principal residence.

Note

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

Changing all of 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 when you change the use of your rental or business property

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 submit a letter signed by you 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

- the date you are required to file your tax return for 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. 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*.

Farm property

If you are a farmer and you sell farmland in 1995 that includes your principal residence, you can choose one 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 the disposition of property that includes land and a building (see Chapter 3); and
- calculate a recapture or terminal loss on the disposition of depreciable property (see Chapter 3).

In November 1988, Sean 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, Sean 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 1995, Sean sold the property for \$175,000. He incurred expenses of \$10,500 to make the sale. According to a recent municipal assessment, the entire property was now valued at \$150,000. The land was worth \$30,000 and the building was worth \$120,000.

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

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

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

a) Building: 40%	x	$\frac{\$ 75,000}{\$100,000}$	x	\$125,000	=	\$37,500
b) Land: 40%	x	$\frac{\$ 25,000}{\$100,000}$	x	\$125,000	=	\$12,500

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

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

a) Building: 40%	x	$\frac{\$120,000}{\$150,000}$	x	\$175,000	=	\$56,000
b) Land: 40%	x	$\frac{\$ 30,000}{\$150,000}$	x	\$175,000	=	\$14,000

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

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

a) Building: 40%	x	$\frac{\$120,000}{\$150,000}$	x	\$10,500	=	\$ 3,360
b) Land: 40%	x	$\frac{\$ 30,000}{\$150,000}$	x	\$10,500	=	\$ 840

Sean 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 1995 was \$34,728. From the UCC, Sean subtracts the lesser of the following:

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

UCC at the beginning of 1995	\$34,728
Minus: Purchase price	<u>\$37,500</u>
Recapture of CCA	<u>\$ (2,772)</u>

To help him complete the above calculations, Sean 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 us.

Sean can now calculate his capital gain. To do this, he completes the section called "Real estate and depreciable property" on Schedule 3, *Capital Gains (or Losses) in 1995*. 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)	1988	56,000	00	37,500	00	3,360
Street, City, Province (Land)	1988	14,000	00	12,500	00	840
Total proceeds	023	70,000	00	Gain (or loss)	024	15,800
					+	00

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Your opinion counts!

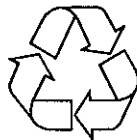


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