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# Capital Gains

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## Before You Start

### Is this guide for you?

Use this guide to get information on capital gains or capital losses in 1997. 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 4. Use Schedule 3, *Capital Gains (or Losses) in 1997*, to calculate and report your taxable capital gains or allowable capital losses. 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 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 Form T2017, *Summary of Reserves on Dispositions of Capital Property*, that you may have to complete. Throughout the guide, we also refer to other forms and publications. If you need any forms or publications, you can order them from your tax services office or tax centre by mail, by telephone, or in person.

### Internet

Many of our publications are available on the Internet. Our Internet address is:

<http://www.rc.gc.ca>

## What's New for 1997?

### Changes to the guide

- We have added a new chart to help you keep track of the exempt capital gains balance of certain flow-through entities.
- The lines on Schedule 3 of the General income tax package have been renumbered. Consequently, all line references to Schedule 3 in this guide and in its related forms have been changed.

### Proposed changes

This guide includes income tax changes that have been announced, but were not law at the time of printing. If they become law as proposed, they will be effective for 1997, or as of the dates indicated. These changes are boxed in red throughout the guide.

Under proposed changes, if after February 18, 1997, and before 2002, you donate certain properties to a qualified donee other than a private foundation and realize a capital gain, the portion you have to report as income is three-eighths of the capital gain. This reduced rate only applies to capital gains from the following donated properties:

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

This change does not apply to capital losses you may realize from such donations.

If you realize a capital gain from this type of donation, you should use Form T1170, *Capital Gains on Gifts of Certain Capital Property*, to calculate the gain you report on Schedule 3. For more information, get the pamphlet called *Gifts and Income Tax*.

Under proposed changes, for 1997 and later taxation years, if you donate certain securities to a qualified donee and realize a capital gain, you may be able to claim a reserve in order to postpone the inclusion of the capital gain in income. For more information, see the section called "Claiming a reserve," on page 9.

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 from 8:15 a.m. to 5:00 p.m. (Eastern Time).

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

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## Glossary

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

### Note

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

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

**ABIL** – Allowable business investment loss

**ACB** – Adjusted cost base

**CCA** – Capital cost allowance

**CNIL** – Cumulative net investment loss

**FMV** – Fair market value

**LPP** – Listed personal property

**UCC** – Undepreciated capital cost

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

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

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

**Arm's length transaction** – This is an expression used to describe a transaction between persons that each act in their 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 persons usually deal with each other at arm's length, although this might not be the case if, for example, one is under the influence or control of the other.

**Business investment loss** – See the section called "Allowable business investment loss (ABIL)" on page 31.

**Canadian-controlled private corporation** – Under proposed changes, for 1996 and later taxation years, a Canadian-controlled private corporation is a private corporation that is a Canadian corporation **other than** a corporation that:

- is controlled directly or indirectly in any way by one or more non-resident persons, by one or more public corporations (other than a prescribed venture capital corporation), or by any combination of the above;
- would be controlled by one person if that one person owned all the shares of any corporation that are owned by any non-resident person or any public corporation (other than a prescribed venture capital corporation); or
- has a class of its shares listed on a prescribed stock exchange.

**Canadian security** – A Canadian security is:

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

Prescribed securities are not considered to be Canadian securities.

**Capital cost allowance (CCA)** – 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 the total of its adjusted cost base and the outlays or expenses incurred to sell the property.

**Capital loss** – You have a capital loss when you sell, or are considered to have sold, a capital property for **less** than the total of its adjusted cost base and the outlays or expenses incurred to sell the property.

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

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

**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 the disposition of 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.

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

**Flow-through entity** – We explain this term in Chapter 4.

**Listed personal property (LPP)** – See the section called "Listed personal property, line 159" on page 16.

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

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

It also generally 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 property described above.

**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.

**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. You cannot reduce your other income by claiming a deduction for these outlays and expenses. These types of expenses include fixing-up expenses, finders' fees, commissions, brokers' fees, surveyors' fees, legal fees, transfer taxes, and advertising costs.

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

**Prescribed security** – A prescribed security generally includes:

- a share of a corporation (other than a public corporation) 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.

A prescribed security is not considered to be a Canadian security.

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

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

- has a class of shares listed on a prescribed Canadian stock exchange; or
- has elected, or has been designated by the Minister of National Revenue, to be a public corporation. Also, at the time of the election or designation, the corporation complied with prescribed conditions on the number of its shareholders, the dispersal of ownership of its shares, the public trading of its shares, and its size.

**Qualified donee** – Under proposed changes, for 1997 and later taxation years, in this guide a qualified donee includes the following:

- a Canadian registered charity;
- a registered Canadian amateur athletic association;
- a prescribed university outside Canada;
- a Canadian non-profit organization that only provides low-cost housing for seniors;
- a Canadian municipality;
- the Government of Canada, a province, or a territory;
- the United Nations or an agency thereof; and
- a charitable organization outside Canada to which the Government of Canada has made a donation in 1996 or 1997.

**Qualified small business corporation shares** – See the section called “Qualified small business corporation shares, lines 106 and 107” on page 11.

**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.

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

Under proposed changes, if after February 18, 1997, and before 2002, you donate certain properties to a qualified donee other than a private foundation and realize a capital gain, the taxable portion to be included in income is three-eighths of the capital gain. For more information, see the section called “What’s New for 1997?” on page 2.

**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 previous years. If you sell depreciable property in a year, you also have to subtract from the UCC one of the following two amounts, **whichever is less**:

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

## Chapter 1 – General Information

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

Generally, when 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).

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

For more information on the difference between capital and income transactions, see Interpretation Bulletin IT-218, *Profit, Capital Gains and Losses from the Sale of Real Estate, Including Farmland and Inherited Land and Conversion of Real Estate from Capital Property to Inventory and Vice Versa*, IT-459, *Adventure or Concern in the Nature of Trade*, and IT-479, *Transactions in Securities*, and its Special Release.

If you have income transactions, see the income tax guide called *Business and Professional Income*, for information on how to report your income gain or loss.

### 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;
- a corporation redeems or cancels shares or other securities that you hold (you will usually be considered to have received a dividend, the amount of which will be shown on a T5 slip);
- you change all or part of the property's use (see the section called "Changes in use" on page 35);
- you leave Canada (see the pamphlet called *Emigrants and Income Tax*); or
- the owner dies (see the income tax guide called *Preparing Returns for Deceased Persons*).

### Elections

There are situations when you can choose to report a capital gain or loss. This happens when:

- you file (applicable to the 1995 taxation year) Form T664 or T664(Seniors), *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*; or
- you elect to report the gain or loss from the disposition of Canadian securities as a capital transaction.

**Eligible capital property owned at the end of February 22, 1994** – The \$75,000 capital gains deduction is no longer available for dispositions of 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, you may elect 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*.

You can no longer file this election for the 1994 taxation year since the deadline expired on April 30, 1997. However, if you operated a business with a fiscal year that includes February 22, 1994, and ended in 1995, the election was also available for the 1995 taxation year for any eligible capital property you owned at the end of February 22, 1994. In this case, you generally had to file the election by June 15, 1996. If you did not file an election by June 15, 1996, and you would like to take advantage of it for the 1995 taxation year, we will accept a late election until June 15, 1998, if you estimate and pay a penalty at the time you actually file it.

If you sold eligible capital 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 1995 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 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.

**Disposition of Canadian securities** – If you dispose of Canadian securities, you may have an income gain or loss. However, in the year you dispose of Canadian securities, you can elect to report your gain or loss as a capital gain or loss. If you make this 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 a partnership owns Canadian securities, each partner is treated as owning the security. When the partnership disposes of the security, each partner can elect to treat the security as capital property. An election by one partner will not result in each partner being treated as having made the election.

To make this election, complete Form T123, *Election on Disposition of Canadian Securities*, and attach it to your 1997 return. Once you make this election, you cannot reverse your decision.

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

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

**Personal-use property** – When you sell personal-use property such as cars and boats, 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. For more information, see the section called “Personal-use property, line 158” on page 16.

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

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

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

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

#### Note

Regardless of whether or not the sale of a capital property results in a capital gain or capital loss, you have to file a tax return to report the transaction (even if you do not have to pay tax). This rule also applies when you report the taxable part of any capital gains reserve you deducted in 1996.

**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.

For more information on how to report capital gains and losses, see Chapter 2.

#### Example

Jessica owns a small business. The fiscal year end for her business is June 30, 1997. In August 1997, she sold a capital property that she used in her business. As a result of the sale, she realized a capital gain. Jessica has to report the capital gain on her income tax return for 1997. She does this even though the sale took place after her business' fiscal year end date of June 30.

For more information on how to report capital gains and losses, see Chapter 2.

**Are you a member of a partnership?** – If you are a member of a partnership, it is possible that your partnership has a fiscal year end other than December 31. If the partnership

sells capital property during its fiscal year, you generally report your share of any capital gain or capital loss in the calendar year in which that fiscal year ends.

### Calculating your capital gain or 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.

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

You have a capital gain when you sell, or are considered to have sold, a capital property for more than its ACB plus the outlays or expenses incurred to sell the property. Usually, you have to report three-quarters of your capital gains as income on your return.

When you sell, or are considered to have sold, a capital property for less than its ACB plus the outlays or expenses incurred to sell the property, you have a capital loss. You can deduct three-quarters of your capital losses from your taxable capital gains.

Use Schedule 3, *Capital Gains (or Losses) in 1997*, to calculate and report all your capital gains and capital losses. Do not include any capital gains or capital losses in your business or property income, even if you used the property for your business. For more information on how to complete Schedule 3, see Chapter 2.

Under proposed changes, if after February 18, 1997, and before 2002, you donate certain properties to a qualified donee other than a private foundation and realize a capital gain, you should use Form T1170, *Capital Gains on Gifts of Certain Capital Property*, to calculate the gain you report on Schedule 3. For more information, see the section called “What's New for 1997?” on page 2.

#### Note

Before 1972, capital gains were not taxed. Therefore, if you sold capital property in 1997 that you owned before 1972, you have to apply special rules when calculating your capital gain or capital loss to remove any capital gains accrued before 1972. We do not explain these rules 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*.

#### Example

In 1997, Jack sold 400 shares of XYZ Public Corporation of Canada for \$6,500. He received the full proceeds at the time of the sale and paid a commission of \$60. The adjusted cost base of the shares is \$4,000 (including a commission at the time of purchase). Jack calculates his capital gain as follows:



Proceeds of disposition		\$ 6,500	1
Adjusted cost base	\$ 4,000		2
Outlays and expenses incurred at the time of disposition	+ 60		3
Line 2 plus line 3	= \$ 4,060		4
Capital gain, line 1 minus line 4		= \$ 2,440	5

Since only 3/4 of the capital gain is taxable, Jack would report \$1,830 as his taxable capital gain on his income tax return.

## What happens if you have a capital gain?

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

- defer part of the capital gain by claiming a reserve;
- reduce or offset all or a part of the gain by claiming a capital gains deduction; or
- reduce or offset all or a part of the gain by claiming a capital gains reduction (applicable to flow-through entities). For more information on this subject, see Chapter 4.

### Claiming a reserve

When you sell a capital property, you usually receive full payment at that time. However, sometimes you receive the amount over a number of years. For instance, you may sell a capital property for \$50,000 and receive \$10,000 at the time of sale and the remaining \$40,000 over a period of four years. When this situation occurs, 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 of disposition.

**Who can claim a reserve?** – Most people can claim a reserve when they dispose of a capital property. However, you **cannot** claim a reserve if you:

- were not a resident of 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 and report a reserve?** – 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 disposition.

To deduct a reserve in any year, you have to complete Form T2017, *Summary of Reserves on Dispositions of Capital Property*. The information provided on the back of Form T2017 explains the limits on the number of years for

which you can claim a reserve and the amount of the reserve you can deduct. You will find two copies of this form in the middle of this guide.

If you claimed a reserve in the previous year, include that reserve when you calculate your capital gains for the current year. For instance, if you claimed a reserve in 1996, you have to include it in your capital gains for 1997. If you still have an amount that is payable to you after 1997, you may be able to calculate and deduct a new reserve, which you include in your capital gains for 1998.

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

#### Note

You do not have to claim the maximum reserve in the 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.

**Reserve for a gift of securities** – Under proposed changes, for 1997 and later taxation years, if you donate certain securities to a qualified donee and realize a capital gain, you may be able to claim a reserve in order to postpone the inclusion of the capital gain in income. This change only applies to capital gains realized from a donation of:

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

Excluded from the above are shares, obligations, and other securities, listed on a prescribed stock exchange and deposits with financial institutions.

You can claim this reserve for any taxation year ending within 60 months after the time you made the gift. However, you **cannot** claim a reserve if:

- you were not a resident of Canada at the end of the taxation year, or at any time in the following year;
- you were exempt from paying tax at the end of the taxation year, or at any time in the following year; or
- the donee disposes of the securities.

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

### Claiming a capital gains deduction

If you realize a capital gain on the sale of certain properties, you may be able to claim a capital gains deduction.

**What is a capital gains deduction?** – It is a deduction that you can claim against taxable capital gains you realized from the disposition of certain capital properties. By claiming this deduction, you can reduce your taxable income.

**Which capital gains are eligible for the capital gains deduction?** – You may be able to claim the capital gains deduction on taxable capital gains you realize in 1997 from:

- dispositions of qualified farm property after 1984;
- dispositions of qualified small business corporation shares after June 17, 1987; and
- a reserve brought into income in 1997, from either of the above.

**Note**

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

You will find the definition of qualified small business corporation shares on page 11. To determine what is considered qualified farm property, see the income tax guide called *Farming Income* or *Farming Income and NISA*.

**Who is eligible to claim the capital gains deduction?** – You have to be a resident of Canada throughout 1997 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 1997 if:

- you were a resident of Canada for at least part of 1997; and
- you were a resident of Canada throughout 1996 or 1998.

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

**What is the capital gains deduction limit?** – For 1997, 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 the capital gains from these properties in your taxable income, your cumulative capital gains deduction is \$375,000 (three-quarters of \$500,000).

The total of your capital gains deductions from 1985 to 1997 for all types of capital properties cannot be more than your cumulative deduction of \$375,000.

**How do you claim the capital gains deduction?** – Use Form T657, *Calculation of Capital Gains Deduction for 1997*, to calculate the capital gains deduction. If you have investment income or investment expenses in any years from 1988 to 1997, you will also have to complete Form T936, *Calculation of Cumulative Net Investment Loss (CNIL) to December 31, 1997*. You can get these forms from us.

**Tax tip**

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.

**Note**

The \$100,000 capital gains exemption is no longer available for dispositions of eligible capital property after February 22, 1994. However, you may still be able to claim this deduction on your 1995 return. For more information, see the section called “Elections” on page 7.

## What happens if you have a capital loss?

If you have a capital loss in 1997, you can use it to reduce any capital gains you had in the year. If your capital losses are more than your capital gains, three-quarters of the difference between the two amounts is your net capital loss for the year. You can apply your net capital losses to other years. For more information on capital losses, see Chapter 5.

## What records do you have to keep?

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

If you own qualified farm property or qualified small business corporation shares, you should also keep a record of your investment income and expenses just in case you decide to claim a capital gains deduction in the year of sale. You will need these amounts to calculate the cumulative net investment loss (CNIL) component of the capital gains deduction. Form T936, *Calculation of Cumulative Net Investment Loss (CNIL) to December 31, 1997*, can be used for this purpose.

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

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

## Chapter 2 – Completing Schedule 3

This chapter gives you information about how and where you should report some of the more common capital transactions on Schedule 3, *Capital Gains (or Losses) in 1997*. Schedule 3 is included in the General income tax package.

You will notice that Schedule 3 has five columns and is divided into several sections for reporting the disposition of different types of properties. Report each disposition in the appropriate section of Schedule 3. Ensure you provide the information requested in all columns. Complete the bottom portion of the schedule to determine your taxable capital gain or your net capital loss. If you have a taxable capital

gain, transfer the amount onto line 127 of your income tax return. If you have a net capital loss, see Chapter 5 for information on how you can apply the loss.

**Note**

You may need to refer to the glossary which starts on page 4 for the definition of certain terms used in this chapter.

**Example**

The following is a continuation of the example on page 8. Jack would report the sale of his shares on Schedule 3 in the section called "Shares." If he had no other capital gains or capital losses in the year, he would report the disposition as shown below. We have only reproduced the areas of Schedule 3 that Jack would have to complete.

<b>Note:</b> Do not use this schedule to claim an allowable business investment loss from disposing of shares or debts of a small business corporation (see line 217 in the guide).	(1) Year of acquisition	(2) Proceeds of disposition	(3) Adjusted cost base	(4) Outlays and expenses (from dispositions)	(5) Gain (or loss) (column 2 minus columns 3 and 4)
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**Shares**

No. of shares	Name of corporation and class of shares	1994	6,500 00	4,000 00	60 00	2,440 00
400	XYZ Public Corporation of Canada					
		Total 131	6,500 00		Gain (or loss) 132 +	2,440 00

**Total of all gains (or losses) in column 5 before reserves and gifts 191 = 2,440 00**

**Capital gains (or losses) 194 = 2,440 00**

**Total capital gains (or losses) 197 = 2,440 00**

**Total taxable capital gains (or net capital losses)**

Calculate 75% of the amount on line 197. Enter the total taxable capital gains on line 127 of your return. If you have a net capital loss, see line 127 in the guide.

**199 1,830 00**

If Jack had sold his shares for only \$3,700 he would have ended up with a capital loss of \$360 [(\$3,700 - \$4,000) - \$60]. Although he cannot deduct the loss against other sources of income, Jack completes Schedule 3 as follows in order to register the loss.

**Shares**

No. of shares	Name of corporation and class of shares	1994	3,700 00	4,000 00	60 00	(360 00)
400	XYZ Public Corporation of Canada					
		Total 131	3,700 00		Gain (or loss) 132 +	(360 00)

**Total of all gains (or losses) in column 5 before reserves and gifts 191 = (360 00)**

**Capital gains (or losses) 194 = (360 00)**

**Total capital gains (or losses) 197 = (360 00)**

**Total taxable capital gains (or net capital losses)**

Calculate 75% of the amount on line 197. Enter the total taxable capital gains on line 127 of your return. If you have a net capital loss, see line 127 in the guide.

**199 (270 00)**

**Note**

Because the amount at line 199 is a loss, Jack does not report the amount on line 127 of his return. For more information about the application of capital losses, see Chapter 5.

**Qualified small business corporation shares, lines 106 and 107**

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

- as payment for other shares;
- under proposed changes, for dispositions of shares after June 17, 1987, as payment of a stock dividend; or
- in connection with a property that you, a partnership of which you were a member, or a person related to you, disposed of to the corporation that issued the shares. The property disposed must have consisted of either:
  - all or most (90% or more) of the assets used in an active business operated either by you, the members of the partnership of which you were a member, or the person related to you; or
  - an interest in a partnership where all or most (90% or more) of the partnership's assets were used in an active business operated by the members of the partnership.

**Note**

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, see the section called "Allowable business investment loss (ABIL)" on page 31.

**Capital gains deduction** - 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. For more information, see the section called "Claiming a capital gains deduction" on page 9.

**Qualified farm property, lines 109 and 110**

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

If the capital gain or loss is from a mortgage foreclosure or conditional sales repossession, report the capital gain or loss at line 124. For more information, see the section called

"Other mortgage foreclosures and conditional sales repossessions, lines 154 and 155" on page 15.

If you dispose of farm property, other than qualified farm property, report any capital gain or loss on line 138 of Schedule 3. For more information, see the section called "Real estate and depreciable property, lines 136 and 138" on page 13.

There are special reporting instructions regarding the disposition of eligible capital property that is qualified farm property. For more information, see the chapter called "Eligible Capital Expenditures" in the income tax guide called *Farming Income* or *Farming Income and NISA*.

**Capital gains deduction** - If you have a capital gain when you sell qualified farm property, you may be eligible for the \$375,000 capital gains deduction. For more information, see the section called "Claiming a capital gains deduction" on page 9.

**Shares, lines 131 and 132**

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

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

Under proposed changes, if after February 18, 1997, and before 2002, you donate:

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

to a qualified donee other than a private foundation and realize a capital gain, you should use Form T1170, *Capital Gains on Gifts of Certain Capital Property*, to calculate the gain you report on Schedule 3. For more information, see the section called "What's New for 1997?" on page 2.

If you sold any of the items listed above in 1997, you will receive either a T5008 Supplementary, *Statement of Securities Transactions*, or an account statement.

You may buy and sell the same type of property (e.g., units of a mutual fund trust or publicly traded shares) over a period of time. If so, there is a special rule that, if applicable, may affect your capital gain (or loss) calculation. For more information, see the section called "Identical properties" on page 19.

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

### Note

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

- capital gains (or losses) you realize when you sell your shares or units of the mutual fund (report these amounts in the "Shares" area of Schedule 3); and
- capital gains realized by the fund from its investment portfolio which are then flowed out to you. For information on how to report these amounts, see the section called "Information slips – Capital gains (or losses), line 174," on page 17.

## 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 it and actually buy stocks.

**Taxable benefit received through employment** – If you decide to exercise your option and buy stocks at less-than-market value, you will have a taxable benefit received through employment. The taxable benefit is the difference between what you paid for the stocks and the fair market value at the time you exercised your option. You have to include this taxable benefit in your income in the year you acquire the stocks. However, you can reduce the amount of the benefit by any amount you paid to acquire the stock option. Your employer should include this taxable benefit in boxes 14 and 38 on your T4 slip.

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, 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.

### Note

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

**Stock option and shares deduction** – If you meet certain conditions, you may be able to claim a deduction 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.

**Adjusted cost base of shares** – The adjusted cost base of the shares you purchased through an employee stock option agreement is not the actual price you paid for them. To calculate the adjusted cost base of your shares, add the following two amounts:

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

**Disposition of shares** – Report the capital gain (or loss) in the year you exchange or sell the shares purchased through an employee stock option. If the shares are qualified small business corporation shares (see page 11), report the

transaction in the area called "Qualified small business corporation shares." In all other cases, report the transaction in the area called "Shares."

### Example

In 1992, Anna, an employee of Widget Corporation, received an option to buy 20 shares at \$25 each. Widget Corporation is not a Canadian-controlled private corporation. In 1994, Anna exercised her option and bought the shares. The fair market value of the shares at that time was \$30 each. In 1997, she sold her shares for \$40 each. The tax implications for Anna are as follows:

**In 1992**, when she received the option, there were no tax implications.

**In 1994**, when she purchased the shares:

Fair market value (20 × \$30)	\$ 600
<b>Minus:</b> Amount paid (20 × \$25)	– 500
Taxable benefit	= \$ 100

The \$100 was included as a taxable benefit on Anna's 1994 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 income tax return.

**In 1997**, when she sold the shares:

Proceeds of disposition (20 × \$40)	\$ 800
<b>Minus:</b> Amount paid (20 × \$25)	\$ 500
Taxable benefit	+ 100
<b>Total</b>	= \$ 600 → – 600
Capital gain	= \$ 200

Anna reports a capital gain of \$200 in the section called "Shares" of Schedule 3, since these shares are not qualified small business corporation shares.

## Real estate and depreciable property, lines 136 and 138

If you sold real estate or depreciable property in 1997, you have to report your capital gain or loss in this section.

**Do not** use this section 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 these transactions under the sections called "Personal-use property" and "Bonds, debentures, promissory notes, and other properties" respectively.

### Real estate

Real estate includes the following:

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

For each real property you sold in 1997 that includes land and a building, you must:

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

To help you understand how to report a disposition of real property that includes land and a building, see the example on page 37.

If you dispose of a building and end up with a loss, special rules may apply. Under these rules, you may have to consider your proceeds of disposition as an amount other than the actual proceeds. For more information, see the section called "Selling a building in 1997" on page 21.

Special rules may also apply if you dispose of, or are considered to have disposed of, a property that was your principal residence for 1994 for which you or your spouse 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. If this is your situation, see the section called "Disposition of your principal residence" on page 34.

## Depreciable property

When you dispose of depreciable property, you may have a capital gain or a loss. In addition, certain capital cost allowance (CCA) rules may require that you add a recapture of CCA to your income or allow you to claim a terminal loss.

**Capital gain** – Usually, you will have a capital gain on depreciable property if you sell it for more than its adjusted cost base plus the outlays or expenses you incurred to sell the property.

### Note

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

**Recapture of CCA and terminal losses** – The information in this section is meant to provide you with a general look at the recapture and terminal loss rules. For more information about CCA (including the recapture of CCA and terminal losses), see the chapter called "Capital Cost Allowance (CCA)" in one of the following publications that applies to your situation:

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

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

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

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

If the UCC of a class has a **negative** balance at the end of the year, this amount is considered to be a recapture of CCA. 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, this amount 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 or a terminal loss.

### Note

The recapture of CCA and terminal loss rules do not apply to passenger vehicles that you include in Class 10.1.

### Example

In 1991, Ian bought a piece of machinery for \$10,000 for his business. It is the only property in its class at the beginning of 1997. The class has a UCC of \$6,000. He sold the piece of machinery in 1997 and purchased no other property in that class. The chart below gives you three different selling prices to show how Ian would handle a variety of situations.

	A (\$)	B (\$)	C (\$)
<b>Calculation of capital gain</b>			
Proceeds of disposition	4,000	8,000	12,000
<b>Minus: Capital cost</b>	<u>- 10,000</u>	<u>- 10,000</u>	<u>- 10,000</u>
Capital gain	<u>= 0</u>	<u>= 0</u>	<u>= 2,000</u>
<b>Calculation of terminal loss or recapture of CCA</b>			
Capital cost	10,000	10,000	10,000
<b>Minus: CCA 1991-1996</b>	<u>- 4,000</u>	<u>- 4,000</u>	<u>- 4,000</u>
UCC at the beginning of 1997	= 6,000	= 6,000	= 6,000
<b>Minus the lesser of:</b>			
The capital cost of \$10,000 and the proceeds of disposition	<u>- 4,000</u>	<u>- 8,000</u>	<u>- 10,000</u>
Terminal loss or (recapture)	<u>= 2,000</u>	<u>= (2,000)</u>	<u>= (4,000)</u>

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

In **example B**, 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 business income.

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

## Bonds, debentures, promissory notes, and other properties, lines 151 and 153

Use this section to report capital gains or capital losses from the disposition of bonds, debentures, promissory notes, and other properties (including: bad debts; foreign exchange gains; options; and discounts, premiums, and bonuses on debt obligations).

Under proposed changes, if after February 18, 1997, and before 2002, you donate:

- a debt obligation or right listed on a prescribed stock exchange; or
- a prescribed debt obligation;

to a qualified donee other than a private foundation and realize a capital gain, you should use Form T1170, *Capital Gains on Gifts of Certain Capital Property*, to calculate the gain you report on Schedule 3. For more information, see the section called "What's New for 1997?" on page 2.

If you sold any of the types of properties listed above in 1997, you should receive either a T5008 Supplementary, *Statement of Securities Transactions*, or an account statement.

You may buy and sell the same type of property (e.g., treasury bills) over a period of time. If so, there is a special rule that, if applicable, may affect your capital gain (or loss) calculation. For more information, see the section called "Identical properties" on page 19.

### Treasury bills (T-Bills) and stripped bonds

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

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

#### Example

Tom purchased a T-Bill on May 1, 1997, for \$49,000. The T-Bill's term is 91 days and its maturity value on August 1, 1997, is \$50,000. However, he sold it on June 13, 1997, for \$49,500. The effective yield rate is 8.19%.

Tom calculates interest on the T-Bill as follows:

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

Tom calculates his capital gain as follows:

Proceeds of disposition		\$ 49,500.00
Minus: Interest	-	<u>483.77</u>
Net proceeds of disposition	=	\$ 49,016.23
Minus: Adjusted cost base	-	<u>49,000.00</u>
Capital gain	=	<u>\$ 16.23</u>

### 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.

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

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.

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. In this case, you can claim the capital loss in the year that the debt becomes a bad debt. In addition, the capital loss cannot be more than the capital gain you previously reported on the sale of the property that created the debt.

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

#### Note

If the bad debt involves a small business corporation, read the section called "Allowable business investment loss (ABIL)" on page 31.

### 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.

### Other mortgage foreclosures and conditional sales repossession, lines 154 and 155

When you hold a mortgage on a property but have to repossess the property later because you were not paid all or a part of the amount owed under the terms of the mortgage, you may have to report a capital gain or capital loss.

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

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

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

**Note**

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

**Other tax implications** – Capital gains from a mortgage foreclosure or a conditional sales repossession will be excluded from net income when calculating your claim for the goods and services tax credit, the Child Tax Benefit and the age amount. This income should also be excluded when calculating your social benefits repayment.

**Personal-use property, line 158**

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 of **more than \$1,000**, you may end up with a capital gain or a capital loss. You have to report any capital gain from the disposition of personal-use property. 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. This is because if a property depreciates through personal use, the resulting loss on its disposition is a personal expense.

These loss restrictions **do not** apply:

- if you disposed of personal-use property that is listed personal property (we discuss listed personal property 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 15.

**Example**

You sold the following personal-use properties in 1997.

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

Based on the information stated above, you would calculate the capital gain or loss for each transaction as follows:

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

**China cabinet** – Both the adjusted cost base and the proceeds of disposition are considered to be \$1,000 because they are less than \$1,000. As a result, there is no capital gain or capital loss for this transaction and you **do not** have to report it on Schedule 3.

**Boat** – Since the boat's adjusted cost base is less than \$1,000, the adjusted cost base is considered to be \$1,000. Report \$150 as a capital gain.

**Personal computer** – The capital loss from this transaction is not deductible. In addition, you cannot use the loss to decrease any other capital gains realized in the year.

**Listed personal property, line 159**

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

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



To determine the value of many of these items, you can have them appraised by art, coin, jewellery, and stamp dealers. You can also refer to catalogues for the value of these properties.

**Note**

LPP gains do not include gains from selling or donating certified Canadian cultural property to a designated institution. For more information, see the section called "Selling or donating certified Canadian cultural property," on page 23.

Because LPP is personal-use property, the \$1,000 minimum proceeds of disposition and adjusted cost base rules apply. For more information about these rules, see the previous section called "Personal-use property, line 158."

If your 1997 gains from dispositions of LPP are more than your losses from such dispositions in 1997, you can use unapplied LPP losses from 1990 and later years to reduce the balance of your 1997 gains. If you want to do this, **do not** enter these losses on line 253 of your return. Instead, reduce the excess of your gains. You should only complete the "Listed personal property" area of Schedule 3 if, after doing these calculations, you still have a net LPP gain in 1997.

If your 1997 losses from dispositions of LPP are more than your gains from such dispositions in 1997, the difference

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

For more information on the applying LPP losses, see the section called "Applying listed personal property (LPP) losses," on page 30.

## **Information slips – Capital gains (or losses), line 174**

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

Although you would report most of these amounts on line 174 of Schedule 3, there are exceptions. For example, because capital gains from qualified small business corporation shares and qualified farm property are eligible for the \$375,000 capital gains deduction, you have to report these gains on line 107 or line 110, whichever applies.

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

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

Note that it is also important that you read the instructions on the back of the slip to ensure that you claim all deductions and credits that you may be entitled to.

Type of slip	Description of amounts to be reported	Line on Schedule 3	Other information
T3	<b>Box 21, Capital gains</b> – This amount is your total capital gain from a trust. The footnotes area may indicate that part or all of the gains in box 21 are from securities the trust donated.	N/A	See note 1
	<b>Other capital gains</b> – This amount represents the amount in box 21 minus the total of the footnoted gains and the amount in box 30.	Line 174	See note 2
	<b>Box 30, Capital gains eligible for deduction</b> – If there is an amount in this box, the footnotes area will indicate that all or part of your gain is from the disposition of: <ul style="list-style-type: none"> <li>■ qualified small business corporation shares; or</li> <li>■ qualified farm property.</li> </ul>	Line 107 Line 110	See note 3 See note 3
	<b>Box 26, Other income</b> – If there is an asterisk in this box, the footnotes area may indicate that all or part of the amount in box 26 is farming income eligible for the capital gains deduction. Report the footnoted amount.	Line 173	See note 4
	<b>Box 37, Insurance segregated fund capital losses</b>	Line 174	See note 5
T4PS	<b>Box 34, Capital gains (or losses)</b>	Line 174	See note 6
T5	<b>Box 18, Capital gains dividends</b>	Line 174	See note 2
T5013	<b>Box 18, Canadian and foreign net business income (loss)</b> – This amount is your total business income (loss) from the partnership. The footnotes area may indicate that box 18 includes: <ul style="list-style-type: none"> <li>■ business income from the disposition of eligible capital property (other than the recapture of annual allowances deducted in previous years); or</li> <li>■ farming income eligible for the capital gains deduction.</li> </ul>	N/A Line 173	See note 7 See note 4
	<b>Box 27, Capital gains (losses)</b> – This amount is your total capital gains from the partnership. The footnotes area may indicate that all or part of your gains are from: <ul style="list-style-type: none"> <li>■ the disposition of qualified small business corporation shares;</li> <li>■ the disposition of qualified farm property;</li> <li>■ a security the partnership donated; or</li> <li>■ a reserve allocated to you from the partnership in 1996.</li> </ul>	Line 107 Line 110 N/A N/A	See note 3 See note 3 See note 1 See note 8
	<b>Other capital gains (or losses)</b> – To calculate this amount, subtract from the amount shown in box 27: the amount identified as the previous year's reserve, capital gains from donated securities, and the amounts from this box that you reported on lines 107 and 110.  The footnotes area may also indicate that all or part of the amount in box 27 is foreign capital gains. Report the footnoted amount on line 433 of Schedule 1, and use it to calculate your foreign tax credit.	Line 174	See note 2
	<b>Box 28, Capital gains reserve</b> – This amount is your 1997 capital gains reserve from the partnership.	N/A	See note 8

**Notes**

1. Complete Form T1170, *Capital Gains on Gifts of Certain Capital Property*, if the footnotes area indicates that part or all of the gains are from a donation of the following securities:
  - a share, debt obligation, or right listed on a prescribed stock exchange;
  - a share of a mutual fund corporation;
  - a unit of a mutual fund trust;
  - an interest in a related segregated fund trust; or
  - a prescribed debt obligation.
 For more information, get the pamphlet called *Gifts and Income Tax*.
2. You may be able to reduce all or part of any capital gains. For more information, see Chapter 4.
3. These amounts are eligible for the \$375,000 capital gains deduction. For information, see the section called "Claiming a capital gains deduction," on page 9.

(See next page)

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

4. Complete line 173 if you want to take advantage of the capital gains deduction. If the amount is reported on a T5013 slip, you have to reduce the amount that you enter on line 173 by any business income reduction that you claim for the partnership income (see note 7). Use Form T657, *Calculation of Capital Gains Deduction for 1997*, to calculate your capital gains deduction.
5. If this is your only entry on line 174, 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 174.
6. If the amount is in brackets, it is a capital loss. If the amount is a capital loss and it is your only entry on line 174, put brackets around it. Otherwise, subtract the amount from the total of all other amounts you have to enter on line 174.
7. You may be able to reduce all or part of your share of the partnership's business income. For more information, see Chapter 4.
8. Enter the amount of the reserve in the appropriate area on Form T2017, *Summary of Reserves on Dispositions of Capital Property*. The footnotes area should identify to what type of property the reserve applies.

## Chapter 3 – Special Rules and Other Transactions

This chapter explains some of the special rules that may affect the calculation of your capital gain or capital loss. It also explains some of the less common capital transactions and how to report them.

### Adjusted cost base (ACB)

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. This section explains these rules.

### Identical properties

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

You may buy and sell several identical properties at different prices over a period of time. If you do this, you have to calculate the average cost of each property in the group at the time of each purchase to determine your ACB (dispositions of identical properties do not affect the ACB). The average cost is determined by dividing the total cost of identical properties purchased (this is usually the cost of the property plus any expenses incurred to acquire it) by the total number of identical properties owned.

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.

### Example 1

Over the years Debbie has purchased and sold common shares of a particular corporation. The following chart shows how, after each purchase, the ACB of her shares changes.

Transaction	A Cost (\$)	B # shares	A+B ACB (\$)
Purchase in 1992: \$15.00/share	1,500	100	15.00
Purchase in 1993: \$20.00/share	+ 3,000	+ 150	
<b>New average cost</b>	= 4,500	= 250	18.00
Sale in 1997	- 3,600	- 200	
<b>Average cost</b>	= 900	= 50	18.00
Purchase in 1997: \$21.00/share	+ 7,350	+ 350	
<b>New average cost</b>	= 8,250	= 400	20.63

### Example 2

In 1995, Carl bought units of a mutual fund trust. At the time of purchase, Carl chose to have his annual income distributions reinvested in more units. The following chart shows how the ACB of his units changes after each purchase.

Transaction	A Cost (\$)	B # units	A+B ACB (\$)
Purchase in 1995: \$18.00/unit	15,000.00	833.3333	18.00
Reinvested distributions in 1995: \$19.55/unit	+ 1,170.00	+ 59.8466	
<b>New average cost</b>	= 16,170.00	= 893.1799	18.10
Reinvested distributions in 1996: \$20.63/unit	+ 1,455.30	+ 70.5429	
<b>New average cost</b>	= 17,625.30	= 963.7228	18.29
Sale in 1997	- 7,316.00	- 400.0000	
<b>Average cost</b>	= 10,309.30	= 563.7228	18.29
Reinvested distributions in 1997: \$19.89/unit	+ 721.65	+ 36.2821	
<b>New average cost</b>	= 11,030.95	= 600.0049	18.38

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

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*.

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 determine your adjusted cost base on February 23, 1994.

### Chart 2 – Calculating the revised adjusted cost base of a flow-through entity

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

#### Step 1 – Reduction to the ACB

- |   |   |          |            |   |
|---|---|----------|------------|---|
| 1 | Designated proceeds of disposition (column 2, Chart A of Form T664)     |          | \$ _____   | 1 |
| 2 | Fair market value at the end of February 22, 1994 (Step 1 of Form T664) | \$ _____ | 2          |   |
| 3 | Amount from line 2 \$ _____ x 1.1                                       |          | - _____    | 3 |
| 4 | Line 1 <b>minus</b> line 3 (if negative, enter "0")                     |          | = \$ _____ | 4 |

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

- |   |  |            |   |  |
|---|--|------------|---|--|
| 5 | ACB at the end of February 22, 1994 (column 1, Chart A of Form T664) | - _____    | 5 |  |
| 6 | Line 2 <b>minus</b> line 5   | = \$ _____ | 6 |  |

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

- |   |  |            |            |   |
|---|--|------------|------------|---|
| 7 | $\left( \begin{array}{l} \text{Amount from column 4,} \\ \text{Chart A of Form T664 } \$ \text{_____} \\ \text{Amount from column 3,} \\ \text{Chart A of Form T664 } \$ \text{_____} \end{array} \right) \times \text{line 6 } \$ \text{_____}$ |            | - _____    | 7 |
| 8 | Line 6 <b>minus</b> line 7   | = \$ _____ | - _____    | 8 |
| 9 | Reduction (line 4 <b>minus</b> line 8)   |            | = \$ _____ | 9 |

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

#### Step 2 – Revised ACB

- |    |   |            |    |
|----|---|------------|----|
| 10 | ACB at the end of February 22, 1994 (line 5)  | \$ _____   | 10 |
| 11 | Reduction (line 9)  | - _____    | 11 |
| 12 | <b>Revised adjusted cost base on February 23, 1994</b> (line 10 <b>minus</b> line 11; if negative, enter "0") | = \$ _____ | 12 |

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

### Chart 3 – Calculating the revised adjusted cost base of 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.

1	Fair market value of the property at the end of February 22, 1994 [from Step 1 of Form T664 or T664(Seniors)]		\$ _____	1
2	Designated proceeds of disposition [column 2, Chart B of Form T664, or column 2, Step 2 of Form T664(Seniors)]		\$ _____	2
3	Amount from line 1 \$ _____ × 1.1	-	_____	3
4	Line 2 <b>minus</b> line 3 (if negative, enter "0")	= \$	_____	4
5	Line 1 <b>minus</b> line 4 (if negative, enter "0")	= \$	_____	5
6	If the property is non-qualifying real property, enter the amount from column 4, Chart B of Form T664, or column 4, Step 2 of Form T664(Seniors). Otherwise, enter "0"	-	_____	6
7	<b>Revised adjusted cost base on February 23, 1994</b> (line 5 <b>minus</b> line 6; if negative, enter "0")	= \$	_____	7

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

### Property you receive as a gift or inherit

If you 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.

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 which rules apply to your situation.

### Selling a building in 1997

If you sold a building in 1997, 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	=	Cost amount
Capital cost of all properties in the class that have not been previously disposed of		the class		of the building

### Note

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

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

For more information, contact your tax services office.

If you sold a building under these conditions, this may restrict the terminal loss on the building and reduce the capital gain on the land. For more information, see the 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:

Total ACB	\$ 100,000
<b>Minus:</b> The ACB of the part she sold ( $\$100,000 \times 1/4$ )	- 25,000
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.

## Other transactions

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

### Eligible capital property

If you disposed of eligible capital property (see definition in the glossary on page 5) that is qualified farm property, you may be eligible to claim the \$375,000 capital gains deduction.

You will find details on how to report the disposition of this type of property and what amount will be considered eligible for the capital gains deduction in the income tax guide called *Farming Income* and *Farming Income and NISA*. Read the chapter called "Eligible Capital Expenditures."

### Partnerships

A partnership does not pay tax on its capital gains or losses and it does not report them on an income tax return. Instead, each member of the partnership reports his or her share of the partnership's capital gains or losses on his or her income tax return.

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

If you receive a T5013 Supplementary slip indicating your share of the capital gain or loss from the partnership, see the chart on page 18 to find out how to report the capital gains or capital losses.

However, if you are a member of a partnership that does not have to file Form T5013 Summary for 1997, you have to report your share of any capital gain or loss from each disposition of capital property separately on Schedule 3. Use the appropriate area of Schedule 3 to report your share of any capital gains or losses. For example, if the capital gain is from the disposition of depreciable property, you would report the gain in the area called "Real estate and depreciable property."

If the partnership disposed of eligible capital property that is qualified farm property, a portion of the business income from this transaction may be considered a taxable capital gain. This amount qualifies for the \$375,000 capital gains deduction. The chapter called "Eligible Capital Expenditures" in the income tax guides called *Farming Income* and *Farming Income and NISA*, explains how to calculate and report this amount.

### Capital gains reduction (flow-through entity)

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

### Capital gains deduction

You may be eligible for the \$375,000 capital gains deduction if you are reporting any of the following amounts:

- a capital gain from the disposition of small business corporation shares;

- a capital gain from the disposition of qualified farm property; and
- farming income from the disposition of eligible capital property that is qualified farm property.

For more information, see the section called "Claiming a capital gains deduction" on page 9.

### Purchase of replacement property

In certain situations, you can elect to postpone or defer the reporting of the capital gain, recapture of capital allowance, or business income from the disposition of a property. This is the case where, provided certain conditions are met, you use the proceeds of disposition of the property to purchase a replacement property. The election may defer the tax consequences on the amounts indicated above until such time as the replacement property is sold. You can make this election when, for example, you sell a business property, or a property you own is expropriated, destroyed, or stolen. For more information on the election, read Interpretation Bulletin IT-259, *Exchanges of Property*, and its Special Release, and Interpretation Bulletin IT-491, *Former Business Property*, and its Special Release.

### Transfers of property to your spouse or to a trust for your spouse

Since 1993, the meaning of spouse has changed to include common-law spouses. Before reading this section, you may want to read the definition of spouse on page 6.

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.

If you have transferred property to your spouse, a person who has since become your spouse, or a trust for your spouse 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 do this if, at the time of the sale:

- you are a resident of Canada; and
- you and your spouse are married (or living in a common-law relationship).

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 the trust has to report any capital gain or loss from the sale.

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

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

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

### Other transfers of property

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 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.

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* or *Farming Income and NISA*.

### Elections

It is possible to postpone reporting a capital gain when you transfer property:

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

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

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

### Selling or donating certified Canadian cultural property

You do not have to report a capital gain when you sell or donate certified Canadian cultural property (national treasures) to an institution or public authority designated by the Minister of Canadian Heritage. The Canadian Cultural Property Export Review Board, 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. If this is the case, the rules for listed personal property losses will apply. For information on how to apply capital losses, see Chapter 5.

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

## Chapter 4 – Flow-Through Entities

This chapter provides information on the deductions you may be able to claim for the income flowed out to you from certain trusts and corporations, and from a partnership.

### What is a flow-through entity?

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

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

### Did you file Form T664 for your shares of, or interest in, a flow-through entity?

If, for the 1994 taxation year, you filed Form T664, *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*, for your shares of, or interest in, a flow-through entity, the elected capital gain you indicated on the form created an exempt capital gains balance (ECGB) for that entity. You can use your ECGB to reduce capital gains and certain business income flowed out to you by the entity.

Generally, your ECGB expires after the year 2004. If you did not use all of your ECGB by the end of 2004, the unused balance may be added to the adjusted cost base of your shares of, or interest in, the flow-through entity.

### Capital gains reduction

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

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

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

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

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

#### Note

Under proposed changes, for the 1994 to 2004 taxation years, if you realize a capital gain on the disposition of your remaining shares of, or interests in, a flow-through entity described in items 1 to 6 of the section "What is a flow-through entity?" and you have an unused ECGB for the entity at the time of disposition, do not claim a capital gains reduction. For more information, see the section called "Disposing of your shares of, or interest in, a flow-through entity" on page 26.

### Business income reduction

If the flow-through entity is a partnership, you can also use the ECGB to reduce your share of the partnership's business income 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 partnership's business income by claiming a business income reduction. Claim the reduction by completing the chart called "Other amounts deductible from your share of net partnership income (loss)" on 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*, *Farming Income and NISA* and *Fishing Income*.

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

However, if you are a member of a partnership that does not have to file a T5013 Summary, 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.

#### Note

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

#### Tax tip

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.



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

Under proposed changes, for 1994 and later taxation years, if you own an interest in a flow-through entity described in items 7 to 10 of the section "What is a flow-through entity?" and you receive property from the trust in satisfaction of all or a part of your interest in the trust, you can elect to use the ECGB for the entity to increase the cost of property you received from the trust. For more information, contact your tax services office.

## Keeping track of your ECGB

Depending on your situation, you can use Chart 4 below or Chart 7 on page 38 to keep track of your ECGB.

Use Chart 4 to determine the capital gains reduction you can claim for the year and the ECGB carry forward for the following flow-through entities:

- an investment corporation;
- a mortgage investment corporation;
- a mutual fund corporation;
- a mutual fund trust; and
- a related segregated fund trust.

For all other flow-through entities, use Chart 7 on page 38.

### Chart 4 – Calculating your 1997 exempt capital gains balance (ECGB) and capital gains reduction

- Use this chart if the flow-through entity is an investment corporation, a mortgage investment corporation, a mutual fund corporation, a mutual fund trust or a related segregated fund trust. For all other flow-through entities, use Chart 7 on page 38.
- If you disposed of your remaining shares of, or interests in, the flow-through entity in the year and realized a capital gain, **do not** claim a capital gains reduction. For more information, see the section called "Disposing of your shares of, or interest in, a flow-through entity" on page 26.
- Do a separate calculation for each flow-through entity.

1	ECGB carry forward (enter the ECGB carry forward you calculated the last time you claimed a capital gains reduction for the entity). If you have never claimed a capital gains reduction for the flow-through entity, see the Note below.			\$ _____	1
2	Capital gains flowed out to you by the entity in 1997	\$ _____	2		
3	Capital gains from the disposition of shares or units of the entity in 1997	+	_____	3	
4	Line 2 plus line 3	= \$ _____	4		
5	<b>Capital gains reduction</b> – The maximum amount you can claim is the <b>lesser</b> of line 1 and line 4. However, you may enter an amount that is less than the maximum. Enter this amount on line 195 of Schedule 3 or line 6826 of Form T1170, whichever applies.			- _____	5
6	<b>ECGB available to carry forward to 1998</b> (line 1 minus line 5). If you disposed of all your remaining shares or units of the flow-through entity, enter "0."			= \$ _____	6

#### Note

If you have never before claimed a capital gains reduction for the flow-through entity, see Chart 8 on page 39 to determine the amount you have to enter on line 1.

#### Example

Paul filed Form T664 for his 800 units in a mutual fund trust with his 1994 tax return. He designated the fair market value of the units at the end of February 22, 1994, as his proceeds of disposition. Paul claimed capital gains reductions of \$500 in 1994 and \$600 in 1995. His 1996 exempt capital gains balance available to carry forward was \$2,250. In 1997, he realized a \$935 capital gain from the sale of 300 units. Paul completes Chart 4 as follows (we have not reproduced the entire chart):

1	ECGB carry forward			\$ 2,250	1
2	Capital gains flowed out	\$ _____	2		
3	Capital gains from dispositions	+ 935	3		
4	Line 2 plus line 3	= \$ 935	4		
5	Capital gains reduction			- 935	5
6	<b>ECGB available to carry forward to 1998</b>			= \$ 1,315	6

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

When you dispose of your shares of, or interest in, a flow-through entity, calculate the capital gain or capital loss in the same manner as any other disposition of capital property (i.e., proceeds of disposition minus the adjusted cost base and selling expenses).

Report the disposition of shares of, or interest in, a flow-through entity on Schedule 3, as follows:

- for shares of a flow-through entity, use the section called "Shares"; or
- for an interest in a flow-through entity, use the section called "Bonds, debentures, promissory notes, and other properties."

For more information, see the appropriate section in Chapter 2.

If you filed Form T664 for your shares of, or interest in, a flow-through entity, and the proceeds of disposition you indicated on the form for your investment were more than its fair market value, the adjusted cost base (ACB) of your investment may be affected. For information see the section called "Property for which you filed Form T664 or T664(Seniors)" on page 20.

Under proposed changes, for the 1994 to 2004 taxation years, in the year you dispose of your remaining shares of, or interests in, a flow-through entity described in items 1 to 6 of the section "What is a flow-through entity?" for which you filed Form T664, use the ECGB available for the entity immediately before the disposition to increase the ACB of the shares or interests. Do this instead of claiming a capital gains reduction on line 195 of Schedule 3, or line 6826 of Form T1170 (for donated securities).

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

## Chapter 5 – Capital Losses

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

- report your 1997 capital losses;
- apply your unused 1997 capital losses to other years; and
- apply your unused capital losses of other years against your 1997 taxable capital gains.

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

You will find a summary of the loss application rules discussed in this chapter on page 33.

If you had a capital loss in a year, you have to apply it against your capital gain for that year. If you still have a loss after doing this, three-quarters of the difference

represents your net capital loss. You can use your net capital loss to reduce your taxable capital gain in any of the three preceding years or in any future year.

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 another in 1991, and you would like to apply these losses against your taxable capital gains in 1997, you have to follow a certain order. First, you apply your 1987 net capital loss against your taxable capital gain. Then you apply your 1991 net capital loss against it. To help you keep track of your capital losses, make sure you keep separate balances of unapplied net capital losses for each year.

### Note

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

- depreciable property (for more information, see the section called "Depreciable property" on page 14); or
- personal-use property (for more information, see the section called "Personal-use property, line 158" on page 16).

### Example

In 1997, Linda sold two different securities. As a result, she had a capital loss of \$800 and a capital gain of \$600. After applying her capital loss against her capital gain, Linda has an unused capital loss of \$200 (\$800 – \$600). Her net capital loss for the year is \$150 ( $\$200 \times 3/4$ ).

While she cannot deduct the loss against other sources of income in 1997, she can apply this amount against her taxable capital gains in any of the three previous years, or in any future year.

Linda completes Schedule 3 and attaches it to her 1997 income tax return to ensure that the loss is updated on our records.

## How do you apply your 1997 net capital loss to previous years?

You can carry your 1997 net capital loss back three years to 1994, 1995, and 1996 and use it to reduce your taxable capital gains in any of these years. When you carry back your net capital loss, you can choose the year to which you want to apply the loss.

To apply a 1997 net capital loss to 1994, 1995, or 1996, complete "Area III – Net capital loss for carry-back" on Form T1A, *Request for Loss Carry-Back*. It will also help you determine the amount you have left to carry forward to future years. You can get Form T1A from us.

### Note

If you apply a 1997 net capital loss to a previous year, any capital gains deduction that you claimed in that year, or a following year, may be reduced.

## How do you apply your net capital losses of other years to 1997?

You can apply your net capital losses of other years to your taxable capital gains in 1997. You do this by claiming a deduction on line 253 of your income tax return. However, the amount you can claim will depend on when you incurred the loss. This is because the rate used to determine the taxable part of a capital gain and the allowable part of a capital loss has changed over the years. We call these amounts inclusion rates.

**Net capital losses incurred in 1990 to 1996** – You can directly apply net capital losses incurred in 1990 to 1996 against 1997 taxable capital gains. You can do this because the inclusion rate for these years was the same.

### Example

In 1997, John realized a taxable capital gain of \$15,000. At the end of 1996, he had \$25,000 of unapplied net capital losses (\$5,000 for 1995 and \$20,000 for 1996). He has never claimed a capital gains deduction.

John claims a \$15,000 deduction on line 253 of his 1997 income tax return to offset his taxable capital gain. John would record the application of his losses as follows:

	1995		1996
	Net capital losses		Net capital losses
Unapplied balance on December 31, 1996	\$ 5,000		\$ 20,000
<b>Minus:</b>			
Portion applied against 1997 taxable capital gains	– 5,000	–	10,000
Unapplied balance on December 31, 1997	= \$ 0	=	\$ 10,000

**Net capital losses incurred before 1990** – If you want to apply net capital losses of other years to 1997, and some of your net capital losses were incurred before 1990, you have

to separate the losses into groups, depending on when you incurred the losses. You do this because certain years have a different inclusion rate. Also, the way you apply these losses may differ if you incurred them before May 23, 1985.

Period net capital loss incurred	Inclusion rate
Before May 23, 1985	1/2
After May 22, 1985, and before 1988	1/2
In 1988 and 1989	2/3
In 1990 to 1997	3/4

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

Usually, you can apply net capital losses of other years only against taxable capital gains. However, if you incurred the losses before May 23, 1985, you may use them to offset other income. Once you have applied your net capital losses of other years against taxable capital gains, you can use any excess to offset other income. The amount you can use is limited to the **least** of the excess amount, \$2,000, or your **pre-1986 capital loss balance** available for 1997.

Your **pre-1986 capital loss balance** available for 1997 is:

- the unapplied balance of your total net capital losses that you had at any time before May 23, 1985;
- minus
- the total adjusted amount of capital gains deductions that you claimed before 1997.

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.

Use the chart on the next page to determine the amount of your net capital losses of other years that you can apply to 1997, and to determine your unapplied balance that you can carry forward to future years.

**Chart 5 - Applying net capital losses of other years to 1997**

Use this chart to apply your net capital losses of other years to 1997, and to calculate your balance of unapplied losses that is available for you to carry forward to a future year.

**Step 1 - Pre-1986 capital loss balance available for 1997**

Complete this step **only** if you have a balance of unapplied net capital losses from before May 23, 1985. Otherwise, enter "0" on line 3 and go to Step 2.

- 1 Balance of unapplied net capital losses you had before May 23, 1985 \$ \_\_\_\_\_ 1
- 2 Capital gains deductions you claimed:
  - Before 1988 \$ \_\_\_\_\_
  - In 1988 and 1989  $\$ \text{_____} \times 3/4 =$  + \_\_\_\_\_
  - In 1990 to 1996  $\$ \text{_____} \times 2/3 =$  + \_\_\_\_\_
  - Total capital gains deductions after adjustment = \$ \_\_\_\_\_ - \_\_\_\_\_ 2
- 3 Pre-1986 capital loss balance available for 1997 (line 1 minus line 2) = \$ \_\_\_\_\_ 3

**Step 2 - Applying net capital losses of other years to 1997**

Complete lines A to C of the table below before proceeding.

- 4 Total unapplied adjusted net capital losses of other years (total of amounts from line C below) \$ \_\_\_\_\_ 4
- 5 Taxable capital gains reported on line 127 of your 1997 return \$ \_\_\_\_\_ 5
- 6 Enter the amount from line 4 or line 5, **whichever is less** \$ \_\_\_\_\_ 6
- 7 You can apply all, or part of, the amount on line 6 against your taxable capital gains in 1997. 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 12 (**do not** complete lines 8 to 11). If you completed Step 1, complete lines 8 to 11 inclusive.
- 8 Total of the amounts from line G below \$ \_\_\_\_\_ 8
- 9 Amount from line 3 \$ \_\_\_\_\_ 9
- 10 Pre-1986 deductible amount \$ 2,000 10
- 11 Line 8, 9, or 10, **whichever is less** + \_\_\_\_\_ 11
- 12 Deduction in 1997 for net capital losses of other years (line 7 plus line 11). Enter this amount on line 253 of your 1997 return and complete the remainder of the chart below to determine your balance of unapplied net capital losses available to carry forward. = \$ \_\_\_\_\_ 12

(Do not complete the shaded areas)	Before May 23, 1985	After May 22, 1985, and before 1988	In 1988 and 1989	After 1989 and before 1997	Total
A Amount of your unapplied net capital losses					
B Adjustment factor	3/2	3/2	9/8	1	
C (Line A x line B)					
D Total adjusted net capital losses you applied against taxable capital gains in 1997 (the total must equal the amount on line 7). You have to apply the oldest losses first.					
E (Line C - line D)					
F Adjustment factor	2/3	2/3	8/9	1	
G (Line E x line F)					
H Reduction for the portion of your net capital losses incurred before May 23, 1985 applied against other income (see note below)					
I (Line G - line H): This amount is your net capital losses available to carry forward to future years					

**Note**

If you claimed an amount at line 11 above, you have to reduce the balance of your oldest group of unapplied net capital losses. If the result at line I is negative, enter "0" and subtract the difference from the balance of your next group of losses. The total of line H must equal the amount on line 11.

**Example**

Claudio has unapplied net capital losses of \$6,000 he incurred before May 23, 1985. He claimed a capital gains deduction of \$500 in 1986, and \$300 in 1989. Claudio also has the following unapplied net capital losses: \$3,000 from 1987; \$4,000 from 1988; and \$1,000 from 1990. He reported a taxable capital gain of \$10,000 on line 127 of his 1997 return. He completes Chart 5 to calculate the maximum deduction he can claim for his unapplied net capital losses of other years in 1997, 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 1997**

1	Balance of unapplied net capital losses you had before May 23, 1985			\$	<u>6,000</u>	1
2	Capital gains deductions you claimed:					
	Before 1988			\$	<u>500</u>	
	In 1988 and 1989	\$	<u>300</u> × 3/4 =	+	<u>225</u>	
	In 1990 to 1996	\$	_____ × 2/3 =	+	_____	
	Total capital gains deductions after adjustment			= \$	<u>725</u>	2
3	Pre-1986 capital loss balance available for 1997 (line 1 minus line 2)			= \$	<u>5,275</u>	3

**Step 2 – Applying net capital losses of other years to 1997**

4	Total unapplied adjusted net capital losses of other years (total of amounts from line C below)			\$	<u>19,000</u>	4
5	Taxable capital gains reported on line 127 of your 1997 return			\$	<u>10,000</u>	5
6	Enter the amount from line 4 or line 5, <b>whichever is less</b>			\$	<u>10,000</u>	6
7	You can apply all, or part of, the amount on line 6 against your taxable capital gains in 1997. Enter on line 7 the amount of losses you want to claim			\$	<u>10,000</u>	7
8	Total of the amounts from line G below			\$	<u>7,333</u>	8
9	Amount from line 3			\$	<u>5,275</u>	9
10	Pre-1986 deductible amount			\$	<u>2,000</u>	10
11	Line 8, 9, or 10, <b>whichever is less</b>			+	<u>2,000</u>	11
12	Deduction in 1997 for net capital losses of other years (line 7 plus line 11)			= \$	<u>12,000</u>	12

(Do not complete the shaded areas)	Before May 23, 1985	After May 22, 1985, and before 1988	In 1988 and 1989	After 1989 and before 1997	Total
A Amount of your unapplied net capital losses	\$6,000	\$3,000	\$4,000	\$1,000	
B Adjustment factor	<b>3/2</b>	<b>3/2</b>	<b>9/8</b>	<b>1</b>	
C (Line A x line B)	\$9,000	\$4,500	\$4,500	\$1,000	\$19,000
D Total adjusted net capital losses you applied against taxable capital gains in 1997 (the total must equal the amount on line 7).	\$9,000	\$1,000	\$0	\$0	\$10,000
E (Line C – line D)	\$0	\$3,500	\$4,500	\$1,000	
F Adjustment factor	<b>2/3</b>	<b>2/3</b>	<b>8/9</b>	<b>1</b>	
G (Line E x line F)	\$0	\$2,333	\$4,000	\$1,000	\$7,333
H Reduction for the portion of your net capital losses incurred before May 23, 1985 applied against other income.	\$0	\$2,000	\$0	\$0	\$2,000
I (Line G – line H): This amount is your net capital losses available to carry forward to future years	\$0	\$333	\$4,000	\$1,000	

Claudio has to apply his older losses first. Although the chart above shows that Claudio used all his unapplied adjusted net capital losses incurred before May 23, 1985 to reduce the taxable capital gain, he is still able to claim a deduction against other income. He can do this because his total unapplied adjusted net capital losses (total of line C) exceed his taxable capital gains in 1997. Claudio accounts for the amount deducted against other income by reducing the balance of his oldest unapplied losses.

## Applying listed personal property (LPP) losses

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

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

If you have an LPP loss in 1997, you can use the loss to reduce gains from dispositions of LPP you had in any of the three years before 1997 or the seven years after.

For information on how to apply a prior year LPP loss to 1997 gains from dispositions of LPP, see the section called "Listed personal property, line 159" on page 16.

If you would like to carry back your 1997 LPP losses to reduce your LPP net gains from 1994, 1995, and 1996, complete Form T1A, *Request for Loss Carry-Back*. You can get this form from us. File one copy with your 1997 tax return. Do not file an amended return for the year to which you would like to apply the loss.

### Example

Marino bought some jewellery in 1985 for \$5,800. In 1997, he sold it for \$6,000. He ended up with a gain of \$200. He also sold a coin collection for \$2,000 in 1997. 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 1997 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 1997 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 loss against his gains from dispositions of LPP in any of the three previous years, or the seven years following 1997.

Marino should not complete Schedule 3 for 1997. 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

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

- you, or a person affiliated with you, buys, or has a right to buy, the same or identical property (called "substituted property") during the period starting 30 days before the sale and ending 30 days after the sale; 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 1997, 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 when this type of loss is not considered a superficial loss. Some of the more common situations are when:

- you are considered to have sold the capital property because you became or ceased to be a resident of Canada;
- the property is considered to have been sold because the owner died;
- the disposition results from the expiry of an option;
- you are considered to have sold the property because you changed its use; or
- under proposed changes, for dispositions that occur after April 26, 1995, you disposed of the property 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 your chief source of income is neither from farming nor from a combination of farming and some other source of income, you can only deduct a portion of your farm loss for the year. The portion of the loss that you cannot deduct becomes 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 determining your chief source of income and how to calculate a restricted farm loss, see the income tax guide called *Farming Income or Farming Income and NISA*.

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 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 1997 for \$200,000. The adjusted cost base 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	1
ACB	\$ 160,000		2
Plus: Property taxes	+ 5,000		3
Interest	+ 5,000		4
Total	= \$ 170,000	➔ - 170,000	5
Capital gain (line 1 minus line 5)	= \$ 30,000		6
Taxable capital gain (line 6 × 3/4)	\$ 22,500		7

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.

**Allowable business investment loss (ABIL)**

If you had a business investment loss in 1997, you can deduct three-quarters of the loss from income. We call this amount your allowable business investment loss (ABIL).

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

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

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

You may also 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 start to carry on business. \*

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

You can elect to be deemed to have disposed of the debt or the share of the small business corporation at the end of the year for nil proceeds of disposition, and to have immediately reacquired the debt or the share after the end of the year at a cost equal to nil. To do this, you have to file an election with your 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.

**What happens when you incur an ABIL?** – You can deduct your ABIL from your other sources of income for the year. If your ABIL is more than your other sources of income for the year, include the difference as part of your non-capital loss for 1997. You can carry a non-capital loss back three years and forward seven years.

To carry a non-capital loss back to 1994, 1995, or 1996, complete Form T1A, *Request for Loss Carry-Back*, and file it with your tax return for 1997. You can get this form from us. Do not file an amended tax return for the year to which you want to apply the loss.

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 that 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 1989 that became a non-capital loss and you were not able to deduct it in the three years before 1989 or the seven years after 1989. You can now use the loss to reduce your taxable capital gains in 1997 or any year after.

**Note**  
Any ABIL that you claim for 1997 will reduce the capital gains deduction you can claim in 1997 and in future years.

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

If you had more than one business investment loss in 1997, calculate each loss separately.

<b>Step 1</b> – Business investment loss (enter this amount on line 228 of your return).	\$ _____	<b>A</b>
<b>Step 2</b> – If you claimed a capital gains deduction in a previous year, you have to reduce your business investment loss. To determine the reduction, complete the calculation below and enter the result from line 10. Otherwise, enter "0."	– _____	<b>B</b>
Line A <b>minus</b> line B.	= \$ _____	<b>C</b>
<b>Step 3</b> – Allowable business investment loss; line C <b>multiplied by 3/4</b> (enter this amount on line 217 of your return).	\$ _____	<b>D</b>

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

<ul style="list-style-type: none"> <li>■ name of the small business corporation;</li> <li>■ number and class of shares, or the type of debt you disposed of;</li> <li>■ insolvency, bankruptcy, or wind-up date;</li> <li>■ date you bought the shares, or the date you acquired the debt;</li> </ul>	<ul style="list-style-type: none"> <li>■ amount of the proceeds of disposition;</li> <li>■ adjusted cost base of the shares or debt;</li> <li>■ outlays or expenses on the disposition; and</li> <li>■ amount of the loss.</li> </ul>
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### Calculation of the business investment loss reduction

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

#### Total of all capital gains deductions claimed in 1985 to 1996

1 For 1985 to 1987, total of the amounts from line 254 of your returns for these years	\$ _____ × 2	➔	\$ _____	<b>1</b>
2 For 1988 and 1989 (other than for eligible capital property gains), total of the amounts from line 254 of your returns <b>minus</b> any amounts reported on lines 543 and 544 on Schedule 3; if negative enter "0"	\$ _____ (a) × 3/2	➔	+ _____	<b>2</b>
3 For 1988 and 1989 for eligible capital property gains, total of the amounts at line 254 of your returns <b>minus</b> the amount calculated at line (a) above; not to exceed lines 543 and 544 on Schedule 3	\$ _____ × 4/3	➔	+ _____	<b>3</b>
4 For 1990 to 1996, total of the amounts from line 254 of your returns for these years	\$ _____ × 4/3	➔	+ _____	<b>4</b>
5 Total of lines 1 to 4			= \$ _____	<b>5</b>

#### Total of all other business investment loss reductions for 1986 to 1997

6 For 1986 to 1995, total of the amounts reported at line 535 of Schedule 3 of your 1986 to 1994 returns <b>plus</b> line 034 of Schedule 3 of your 1994 to 1996 returns	\$ _____	<b>6</b>		
7 Total of all reductions calculated for any other business investment losses in 1997	+ _____	<b>7</b>		
8 Line 6 <b>plus</b> line 7	= \$ _____	➔	– _____	<b>8</b>
9 Line 5 <b>minus</b> line 8			= \$ _____	<b>9</b>

#### Business investment loss reduction

10 Line 9 or line A above, <b>whichever is less</b> . Enter this amount on line B in Step 2 above and on line 178 of Schedule 3.	\$ _____	<b>10</b>
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## Summary of loss application rules

Type of loss	Application rules	Limit to annual deduction
Allowable business investment losses (see page 31)	Any unapplied portion in the year of the loss becomes a non-capital loss which can be carried back three years and forward seven years.  The unapplied portion of the non-capital loss becomes a net capital loss which can be used to reduce taxable capital gains in the eighth year or any year after.	No limit  Limited to taxable capital gains in the year
Net capital losses (see page 26)	<ul style="list-style-type: none"> <li>■ Carry back three years</li> <li>■ Carry forward indefinitely</li> </ul>	Limited to taxable capital gains in the year *
Farm losses (see the income tax guides called <i>Farming Income</i> or <i>Farming Income and NISA</i> )	<ul style="list-style-type: none"> <li>■ Carry back three years</li> <li>■ Carry forward ten years</li> </ul>	No limit
Listed personal property (LPP) losses (see page 30)	<ul style="list-style-type: none"> <li>■ Carry back three years</li> <li>■ Carry forward seven years</li> </ul>	Limited to net gains from LPP in the year
Losses from personal-use property (see page 16)	No loss allowed **	Not applicable
Restricted farm loss (see page 30)	<ul style="list-style-type: none"> <li>■ Carry back three years</li> <li>■ Carry forward ten years</li> </ul> <p>You can use part of any unapplied loss to reduce your capital gains from the sale of the farmland that was used in a farming business.</p>	Limited to net farming income in the year  Cannot be more than the property taxes and the interest on money you borrowed to buy the farmland that you included in the calculation of the restricted farm losses for each year (cannot be used to create or increase a capital loss).
Superficial losses (see page 30)	<ul style="list-style-type: none"> <li>■ No loss allowed</li> </ul> <p>You can usually add the amount of the loss to the adjusted cost base of the substituted property.</p>	Not applicable

\* For net capital losses incurred before May 23, 1985, an additional amount (up to \$2,000) may be deducted from other income. For more information, see the section called "How do you apply your net capital losses of other years to 1997?" on page 27.

\*\* For exceptions to this rule, see the section called "Personal-use property, line 158" on page 16.

## Chapter 6 – Principal Residence

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

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

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

### What is your principal residence?

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

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

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

- it is a housing unit, a leasehold interest in a housing unit, or a share of the capital stock of a co-operative housing corporation, 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.

### Designating a principal residence

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

### Can you have more than one principal residence?

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

If you were married or were 18 or older, your 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 children (other than a child who was married during the year or who was 18 or older).

If you were not married or were not 18 or older, your family also includes:

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

For 1993 and later years, a spouse includes a common-law spouse, as explained in the definition of spouse on page 6. Therefore, common-law spouses cannot designate different housing units as a principal residence for any year after 1992.

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

## Disposition of your principal residence

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

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

### Note

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

If only a part of your home qualifies as your principal residence and you used the other part to earn or produce income, you have to split the selling price between the part you used for your principal residence and the part you used for other purposes (e.g., rental or business). You can do this by using square metres or the number of rooms, as long as the split is reasonable. Report only the gain on the part you used for purposes of producing income. For more information, see the section called "Real estate and depreciable property, lines 136 and 138" on page 13.

### 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.

**Did you or your spouse file Form T664 or T664(Seniors)?** – If you sell, or are considered to have sold, 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*, and:

- the property was your principal residence for 1994; or
- you are designating it in 1997 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 1997*, 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 1997.

#### 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 1997.

If the property was not your principal residence for 1994 and you are not designating it in 1997 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 section called "Property for which you filed Form T664 or T664(Seniors)" on page 20.

## Changes in use

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

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

If the property was your principal residence for any year you owned it before you changed its use, you do not have to pay tax on any gain that relates to those years. You only have to report the gain that relates to the years your home was not your principal residence. For information on how to calculate and report the gain, if any, see the section called "Disposition of your principal residence" on page 34.

If you were using the property to earn or produce income before you changed its use, see the section called "Real estate and depreciable property, lines 136 and 138" on page 13 for information on how to report any capital gain or capital loss.

## Special situations

There are situations where the change in use rules stated above do not apply. The following are some of the more common situations.

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

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

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

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

- you live away from your principal residence because your employer, or your spouse's 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 (by the shortest public route) 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 the section called "Disposition of your principal residence" on page 34 to calculate the taxable part of your gain.

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*.

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

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*.

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

To make this election, 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.

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

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

- you do not deduct any CCA on the part you are using for rental or business purposes.

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

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

- split the selling price between the part you used for your principal residence and the part you used for rental or business purposes (by using either square metres or the number of rooms) as long as the split is reasonable; and
- report any capital gain on the part you used for rental or business purposes. For more information, see the section called “Real estate and depreciable property, lines 136 and 138” on page 13. You do not have to report any capital gain for the part you used for your principal residence.

**Note**

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

## Farm property

If you are a farmer and you sell farmland in 1997 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* and *Farming Income and NISA*.

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

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

- treat the sale of property that was used partly as a principal residence and partly for earning income;
- report a capital gain on the disposition of property that includes land and a building (see Chapter 2 on page 13); and
- calculate a recapture of capital cost allowance (CCA) or terminal loss on the disposition of depreciable property (see Chapter 2 on page 14).

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 property's total number of square meters, he determined that the portion he used to earn rental income was 40%.

In 1997, 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 CCA or a terminal loss on the rented portion of the building. For this reason, he will break down the rental portion of the purchase price, the selling price, and the related expenses between the land and the building. Keeping in mind that 40% of the property 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:**

$$\begin{aligned} \text{a) Building: } 40\% & \times \frac{\$75,000}{\$100,000} \times \$125,000 = \$37,500 \\ \text{b) Land: } 40\% & \times \frac{\$25,000}{\$100,000} \times \$125,000 = \$12,500 \end{aligned}$$

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:**

$$\begin{aligned} \text{a) Building: } 40\% & \times \frac{\$120,000}{\$150,000} \times \$175,000 = \$56,000 \\ \text{b) Land: } 40\% & \times \frac{\$30,000}{\$150,000} \times \$175,000 = \$14,000 \end{aligned}$$

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:**

$$\begin{aligned} \text{a) Building: } 40\% & \times \frac{\$120,000}{\$150,000} \times \$10,500 = \$3,360 \\ \text{b) Land: } 40\% & \times \frac{\$30,000}{\$150,000} \times \$10,500 = \$840 \end{aligned}$$

Sean can now determine if he has a recapture of CCA or a terminal loss on the rented part of the building. The undepreciated capital cost (UCC) of the portion of the building used for rental purposes at the beginning of 1997 was \$34,728. From the UCC, Sean subtracts one of the following amounts, whichever is less:

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

UCC at the beginning of 1997	\$ 34,728
<b>Minus:</b> Purchase price	– 37,500
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*.

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 1997*. 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	00	15,140	00	
Street, City, Province (land)	1988	14,000	00	12,500	00	840	00	660	00	
<b>Total</b>	<b>136</b>	<b>70,000</b>	<b>00</b>			<b>Gain (or loss)</b>	<b>136</b>	<b>+</b>	<b>15,800</b>	<b>00</b>

# Appendix

## Chart 7 – Calculating your 1997 exempt capital gains balance (ECGB) and your capital gains and business income reductions

Use this chart to track your ECGB if the flow-through entity is (do a separate calculation for each flow-through entity):

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

If you disposed of your remaining interest in a partnership in the year and realized a capital gain, **do not** claim a capital gains reduction. For more information, see the section called "Disposing of your shares of, or interest in, a flow-through entity" on page 26.

### Step 1 – ECGB available for the year

If you claimed a capital gains or business income reduction in 1994 to 1996, or if you had to adjust the ECGB of the flow-through entity in 1995 or 1996, because you filed an election to increase the cost of property you received from a trust (see the section called "Elections to increase the cost of property you received from a trust" on page 25), enter on line 1 the ECGB available to carry forward that you calculated the last time you claimed a reduction or filed an election. In all other cases, see Chart 8 on page 39 to determine the amount you have to enter on line 1.

1	ECGB carry forward	\$ _____	1
2	Portion of the ECGB (amount at line 1) that you elected to add to the cost of property you received in 1996 (for more information, see the section called "Elections to increase the cost of property received from a trust" on page 25).	-	2
3	ECGB available for 1997 (line 1 <b>minus</b> line 2)	= \$ _____	3

### Step 2 – Capital gains reduction

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

4	Capital gains flowed out to you by the flow-through entity in 1997	\$ _____	4
5	Capital gains from the disposition of shares of, or interest in, the flow-through entity in 1997	+	5
6	Total capital gains (line 4 <b>plus</b> line 5)	= \$ _____	6
7	<b>Capital gains reduction</b> – The maximum capital gains reduction you can claim is the <b>lesser</b> of the amounts on line 3 and line 6. However, you may enter an amount that is less than the maximum. Enter this amount on line 195 of Schedule 3.	-	7
8	Exempt capital gains balance before the business income reduction (line 3 <b>minus</b> line 7)	= \$ _____	8

### Step 3 – Business income reduction

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

9	Amount from line 8 \$ _____ × 3/4 =	\$ _____	9
10	Your share of the partnership's business income (including your share of any farming income) from the disposition of eligible capital property (other than the recapture of annual allowances deducted in previous years)	\$ _____	10
11	<b>Business income reduction</b> – The maximum you can claim is the <b>lesser</b> of the amounts on line 9 and line 10. However, you may enter an amount that is less than the maximum. You <b>cannot</b> use a business income reduction to create or increase a business loss. Claim this amount as a deduction in the chart called "Other amounts deductible from your share of net partnership income (loss)" on Form T2032, T2042, T2121, or T2124, whichever applies.	\$ _____	11
12	Amount from line 11 \$ _____ × 4/3 =	-	12

### Step 4 – Exempt capital gains balance available to carry forward

13	Line 8 <b>minus</b> line 12. If you disposed of all your shares of, or your entire interest in, the flow-through entity in 1997, enter "0."	= \$ _____	13
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**Chart 8 - Calculation of line 1 of Chart 4 and line 1 of Chart 7**

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

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

Where the flow-through entity is:	Exempt capital gains balance
<ul style="list-style-type: none"> <li>■ a trust (other than a mutual fund trust), such as a related segregated fund trust or a trust governed by an employee profit-sharing plan;</li> </ul>	Enter the elected capital gain you reported in column 5, Chart A of Form T664 on line 1 of Chart 4 on page 25 or on line 1 of Chart 7 on page 38.
<ul style="list-style-type: none"> <li>■ an investment corporation;</li> <li>■ a mortgage investment corporation;</li> <li>■ a mutual fund corporation;</li> <li>■ a mutual fund trust; or</li> <li>■ a partnership.</li> </ul>	<p>If the proceeds of disposition you designated on Form T664 are <b>not more</b> than the fair market value of the entity at the end of February 22, 1994, enter the elected capital gain you reported in column 5, Chart A of Form T664 on line 1 of Chart 4 on page 25 or on line 1 of Chart 7 on page 38.</p> <hr style="border-top: 1px dashed black;"/> <p>If the proceeds of disposition you designated on Form T664 are <b>more</b> than the fair market value of the entity at the end of February 22, 1994, complete the calculation below and enter the amount from line 10 on line 1 of Chart 4 on page 25 or on line 1 of Chart 7 on page 38.</p>

1	Designated proceeds of disposition (column 2, Chart A of Form T664)	\$ _____	1	
2	Fair market value at the end of February 22, 1994 (Step 1 of Form T664)			\$ _____ 2
3	Line 2 multiplied by 1.1	- _____	3	
4	Line 1 minus line 3 (if negative, enter "0")	= \$ _____	4	
5	Adjusted cost base (column 1, Chart A of Form T664)	+ _____	5	
6	Line 4 plus line 5	= \$ _____	6	
7	Exempt capital gains balance before the reduction for non-qualifying real property (line 2 minus line 6. If negative, enter "0")			= \$ _____ 7
	If you entered an amount in column 4, Chart A of Form T664, complete lines 8 and 9. Otherwise, enter the amount from line 7 on line 10.			
8	The amount from column 4, Chart A of Form T664 divided by the amount from column 3, Chart A of Form T664	\$ _____	8	
9	Non-eligible portion of line 7 (line 7 multiplied by line 8)	- _____	9	
10	Exempt capital gains balance (line 7 minus line 9)	= \$ _____	10	

# Index

In addition to listing topics, this index provides references to any interpretation bulletin (IT) and information circular (IC) related to each topic mentioned. If after

reading the explanations provided in this guide, you still need more information, get a copy of these publications. We provide a complete list of references on the next page.

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## References

The following publications are available from your tax services office or tax centre. Many of our publications are also available on the Internet. Our Internet address is:

<http://www.rc.gc.ca>

### Forms

- T1A *Request for Loss Carry-Back*
- T123 *Election on Disposition of Canadian Securities*
- T664 and T664(Seniors)  
*Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*
- T657 *Calculation of Capital Gains Deduction for 1997*
- T936 *Calculation of Cumulative Net Investment Loss (CNIL) to December 31, 1997*
- T1105 *Supplementary Schedule for Dispositions of Capital Property Acquired Before 1972*
- T1170 *Capital Gains on Gifts of Certain Capital Property*
- T2017 *Summary of Reserves on Dispositions of Capital Property*
- T2091(IND)  
*Designation of a Property as a Principal Residence by an Individual (Other Than a Personal Trust)*
- T2091(IND)-WS  
*Principal Residence Worksheet for 1997*

### Information circulars

- IC 76-19 *Transfer of Property to a Corporation Under Section 85*
- IC 78-10 *Books and Records Retention/Destruction*

### Interpretation bulletins

- IT-78 *Capital Property Owned on December 31, 1971 – Identical Properties*
- IT-84 *Capital Property Owned on December 31, 1971 – Median Rule (Tax-Free Zone)*
- IT-95 *Foreign Exchange Gains and Losses*
- IT-96 *Options Granted by Corporations to Acquire Shares, Bonds or Debentures*
- IT-113 *Benefits to Employees – Stock Options*
- IT-120 *Principal Residence*
- IT-123 *Transactions Involving Eligible Capital Property*
- IT-125 *Dispositions of Resource Properties*
- IT-128 *Capital Cost Allowance – Depreciable Property*
- IT-139 *Capital Property Owned on December 31, 1971 – Fair Market Value*
- IT-159 *Capital Debts Established to be Bad Debts*
- IT-209 *Inter-Vivos Gifts of Capital Property to Individuals Directly or Through Trusts*

- IT-213 *Prizes from Lottery Schemes, Pool System Betting and Giveaway Contests*
- IT-217 *Depreciable Property Owned on December 31, 1971*
- IT-218 *Profit, Capital Gains and Losses from the Sale of Real Estate, Including Farmland and Inherited Land and Conversion of Real Estate from Capital Property to Inventory and Vice Versa*
- IT-220 *Capital Cost Allowance – Proceeds of Disposition of Depreciable Property, and its Special Release*
- IT-221 *Determination of an Individual's Residence Status, and its Special Release*
- IT-232 *Losses – Their Deductibility in the Loss Year or in Other Years*
- IT-236 *Reserves – Disposition of Capital Property*
- IT-239 *Deductibility of Capital Losses from Guaranteeing Loans for Inadequate Consideration and from Loaning Funds at less than a Reasonable Rate of Interest in Non-Arm's Length Circumstances*
- IT-259 *Exchanges of Property*
- IT-264 *Part Dispositions, and its Special Release*
- IT-291 *Transfer of Property to a Corporation under Subsection 85(1)*
- IT-332 *Personal-Use Property*
- IT-366 *Principal Residence – Transfer to Spouse, Spouse Trust or Certain Other Individuals, and its Special Release*
- IT-391 *Status of Corporations*
- IT-405 *Inadequate Considerations – Acquisitions and Dispositions*
- IT-407 *Dispositions of Cultural Property to Designated Canadian Institutions*
- IT-413 *Election by Members of a Partnership under subsection 97(2)*
- IT-419 *Meaning of Arm's Length, and its Special Release*
- IT-456 *Capital Property – Some Adjustments to Cost Base, and its Special Release*
- IT-458 *Canadian-Controlled Private Corporation*
- IT-459 *Adventure or Concern in the Nature of Trade*
- IT-478 *Capital Cost Allowance – Recapture and Terminal Loss*
- IT-479 *Transactions in Securities, and its Special Release*
- IT-481 *Timber Resource Property and Timber Limits*
- IT-484 *Business Investment Losses*
- IT-491 *Former Business Property, and its Special Release*
- IT-505 *Mortgage Foreclosures and Conditional Sales Repossessions*
- IT-511 *Interspousal and Certain Other Transfers and Loans of Property*