Capital Gains

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1988

Capital Gains Tax Guide

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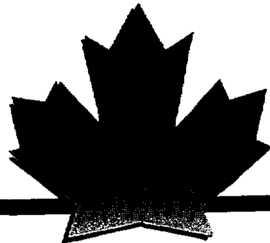
Your Guide



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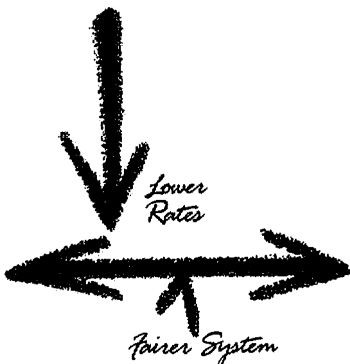

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WHAT'S NEW FOR 1988

As you complete your income tax return and related forms, you will notice there are a number of changes this year. Many of these changes are a result of tax reform and are effective for the 1988 taxation year.

To help you identify the major changes, they are shaded in yellow under the heading "New for 1988" throughout this Guide.

This guide is not a legal document. It uses non-technical language to explain some of the laws about income tax. For official purposes, please consult the *Income Tax Act* and its related regulations.

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INTRODUCTION

This Guide contains detailed information for individuals who realized a capital gain or incurred a capital loss in 1988. Information on the completion of your 1988 income tax return is contained in the *1988 General Tax Guide*. If you are completing a return for a deceased taxpayer, obtain the *1988 Deceased Persons' Income Tax Guide*.

References are made throughout this Guide to additional forms that are to be attached to your return and to departmental publications that cover topics in greater detail. As you read through this Guide, we suggest that you use the order form on the inside back cover to list the forms and publications you require.

Even if no tax is payable for 1988, you must file a tax return

- to report the disposition of any capital property in 1988, whether at a gain or loss, **or**
- to report the taxable portion of any capital gains reserve that relates to the disposition of capital property in a previous year.

If you do not file your 1988 return before April 30, 1990, you may be denied the capital gains deduction. Please refer to Chapter 3 for a detailed discussion of this deduction.
Do not include capital gains or losses in your "income from a business or property" even if the capital property you disposed of was used in a partnership or a proprietorship.
Use Schedule 3, *Summary of Dispositions of Capital Property in 1988*, to calculate and report all of your taxable capital gains or allowable capital losses for 1988. The package of schedules included with your return contains Schedule 3.

You must report the disposition of capital property on a calendar-year basis. If you were a member of a partnership that disposed of capital property in a fiscal period that was other than the calendar year, you report your share of any capital gain or loss on a Schedule 3 for the year in which the partnership's fiscal period ended, rather than the calendar year in which the disposition occurred.

This Guide is intended to help you understand what is meant by capital property, taxable capital gains, allowable capital losses, allowable business investment losses, capital gains deduction and cumulative net investment loss (CNIL). It

- defines key terms,
- identifies some transactions or events that result in taxable capital gains or allowable capital losses,
- explains the application of the lifetime capital gains deduction and other special rules, **and**
- provides examples and tax tips to clarify certain points.

This information should enable you to

- calculate the amount of your capital gains and losses,
- complete Schedule 3 which must be filed with your return, **and**
- determine your capital gains deduction.

What is a capital gain or a capital loss?

Generally, a capital gain or a capital loss arises whenever there is a disposition or deemed disposition of capital property. For example, if you sell a share in a public corporation for more than it cost you, a capital gain results. Similarly, a capital loss would occur if you sold that share for less than it cost you.

How much do you report?

New for 1988
The taxable portion of a capital gain and the allowable portion of a capital loss has increased from one-half to **two-thirds** of the net capital gain or loss.

If you disposed of capital property in 1988 **or** if any portion of a capital gains reserve that relates to a prior year's disposition is taxable in 1988,

- two-thirds of any capital gain is your **taxable capital gain,** and
- two-thirds of any capital loss is your **allowable capital loss.**

If your taxable capital gains are more than your allowable capital losses, you include the difference in your income.

If your taxable capital gains are less than your allowable capital losses, the difference basically represents your **net capital losses** which may not be used to reduce your 1988 income from other sources. However, you may apply your net capital losses against taxable capital gains of other years. See Chapter 2, "Capital Losses," for more details on the treatment of net capital losses.

What is capital property?

Generally, capital property is any property of value, including depreciable property. It is usually acquired for investment purposes or to earn income. Some common types of capital property include:

- principal residences,
- cottages,
- securities such as stocks and bonds, **and**
- land, buildings and equipment used in a business, including farming, or used in a rental operation.

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

Special rules apply to gains or losses from the disposition of

- an insurance policy,
- a Canadian or foreign resource property,
- a timber resource property, **and**
- an eligible capital property such as the goodwill of a business.

New for 1988
The disposition of eligible capital property may result in a deemed taxable capital gain which may qualify for the capital gains deduction. Refer to "Eligible capital property" in Chapter 1 and to Chapter 3 for additional information.

For information on resource properties, obtain Interpretation Bulletin IT-125R3, *Dispositions of Resource Properties*. For details on eligible capital properties, obtain the *1988 Business and Professional Income Tax Guide*, and Interpretation Bulletins IT-143R2, *Meaning of Eligible*

Capital Expenditure and IT-123R4, *Disposition of and Transactions Involving Eligible Capital Property*.

When does a capital gain or loss occur?

A capital gain or capital loss occurs when you dispose of a capital property. However, a capital disposition is not restricted to the sale of property. The following transactions or events may also give rise to a capital disposition:

- the exchange of one property for another,
- giving property, other than cash, as a gift,
- expropriation of your property,
- the conversion of shares you hold,
- the redemption or cancellation of shares or other securities you hold,
- the expiry of an option you hold to acquire or dispose of property,
- the settlement of a debt owed to you,
- theft of property,
- damage or destruction of property, **and**
- most transfers of property to trusts.

There are other situations where a disposition is **deemed** or considered to have occurred even though there is no actual change in ownership. A deemed disposition may occur when the owner of a property

- dies,
- becomes a non-resident, **or**
- changes the use of the property.

For example, a change in use would occur if you moved from your house to an apartment and rented out the house. Although the ownership of your house would not have changed, you would be deemed to have disposed of your principal residence and to have acquired a rental property. Refer to Chapter 4, "Principal Residence," for more information on change in use.

Who is affected?

Most people are not affected by the capital gains provisions because the property they own is for their personal use. For example, because personal effects such as automobiles, furniture and boats do not normally increase in value, their disposition seldom gives rise to a capital gain. Please note that although the value of personal effects may decrease, capital losses on their dispositions are not deductible unless the property is "listed personal property."

A gain on the sale of your home will not be taxable as long as you used it as your principal residence and did not designate any other residence as your principal residence during the period you owned your home.

Please refer to Chapter 4, "Principal Residence," and the sections "Personal-use property" and "Listed personal property" in Chapter 1 for more details.

Keeping records

You do not need to include records or vouchers to support capital acquisitions or dispositions when you file your return. However, you should keep them and make them available for examination upon request.

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

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

You will need this information to calculate a capital gain or capital loss which results when you dispose of the property.

For more details on record-keeping, obtain Information Circular 78-10R, *Books and Records Retention/Destruction*.

Forms

For your convenience, this Guide contains two copies of the following forms:

- T657 — *Calculation of Capital Gains Deduction for 1988*
  You may use this form to help you calculate your capital gains deduction.
- T2017 — *Summary of Reserves on Dispositions of Capital Property*
  You must complete this form if you claim a capital gains reserve in 1988.

CHAPTER 1
COMPLETION OF SCHEDULE 3

If you disposed of a capital property in 1988 or if you claimed a capital gains reserve in 1987, you must complete Schedule 3, *Summary of Dispositions of Capital Property in 1988*. Report your taxable capital gains amount on line 127 of your return. You may offset part or all of your gains by claiming the capital gains deduction that is explained in Chapter 3. If your allowable capital losses exceed your taxable capital gains, this excess is a net capital loss and you should refer to Chapter 2.

Capital transaction versus income transaction

In certain circumstances, you must determine whether the gain or loss on a disposition is taxable as an income gain or loss **or** as a capital gain or loss. You only report dispositions of a capital nature on Schedule 3.

For more details on the distinction between capital and income transactions, obtain Interpretation Bulletins IT-459, *Adventure or Concern in the Nature of Trade*, IT-218R, *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-479R, *Transactions in Securities* and its Special Release.

You were asking...?

Q. I won $10,000 in a provincial lottery last year. Do I report it as a capital gain or include it in income on my 1988 return?

A. Since the amount or value of a prize received from a lottery scheme is not taxable as either a capital gain or income, you do not report the $10,000 on your return. However, any income you earn from investing the prize money is taxable.

If you had won a painting or other capital property, you would be deemed to have acquired the prize at a cost equal to its fair market value at the time of acquisition. You would then use this value to calculate any capital gain or loss when you later dispose of the property. For more details, obtain Interpretation Bulletin IT-213R, *Prizes from Lottery Schemes, Pool System Betting and Giveaway Contests.*

Determining your capital gains or losses

You may realize a capital gain or incur a capital loss whenever you dispose of or are deemed to have disposed of capital property. In certain instances, a deemed taxable capital gain may result on the disposition of eligible capital property. For details on deemed taxable capital gains resulting from the disposition of eligible capital property, refer to "Eligible capital property" in this chapter.

If you had a disposition of capital property in 1988, you will need to know the following three amounts to complete Schedule 3:

- proceeds of disposition,
- adjusted cost base, **and**
- outlays and expenses.

You will find an explanation of each of these terms below.

Proceeds of disposition
This usually refers to the selling price of the property. However, it also includes compensation you received for property that has been destroyed, expropriated, stolen **or** damaged.

In the case of a gift or a deemed disposition, the proceeds of disposition are generally deemed to be the fair market value of the property at the time its ownership or use changes.

Adjusted cost base (ACB)
The adjusted cost base (ACB) is the cost of a property plus or minus adjustments due to certain expenditures or events after it is acquired. In most cases, adjustments result in an ACB amount that is greater than the original cost of the property to you.

Depending on the nature and circumstances of an acquisition, your cost of a capital property may be its actual cost, deemed cost or Valuation Day value. However, for property you acquired after 1971, your cost is usually the actual or deemed cost of acquiring the property. The actual cost of a property is the purchase price of the property plus expenses you incurred to acquire it. Such expenses include commissions, legal fees and other reasonable expenditures. Please refer to Chapter 6 for a detailed description of the special rules for determining the cost of property owned on December 31, 1971.

Adjustments to the cost of a property include the cost of additions and improvements to a property which are capital expenditures. However, current expenses such as maintenance and repair costs are not normally added to the cost base of a property. Interpretation Bulletin IT-128R, *Capital Cost Allowance – Depreciable Property* gives a detailed description of the difference between capital expenditures and current expenses.

Obtain Interpretation Bulletin IT-456, *Capital Property – Some Adjustments to Cost Base* for more information on additions to and deductions from the cost of a property.

Outlays and expenses
Outlays and expenses include reasonable expenditures you made or incurred to dispose of a capital property. They include

- fixing-up expenses,
- finder's fees,
- commissions,
- broker's fees,
- surveyor's fees,
- lawyer's fees,
- transfer taxes, **and**
- advertising costs.

Although you may not reduce your other income by claiming a deduction for outlays and expenses, including them when you report a disposition will reduce your capital gain or increase your capital loss.

Example 1

Taxable capital gain for 1988:

Proceeds of disposition			$20,000
minus			
Adjusted cost base			
purchase price	$13,000		
commission paid on purchase	500		
improvements after purchase	4,000	$17,500	
Outlays and expenses on disposition			
legal fees	500		
fixing-up expenses	200	700	18,200
Capital gain			$ 1,800
Taxable capital gain (2/3 x $1,800)			$ 1,200

Example 2

Allowable capital loss for 1988:

Proceeds of disposition			$ 5,000
minus			
Adjusted cost base			
purchase price	$6,000		
commission paid on purchase	200		
improvements after purchase	400	$6,600	
Outlays and expenses on disposition			
lawyer's fees	400		
advertising costs	100	500	7,100
Capital loss			($2,100)
Allowable capital loss (2/3 x $2,100)			($1,400)

You were asking...?

Q. I sold a real estate property in 1987 and reported the resulting taxable capital gain on my 1987 return. Since the realtor's right to payment was in dispute, I did not pay the real estate commission until 1988 when the matter was finally settled by the courts. Do I deduct the amount of the payment from income in 1988?

A. The real estate commission is an outlay or expense incurred in connection with the disposition you made in 1987. You may not claim such an amount as a deduction from income in any year. However, you may apply it to reduce the capital gain you realized on the disposition of the property. To request an adjustment to your 1987 return, please follow the instructions outlined in the section entitled, ''Changing your return after you mail it'' in the *1988 General Tax Guide.*

The remainder of this chapter discusses the dispositions of the various types of capital property you should report on Schedule 3.

Canadian securities

Shares of a corporation resident in Canada fall within the definition of Canadian securities. A unit of a mutual fund trust, or a bond, debenture, bill, note, mortgage, hypothec or similar obligation issued by a Canadian resident are also Canadian securities.

Note:

On the disposition of a Canadian security, you may elect to have any gain or loss from the transaction treated as a capital gain or loss instead of an income gain or loss. This election deems all Canadian securities owned by you in the year of election or in any subsequent year to be capital properties. This election cannot be rescinded and in making the election, you must treat all future dispositions of Canadian securities as dispositions of capital properties. This option is not available to non-resident individuals and traders or dealers in securities. You may make the election by filing form T123, ***Election on Disposition of Canadian Securities****, with your 1988 return.*

To determine where to report dispositions of Canadian securities on Schedule 3, refer to the sections ''Qualified small business corporation shares,'' ''Qualified farm property'' and ''Other securities and properties'' located in this chapter.

For further information on Canadian securities, refer to Interpretation Bulletin IT-479R, *Transactions in Securities* and its Special Release.

Prescribed securities

Prescribed securities are excluded from the definition of Canadian securities. They include the following:

- shares of companies, other than public corporations, the value of which, at the time you disposed of them, is mainly derived from real estate or resource properties or both;
- securities of companies if you do not deal at arm's length with the companies at any time before you dispose of the securities; **and**
- shares and securities that you acquired in a transaction in which you were not dealing at arm's length.

To determine where to report dispositions of prescribed securities on Schedule 3, refer to the sections ''Qualified small business corporation shares,'' ''Qualified farm property'' and ''Other securities and properties'' located in this chapter.

Qualified small business corporation shares

In the first area of Schedule 3, you should only report capital gains realized on the disposition of **qualified small business corporation shares.**

A **small business corporation** is a Canadian-controlled private corporation (CCPC), in which all or substantially all (90%) of the fair market value of its assets are

- used in an active business carried on primarily in Canada, by the corporation or by a CCPC related to it,
- shares or debts of connected corporations that were small business corporations, **or**
- a combination of the above two categories of assets.

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

- at the time of disposition, it was a share of the capital stock of a small business corporation and it was owned by you, your spouse or a partnership related to you,
- throughout the 24 months immediately before disposition, the share was not owned by anyone other than you or a person or partnership related to you, **and**
- throughout that part of the 24 months immediately before disposition while the share was owned by you or a person or partnership related to you, it was a share of a CCPC of which more than 50% of the fair market value of the assets were
  - assets used in an active business carried on primarily in Canada by the CCPC or by a corporation related to it,
  - certain shares or debts of connected corporations, **or**
  - a combination of the above two categories of assets.

Note:

Only certain shares issued after June 13, 1988 may be qualified small business corporation shares. Contact your district taxation office for more details.

You should **not** report the following transactions in this area:

- dispositions of other shares such as shares listed on a prescribed stock exchange or shares of a foreign corporation, **and**
- losses on the dispositions of any shares of small business corporations. See ''Allowable business investment losses, Line 217 — T1 Return'' in Chapter 2 for more details.

Capital gains that you realize on the disposition of qualified small business corporation shares qualify for the higher capital gains deduction limit. See the section entitled ''Qualified small business corporation shares'' in Chapter 3 for more details.

For more information on a CCPC, please refer to Interpretation Bulletin IT-458, *Canadian-Controlled Private Corporation*. Interpretation Bulletin IT-73R3, *Income from an Active Business*, contains information on active business income.

Qualified farm property

Generally, you report dispositions of qualified farm property in this section of Schedule 3. However, if a deemed taxable capital gain results on the disposition of eligible capital property which is a "qualified farm property," the gain is entered at line 543 of Schedule 3. For more information, refer to "Eligible capital property" in this chapter.

New for 1988
Effective for the 1988 and future taxation years, the definition of **qualified farm property** has been extensively revised as indicated below.

To be considered qualified farm property, the property must be owned by

- you or your spouse, **or**
- a family farm partnership in which you or your spouse hold an interest.

In addition, the property must be property that is

- a share of the capital stock of a family farm corporation that you or your spouse owned,
- an interest in a family farm partnership that you or your spouse owned, **or**
- real property or eligible capital property **used** in carrying on the business of farming in Canada by
  - you or your spouse,
  - any of your children, grandchildren, or great-grandchildren
  - any of your parents,
  - a family farm corporation in which any of the above individuals owned a share of that corporation, **or**
  - a family farm partnership in which you, your spouse or any of your children, grandchildren, great-grandchildren or parents owned an interest.

Real property or eligible capital property will be considered to be used in carrying on the business of farming in Canada if certain conditions are met. The conditions depend on when you, your spouse or family farm partnership acquired the property.

Real property or eligible capital property acquired **before June 18, 1987** will be considered to have been used in the course of carrying on the business of farming in Canada if it or property for which it was substituted was so **used** by an individual, corporation or partnership noted above

- in the year you dispose of the property, **or**
- in at least five years during which the property was owned by
  - you or your spouse,
  - any of your children, grandchildren or great-grandchildren,
  - any of your parents, **or**
  - a family farm partnership in which you, your spouse, or any of your children, grandchildren, great-grandchildren or parents owned an interest.

Note:
These conditions do not apply to property acquired after June 17, 1987 ***unless*** *the property was acquired under an agreement in writing entered into on or before June 17, 1987.*

Real property or eligible capital property acquired **after June 17, 1987** is considered to be used in carrying on the business of farming in Canada if, **throughout the 24 months immediately before its disposition,** it or property for which it was substituted was **owned** by you, your spouse, any of your children, grandchildren, great-grandchildren, parents or a family farm partnership in which any of the above individuals owned an interest, **and**

- for at least two years while the property was so owned, it was **used** by an individual who was actively engaged in the business of farming in Canada and who reported gross farming revenue in excess of his or her income from all other sources for the year,

or

- for at least 24 months while the property was so owned, it was **used** by a family farm corporation or partnership in carrying on the business of farming in Canada during which time you, your spouse or any of your children, grandchildren, great-grandchildren or parents were actively engaged in that farming business.

Similarly, qualified farm property may include property owned by a "personal trust" and property used in a farming business by a beneficiary of a personal trust. For further information, contact your district taxation office.
Capital gains you realize on the disposition of qualified farm property are eligible for the maximum lifetime capital gains deduction. For more information on this deduction, see "Qualified farm property" in Chapter 3.

You should report the disposition of **non-qualified** farm property in the section "Real estate and depreciable property" on Schedule 3. This section is explained later in this chapter.

Other securities and properties

In the next part of Schedule 3, you record any capital gains and losses you realized on all other securities and properties you disposed of in 1988.

Shares
Use this section to report the disposition of all securities that are not described under any other section in this chapter. This includes

- publicly traded shares,
- shares qualifying as Canadian securities or prescribed securities (as previously described) if they are not qualified small business corporation shares or qualified farm property, **and**
- shares issued by foreign corporations.

You should also report the disposition of units in a mutual fund trust in this area.

For a description of methods of reporting profits on the sale of securities, see Interpretation Bulletin IT-479R, *Transactions in Securities* and its Special Release.

Examples

In 1988, Marcel sold his 100 shares of ABC Public Corporation of Canada for $7,500 and paid brokerage fees of $500. When he purchased the shares in 1984 for $3,800, he paid brokerage fees of $200.

In reporting the disposition on Schedule 3, Marcel must determine the proceeds of disposition, the adjusted cost base of the property and the amount of any outlays and expenses relating to the transaction.

Proceeds of disposition			$7,500
minus			
Adjusted cost base			
original cost	$3,800		
brokerage fees	200	$4,000	
Outlays and expenses			
brokerage fees		500	4,500
Capital gain			$3,000
Taxable capital gain (2/3 x $3,000)			$2,000

Marcel records the transaction in the "Shares" area of Schedule 3 and enters his capital gain at line 520, as indicated below.

Other Securities and Properties

Shares No. of shares	Name of corporation and class of shares								Gain (or loss)	
100	ABC Public corporation of Canada	1984	$7,500	00	$ 4,000	00	500	00	3,000	00
	Total Proceeds 519		7,500				Net Gain (or loss) 520		3,000	00

If Marcel has no other capital gains or losses in the year, he enters $2,000 (2/3 x $3,000) as his total taxable capital gains at the bottom of Schedule 3 and again on line 127 of his return. For details on claiming a capital gains deduction, please refer to Chapter 3.

Using the same example, assume that Marcel sold the shares in 1988 for only $3,600. As you can see from the following illustration, Marcel incurred a capital loss of $900 on the disposition of the shares. Marcel may use it to offset any capital gains he realized in 1988. If his capital losses exceed his capital gains, two-thirds of the excess becomes part of his net capital loss for 1988. For details of the treatment of this type of loss, refer to "1988 Capital losses" in Chapter 2.

Other Securities and Properties

Shares No. of shares	Name of corporation and class of shares								Gain (or loss)	
100	ABC Public Corporation of Canada	1984	$3,600	00	$4000	00	$ 500	00	($900	00)
	Total Proceeds 519		3,600	00			Net Gain (or loss) 520		($ 900	00)

You may wish to use form T2082, *Capital Dispositions Supplementary Schedule Re: Shares*, to help you calculate your gains or losses on the disposition of shares.

Real estate and depreciable property
If you disposed of real estate in 1988, you should record the disposition in this area of Schedule 3. The type of real estate dispositions you can record here includes

- vacant land,
- rental properties – land and buildings,
- farm property – land and buildings, **and**
- commercial and industrial land and buildings.

Do not use this area to report the disposition of personal-use property or the disposition of mortgages and other similar debt obligations on real property.

You cannot have an allowable capital loss when you dispose of depreciable property. Therefore, in 1988, if you disposed of real property which includes land and a building,

- allocate the proceeds of disposition between the land and the building, **and**
- report the disposition of the land and the building separately.

Note:
In certain situations, you may be entitled to claim a terminal loss on the disposition of depreciable property. Refer to "Disposition of depreciable property" in Chapter 8.

If you converted a business or rental property to your principal residence in 1988, please refer to "Change in use from rental or business operation" in Chapter 4 of this Guide.

To help you calculate your gains or losses on real estate, obtain form T2083, *Capital Dispositions Supplementary Schedule Re: Real Estate (except principal residence, other personal-use property and depreciable property).*

Bonds, debentures, promissory notes and other properties
Use this area to record dispositions of any type of security not discussed in another section in this chapter. This includes capital gains and losses on

- **Commodity futures** – Refer to Interpretation Bulletin

IT-346R, *Commodity Futures and Certain Commodities* for information on transactions in commodities,

- **Options** – Dispositions of options for the sale or purchase of shares, are discussed in Interpretation Bulletins IT-96R4, *Options Granted by Corporations to Acquire Shares, Bonds or Debentures*, and IT-479R, *Transactions in Securities* and its Special Release, **and**
- **Discounts, premiums and bonuses** – If, in 1988, you received any of these amounts in connection with investments you hold, obtain Interpretation Bulletin IT-114, *Discounts, Premiums and Bonuses on Debt Obligations*.

The applicable form to help you calculate your gains or losses on the disposition of bonds, debentures and promissory notes is form T2084, *Capital Dispositions Supplementary Schedule Re: Bonds and Other Obligations*.

Employees' stock options
An employee stock option is an option granted to an employee to acquire shares at a price that is usually less than the fair market value of the shares.

The difference between the actual cost of the shares to you and their fair market value at the time you exercise the option is normally treated as a taxable benefit you received through your employment rather than as a capital gain.

A capital disposition does **not** occur until you dispose of shares that you acquired with an employee stock option. Therefore, if you exercised an employee stock option to purchase shares in 1988, do not report the transaction on Schedule 3 unless you also disposed of the shares in 1988.

If certain conditions are satisfied, you may be entitled to claim a deduction at line 249 of your return, for a portion of the taxable employee stock option benefit included in your employment income.

New for 1988
The portion of the taxable benefit that you may claim as a deduction has decreased from one-half to one-third so that employee stock options effectively continue to receive the same treatment as capital gains.

As explained below, the year in which you include the taxable benefit in income and claim the related stock option deduction depends on the details of your situation.

Situation A
In the year that you acquire shares through an employee stock option agreement, you are entitled to claim a stock option deduction if all the following conditions are met:

- you included a taxable employee stock option benefit in your income for the year that the shares were acquired,
- you were granted the stock option after February 15, 1984,
- the corporation that employs you, or a corporation that does not deal at arm's length with the corporation that employs you, granted the option,
- you dealt at arm's length with all the corporations involved in the stock option agreement immediately after you were granted the option under the agreement,
- the shares were prescribed shares at the time of their sale or issue, **and**
- you acquired the shares under the stock option agreement at a price not less than their fair market value at the time you were granted the option.

Your employer will report the amount of your stock option benefit in the footnote area of your T4 Supplementary slip. Enter one-third of this amount on line 249 of your return if all of the above conditions are satisfied.

Situation B
You will not have to report an employee stock option benefit on the purchase of shares of a Canadian-controlled private corporation (CCPC) under a stock option plan until the year you dispose of the shares if all the following conditions are met:

- the CCPC is either the corporation that employs you or one that does not deal at arm's length with the corporation that employs you,
- you acquired the shares after May 22, 1985 under a stock option agreement, **and**
- you dealt at arm's length with all of the corporations involved in the stock option agreement immediately after you were granted the option under the agreement.

If you held the shares for at least two years and sold them in 1988, in 1988 you may deduct an amount equal to one-third of the taxable employee stock option benefit you included in your 1988 income. Enter this amount on line 249 of your return.

Should you dispose of the shares within two years after the date you acquire them, you will not normally qualify for this deduction. However, if you meet all the requirements outlined in Situation A, you may qualify for the deduction described in Situation A.

Situation C
If the same conditions in Situation B exist except that you acquired the shares after March 31, 1977 and before May 23, 1985, no amount is required to be included in your income as an employee stock option benefit, even if you owned the shares for two years or longer. Therefore, no stock option deduction is available to you.

If Situation A or B apply to you, any amount included in your income as an employee stock option benefit is added to your actual purchase price to determine the adjusted cost base of your shares. This is so even if you claimed a stock option deduction pertaining to these shares. However, the amount you include in income as a taxable benefit does not qualify for the capital gains deduction.

In the year you exchange or dispose of the shares that you acquired through an employee stock option agreement,

- you must report the disposition at line 513 or 520 of Schedule 3. Any increase or decrease in the value of the shares between the date you acquired them and the date you disposed of them may result in a capital gain or loss; **and**
- you may be entitled to claim a capital gains deduction for part or all of any capital gain realized.

Obtain Interpretation Bulletin IT-113R3, *Benefits to Employees – Stock Options*, for more details.

Personal-use property

Personal-use property refers to items which you own primarily for your own and your family's personal use or enjoyment. Personal-use property includes all personal and household effects such as furniture, automobiles, boats and similar properties. The following rules apply to dispositions of personal-use property:

- if the adjusted cost base (ACB) of the property is less than $1,000, its ACB is deemed to be $1,000;
- if the proceeds of disposition are less than $1,000, the proceeds of disposition are deemed to be $1,000; **and**
- if both the ACB and the proceeds of disposition are $1,000 or less, there is no capital gain or loss and you are not required to report the disposition on your return.

Normally, you may not deduct capital losses arising from the sale or disposition of personal-use property in computing your income for a year. In addition, you cannot usually use such losses to decrease capital gains on other personal-use property. The reason for this is simply that if the value of property decreases through personal use, the resulting loss on its disposition is personal. These rules do not apply to certain items referred to as **listed personal property.**

Refer to the next section in this chapter for more information on listed personal property.

You were asking...?

Q. I sold an old china cabinet for $900 in 1988. The cabinet didn't cost me anything as my grandmother gave it to me ten years ago. She had a dealer appraise it at the time and it was valued at $500. Do I have to report the gain on my income tax return?

A. No. Since the china cabinet is considered a personal-use property, the adjusted cost base and the proceeds of disposition are both deemed to be $1,000. A disposal of personal-use property will never produce a capital gain and be subject to tax unless the proceeds of disposition are greater than $1,000.

Example

Franco sold his motorcycle in 1988 for $1,200. He had purchased it in 1982 for $850. The only expense he incurred in selling the motorcycle was $15 for advertising in the local newspaper. As the ACB of the motorcycle is less than $1,000 ($850), it is deemed to have a cost of $1,000. Although Franco actually realized a gain of $335 ($1,200 – $865), the capital gain he reports on line 530 of Schedule 3 is only $185 ($1,200 – $1,000 – $15).

Personal Use Property (full description)

1974 Motorcycle	1982	$ 1,200 00	$1,000 00	$ 15 00		$ 185 00
				Gain only	530	$ 185 00

Personal-use property includes real estate that you own and use primarily for your own and your family's personal use and enjoyment. Examples include your cottage property and home. However, a gain on the disposition of your home will not be taxed if you use it only as your principal residence. This is explained further in Chapter 4.

Example

In 1988, Anna sold her lakefront property to a developer for $70,000. She bought the property in 1980 for $50,000 and had planned to build a cottage on it. Anna incurred expenses of $1,000 in connection with the sale.

In addition, Anna paid interest and property taxes in the amount of $10,000 during the period of her ownership.

The interest was paid on a loan she took out to purchase the property. The interest and property taxes Anna incurred are considered personal expenses as they were not incurred for the purpose of earning income from a business or property. Therefore, Anna may not claim this amount in computing her income for any taxation year, nor may she apply them to reduce the capital gain that she realized on selling the property. Furthermore, in determining the adjusted cost base of the property, the amount of these expenses is not added to the original $50,000 cost.

In calculating her capital gain on the property, Anna may deduct the $1,000 selling costs. She reports the disposition in the personal-use property area on Schedule 3 and enters her $19,000 capital gain at line 530.

Personal Use Property (full description)

Lot 119-120, Plan 2750	1980	$70,000 00	$ 50,000 00	$ 1,000 00		$ 19,000 00
Canada County				Gain only	530	$ 19,000 00

Disposition of part of a personal-use property

A special provision applies if you dispose of part of a personal-use property and retain the other part. The proceeds of disposition and the adjusted cost base (ACB) of the part you disposed of cannot be less than the result obtained from the following calculation:

$$\frac{\text{ACB of portion disposed of}}{\text{ACB of total property}} \times \$1,000$$

For instance, if the ACB of a property is $200 and you disposed of one-quarter of the property,

- the ACB of the property disposed of is deemed to be the greater of its ACB otherwise determined (1/4 x $200 = $50) and the amount determined under the above calculation ($250), **and**
- the proceeds of disposition of the property disposed of is deemed to be the greater of the actual proceeds and the amount determined under the above calculation ($250).

Sets of personal-use property

Where a number of personal-use properties which would ordinarily be disposed of as a set in one disposition are

- disposed of in more than one disposition,
- acquired by one person or a group of persons not dealing with each other at arm's length, **and**
- properties which had a total fair market value greater than $1,000 before the first disposition,

the properties are deemed to be a single personal-use property. Thus, the set is the whole property and each property disposed of is considered to be a "disposition of part of a personal-use property." The proceeds of disposition and the ACB for each property are calculated under the special provision above.

For more details, please obtain Interpretation Bulletin IT-332R, *Personal-Use Property*. To help you calculate your gains or losses from personal-use property, obtain form T2080, *Capital Dispositions Supplementary Schedule Re: Personal-Use Property (other than listed personal property and principal residence)*.

Listed personal property

Listed personal property (LPP) consists of the following items which normally tend to increase in value:

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

Many of these items can be valued by consulting dealers' catalogues or the art, coin, jewellery or stamp dealers themselves. All or any portion of such property, any interest in it or any right to it, is considered to be listed personal property.

Since listed personal property is a type of personal-use property, the $1,000 minimum proceeds of disposition and adjusted cost base rules also apply. Please refer to the previous section for an explanation of these rules.

If you incur losses on the disposition of listed personal property,

- you may only deduct them from gains realized on the disposition of other listed personal property,
- you may not use them to reduce capital gains arising from the disposition of other types of property, **and**
- the total amount of LPP losses you deduct in the year may not exceed the total amount of LPP gains for that year.

If your losses on listed personal property exceed your gains on such property in 1988,

- you may use any unapplied LPP loss to reduce your net gains on listed personal property in any of the three preceding years and/or any of the following seven years, **and**
- you may select which portion of an unapplied listed personal property loss to carry back or carry forward. The oldest LPP losses must be fully applied before the more recent losses are applied.

If you choose to carry back any portion of your 1988 capital losses from listed personal property to reduce taxable capital gains you realized on listed personal property in 1985, 1986 or 1987, complete form T1A, *Request for Loss Carry-back* and file it with your 1988 return.

If you have no net capital gains on listed personal property in the previous three years, you may use any unapplied listed personal property loss to reduce net capital gains on the disposition of listed personal property in any of the seven years following 1988.

Example

Marina purchased some jewellery in 1980 for $5,800. In 1988, she sold it for $6,000 and realized a capital gain of $200. She also sold her coin collection for $2,000. Marina acquired this collection seven years ago at a cost of $1,700. She therefore realized a capital gain of $300. In addition, Marina disposed of a painting in 1988 which she purchased in 1978 for $12,000. As she sold the painting for $8,000, she incurred a capital loss of $4,000. There were no outlays or expenses relating to the transactions.

Her dispositions of listed personal property in 1988 produced a LPP loss of $3,500 ($200 + $300 – $4,000). Marina cannot use this loss to offset any other type of capital gain in the year nor to reduce income from other sources. However, Marina may apply the LPP loss against LPP gains in any of the three years preceding or seven years following 1988. Marina should report the disposition in the listed personal property area on Schedule 3 as follows.

Listed Personal Property (full description) ⊙

See attached form T2081

NOTE: *Listed Personal Property Losses may only be applied against Listed Personal Property Gains*

Subtract: Unapplied listed Personal Property Losses from other years

Net Gain only 531 ⊙

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Capital Dispositions Supplementary Schedule

Re: Listed Personal Property (This form, when completed, should be retained in your permanent records.)

- Listed Personal Property consists of works of art such as prints, etchings, drawings, paintings and sculptures, jewellery, rare folios, manuscripts and books, stamps, coins. The gain on the sale of such an item (or a set of such items) is treated the same as Personal-Use Property. Losses on Listed Personal Property can be applied only against gains on other items of Listed Personal Property.

A. Particulars of Current Year Dispositions

Description of Property	(1) Date of Acquisition	(2) Proceeds (Greater of Actual or $1,000)	(3) Adjusted Cost Base (Greater of ACB or $1,000)	(4) Outlays and Expenses (re disposition)	(5) Gain (Col. (2) less Cols. (3) and (4))
Jewellery	1980	6000 –	5,800 –	Ø	200 –
Coin collection	1981	2,000 –	1,700 –	Ø	300 –
Painting	1978	8,000 –	12,000 –	Ø	4.000 –

Note:
Never enter the amount of a "listed personal property" loss at line 531 of Schedule 3.

Marina attaches a completed copy of form T2081, *Capital Dispositions Supplementary Schedule Re: Listed Personal Property* to her return. You may use this form to calculate gains or losses from listed personal property and to record the particulars of all current year dispositions of such property.

Information slips

Report any capital gains or losses indicated on the information slips you received for the 1988 taxation year. Record the net gain or loss on line 533 of Schedule 3.

If you are the beneficiary of a trust, you may have received a T3 slip with an asterisk (*) in Boxes B, C or I. If so, the issuer may have attached instructions on how to complete Schedule 3. If instructions are not attached to your slip, you should contact the issuer. If you received a T3 slip that indicates a capital gain in Box B, refer to "T3 Slip — Capital gains eligible for deduction" in Chapter 3 for information on calculating your 1988 capital gains deduction.

You may wish to use form T2089, *Capital Dispositions Supplementary Schedule Re: Information Slips*, to calculate your net gain or loss.

Reduction in business investment loss

If you incurred a business investment loss in 1988 and you claimed a capital gains deduction in 1985, 1986 and/or 1987, the business investment loss is reduced by the **lesser** of

- the amount of the business investment loss for 1988, **and**
- twice the amount of all capital gains deductions claimed in 1985, 1986 and 1987. From this calculation, deduct any amount you already used to reduce any other business investment loss.

You will treat the amount of any such reduction to your business investment loss as a capital loss for 1988. Record this amount on line 535 of Schedule 3.

Note:
Do not report a business investment loss on Schedule 3. Only the reduction discussed above is recorded on Schedule 3.

Business investment losses are discussed in more detail in Chapter 2 under the heading "Allowable business investment losses, Line 217 — T1 Return."

Example
In 1988, for the first time in his life, Kyle incurred a business investment loss. His loss amounted to $15,000. Kyle's allowable business investment loss would normally be two-thirds of that amount ($10,000). However, in both 1985 and 1986 he claimed a capital gains deduction of $2,250 but did not claim any such deduction in 1987 or 1988. Therefore, Kyle must reduce his business investment loss by twice the capital gains deduction he claimed in 1985 and 1986. This reduction amounts to $9,000 [2 x ($2,250 + $2,250)]. Kyle records this $9,000 on line 535 of Schedule 3.

Kyle's remaining business investment loss for 1988 is $6,000 ($15,000 - $9,000). Two-thirds of this amount or $4,000 is his allowable business investment loss. Kyle claims this $4,000 on line 217 of his return as an allowable business investment loss. He does not record this type of loss on Schedule 3. He only records the $9,000 reduction in the allowable business investment loss on Schedule 3.

Unused share-purchase tax credit

If you have a share-purchase tax credit that you earned in 1987 but you did not use it to reduce your taxes payable in 1987 or 1986, the unused credit is deemed to be a capital loss for 1988. You report this amount on line 536 of Schedule 3.

Reserves

If you are claiming a capital gains reserve in 1988, you are required to file form T2017, *Summary of Reserves on Dispositions of Capital Property*. For your convenience, you will find two copies of this form in this Guide.

Any reserve claimed in 1987 must be included as income in 1988. Enter your net reserve for 1988 at line 542 of Schedule 3. Refer to Chapter 5 for further information on reserves and instructions on completing form T2017.

Eligible capital property

New for 1988
The disposition of eligible capital property may result in a deemed taxable capital gain.

If you are deemed to have realized a taxable capital gain on the disposition of eligible capital property that is qualified farm property, enter the amount of the gain on line 543 of Schedule 3. At line 544, enter the taxable capital gain that you are deemed to have realized on the disposition of any other type of eligible capital property.

Note:
Any deemed taxable capital gain is eligible for the lifetime capital gains deduction discussed in Chapter 3 of this Guide.

For further information on deemed taxable capital gains on the dispositions of eligible capital property, refer to the *1988 Farming Income Tax Guide*, the *1988 Fishing Income Tax Guide* or the *1988 Business and Professional Income Tax Guide*.

Taxable capital gains Line 127 — T1 Return

Complete Schedule 3 by calculating your total capital gain or loss for the year. Two-thirds of this amount is your taxable capital gain or allowable capital loss.

If you have a **taxable capital gain** for 1988, enter this amount on line 127 of your return. You should also refer to Chapter 3, "Capital Gains Deduction."

If you have an **allowable capital loss** for 1988, you may use it to reduce your taxable capital gains of the three previous years or any future year. Capital losses are discussed in detail in Chapter 2.

CHAPTER 2
CAPITAL LOSSES

Generally, a capital loss includes any loss that results when you dispose of or are deemed to dispose of capital property for an amount that is less than it cost you. A capital loss cannot occur when you dispose of

- a depreciable property. However, you may be entitled to claim a terminal loss. See the section "Disposition of depreciable property" in Chapter 8.
- a personal-use property, unless the property is listed personal property. Refer to "Listed personal property losses (LPP)" in this chapter.

This chapter discusses the treatment of capital losses.

1988 Capital losses

New for 1988
The allowable portion of capital losses incurred in 1988 has increased from one-half to two-thirds.

You may reduce your 1988 taxable capital gains by any allowable capital losses you incurred in 1988. If your allowable capital losses exceed your taxable capital gains, you may **not** reduce your other sources of income by claiming a deduction in 1988 for the excess. This excess is your **net capital loss** for 1988. You may use your 1988 net capital loss to reduce your taxable capital gains in any of the previous three years **or** in any future year.

- If you choose to apply any portion of a 1988 net capital loss to 1985, 1986 or 1987, complete form T1A, *Request for Loss Carry-back (Rev 1988)*, and file it with your 1988 return.
- If you choose to carry forward all or any portion of your unapplied net capital loss to a future year, keep a record of the amount available.

Note:
The amount of net capital losses of other years you may claim in any year is restricted and an adjustment may be required. For further information, refer to the section in this chapter entitled "Net capital losses of other years, Line 253 — T1 Return."

Whichever choice you make, you must file a Schedule 3 with your 1988 return to report any disposition of capital property which resulted in a capital loss.

You were asking...?

Q. I held shares in a Canadian public corporation and sold them last year at a loss. I had no capital gains in 1988. How do I claim my capital loss?

A. Two-thirds of this capital loss is your allowable capital loss for 1988. Since you have no taxable capital gains in 1988 to apply your loss to, your allowable capital loss becomes your net capital loss for 1988. You may carry it back three years to 1985, 1986 and/or 1987 or carry it forward indefinitely until fully applied against taxable capital gains realized in other years. You should complete and file Schedule 3 so that the amount of your capital loss available for carry-forward or carry-back can be recorded.

Example
Chantal incurred a capital loss of $600 and realized a capital gain of $300 on the sale of securities in 1988. Chantal determines her total capital loss and allowable capital loss as follows:

Capital loss	($600)
Capital gain	300
Total capital loss	($300)
Allowable capital loss ($300 x 2/3)	($200)

Although Chantal must report her capital gain and capital loss when she files her 1988 return, she cannot claim a deduction in 1988 for the allowable capital loss of $200. Therefore, the $200 is Chantal's net capital loss for 1988. She may use it to reduce her taxable capital gains in any of the three previous years or in any future year. For more details refer to "Net capital losses of other years, Line 253 — T1 Return," in this chapter.

Listed personal property losses (LPP)
Listed personal property (LPP) is described under "Listed personal property" in Chapter 1. You may only deduct your losses on the disposition of LPP from your net gains on other LPP. You may carry unapplied LPP losses back three years and forward seven years. If you have unapplied LPP losses from other years, you may subtract them from your LPP gains in computing your 1988 net LPP gain on Schedule 3. Do not claim a previous year's LPP loss on line 253 of your return.

Restricted farm losses
If you disposed of land used in your farming business, you may be able to reduce any resulting capital gain if you have restricted farm losses that were never deducted in computing your income. Determine the amount of your unapplied restricted farm losses that represent

- property taxes on the land, **and**
- interest on money borrowed to purchase the land.

Add the total of these two amounts to the ACB of the land. This in turn reduces your capital gain.

Note:
You may add interest and property taxes to the ACB of the land only to the extent that you do not create or increase a capital loss.

For further details, please obtain Interpretation Bulletin IT-232R2, *Non-Capital Losses, Net Capital Losses, Restricted Farm Losses and Limited Partnership Losses – Their Composition and Deductibility in Computing Taxable Income.*

Superficial losses
A superficial loss is a capital loss which results when you dispose of capital property and, during the period beginning 30 days before the disposition and ending 30 days after the disposition,

- you,
- your spouse, **or**
- a corporation you control directly or indirectly,

acquires substituted property that is the same or identical to the property you disposed of.

You may not deduct a superficial loss in computing your income. However, you may add the amount of a superficial loss to the adjusted cost base of the substituted property. This will decrease any capital gain or increase any capital loss when you dispose of the substituted property.

There are several exceptions to the rule which deems a capital loss to be a superficial loss. These include losses

- for deemed dispositions of property if you cease to be a resident of Canada,
- for deemed dispositions of property on death, **and**
- where the disposition giving rise to the loss was the expiry of an option.

Please obtain Interpretation Bulletin IT-387R, *Meaning of "Identical Properties."*

Allowable business investment losses Line 217 — T1 Return

New for 1988
Shareholders of an insolvent corporation that has ceased to carry on a business may be entitled to claim a loss on shares of the corporation even if the corporation is not bankrupt. Although this change becomes effective for 1988, it applies retroactively to the three previous years. If you incurred a loss on the deemed disposition of shares of this type of corporation in 1985, 1986 or 1987, refer to "Changing your return after you mail it" in the *1988 General Tax Guide*.

A business investment loss for 1988 is a capital loss resulting from the disposition or deemed disposition of a property that is

- a share of a small business corporation or a debt owing to you by a small business corporation which you dispose of to a person with whom you deal at arm's length, **or**
- a debt which a small business corporation owes you, other than a debt from the disposition of personal-use property, and which you established to have become a bad debt in the year, **or**
- a share of a small business corporation, other than a share you received as consideration for a personal-use property, where the corporation
  - has become bankrupt under the Bankruptcy Act in the year,
  - is an insolvent corporation for which a winding-up order has been made under the Winding-up Act in the year, **or**
  - is an insolvent corporation that ceased to operate in the year and does not operate any business within 24 months following the year end. In addition, at the end of the year, your shares in such a corporation must have a fair market value of zero and it is reasonable to expect that the corporation will be dissolved or wound up and will not commence to carry on any business within the year or within 24 months following the end of the year.

Regarding the last three categories, you are deemed to have disposed of the debt or share at the end of the year and to have immediately reacquired the property at a cost of zero.

For more details, obtain Interpretation Bulletin IT-484, *Business Investment Losses.*

The deductible portion of your business investment losses in a year is your **allowable business investment loss.**

New for 1988
The allowable business investment loss has increased from one-half to two-thirds of a business investment loss incurred in the year.

Allowable business investment losses are deductible from all sources of income in the year. If you do not have enough income in 1988 to absorb your allowable business investment losses, the part that you are unable to deduct becomes a non-capital loss for 1988. You may then apply this noncapital loss to reduce your income in the three previous years (1985-1987) **or** in any of the seven future years (1989-1995).

If you are unable to apply your 1988 non-capital loss within the above time frames, the unapplied portion becomes a net capital loss in the seventh year (1995). You may then use it to reduce your taxable capital gains in any future year.

Similarly, if you incurred a business investment loss in 1981 and you were unable to utilize either the allowable portion in 1981 **or** the non-capital loss in any year since 1981, the unapplied loss becomes a net capital loss in 1988 and may be used to reduce a taxable capital gain in any future year.

Note:
You must reduce your 1988 business investment loss if you have ever claimed a capital gains deduction. See the section entitled "Reduction in Business Investment Loss" in Chapter 1.

Enter the amount of your allowable business investment loss on line 217 of your return and attach a statement specifying the

- name of the small business corporation,
- number and class of shares or the type of debt disposed of,
- insolvent, bankrupt or wind-up data,
- date that you purchased the shares or acquired the debt,
- proceeds of disposition,
- adjusted cost base of the shares or debt,
- outlays and expenses on the disposition, **and**
- amount of the loss.

Note:
Any allowable business investment loss you claimed in 1988 will reduce the capital gains deduction you are eligible to claim in 1988 and subsequent years. Refer to Chapter 3 for more details.

Net capital losses of other years Line 253 — T1 Return

If your allowable capital losses exceed your taxable capital gains in a year, the excess is your net capital loss for that year. You may carry net capital losses back three years or carry them forward indefinitely until they are fully applied against taxable capital gains of other years.

- In 1988, if you reported a taxable capital gain at line 127, you may claim a deduction at line 253 for net

capital losses incurred in previous years, to the extent that they were not previously deducted.

- You may apply a 1988 net capital loss to reduce taxable capital gains you realized in 1985, 1986 or 1987. This is done by filing form T1A, *Request for Loss Carry-back (Rev 1988)* with your 1988 return.

Note:

If you realized a taxable capital gain in 1988, you may wish to take advantage of the capital gains deduction available in 1988 instead of applying net capital losses from previous years to reduce your 1988 taxable capital gains. Refer to Chapter 3 of this Guide for more information on the capital gains deduction.

New for 1988

Adjusted net capital loss amount

The taxable portion of capital gains and the allowable portion of capital losses increased from one-half to two-thirds in 1988. As a result of this change in the **inclusion rate,** you may apply a net capital loss to a year in which the inclusion rate is different from the year in which you incurred the loss. Before net capital losses are applied under these circumstances, an adjustment is required so that your net capital loss offsets an equivalent amount of taxable capital gain.

For instance, assume that you had a capital loss of $1,000 in 1987 and a capital gain of $1,000 in 1988. If there had not been a change in the inclusion rate, the 1987 net capital loss of $500 ($1,000 x 1/2) would reduce your 1988 taxable capital gain of $500 ($1,000 x 1/2) to zero. However, since the inclusion rate changed for 1988, an adjustment must be made to increase your 1987 net capital loss of $500 so that it effectively offsets an equal amount of your 1988 taxable capital gain of $666.67 ($1,000 x 2/3).

The amount of adjustment depends on the year in which the net capital loss was incurred and the year in which it is applied. The adjustments to net capital losses are as follows:

- If you are applying net capital losses of prior years to 1988, multiply the amount to be claimed by 4/3.
- If you are applying a 1988 net capital loss to 1985, 1986 and/or 1987, multiply the amount to be claimed by 3/4.

Enter your **adjusted net capital loss amount** in line (6) of the chart contained below under "Maximum deduction."

Maximum deduction

Generally, net capital losses may be used only to reduce taxable capital gains. However, if any net capital losses that were incurred before May 23, 1985 remain unapplied, up to the **lesser** of **$2,000** and your **pre-1986 capital loss balance** may be deducted from other sources of income.

Pre-1986 capital loss balance for a particular year refers to the amount of your total unapplied net capital losses incurred at any time before May 23, 1985 **minus** the total amount of capital gains deductions you claimed before that year.

Use the following chart to calculate your pre-1986 capital loss balance for a year.

Pre-1986 Capital Loss Balance for 19___

Unapplied net capital losses incurred before May 23, 1985	$________(1)
Total amount of capital gains deductions that you claimed **before** the year in which you are applying net capital losses	________(2)
Pre-1986 capital loss balance for 19 Line (1) minus line (2)	$________

If you are applying 1988 net capital losses against taxable capital gains in 1985, 1986 or 1987 **or** if you are applying pre-1988 net capital losses against 1988 taxable capital gains, use the following chart to calculate the maximum amount you may deduct in a particular year.

Calculation of Maximum Deduction for 19___

Note:

You must do a separate calculation for each year to which you are applying net capital losses.

Taxable capital gains reported at line 127 of your 19___ return		$________(1)
	$ 2,000 (2)	
Enter your **pre-1986 capital loss balance** for 19___	________(3)	
Enter the **lesser** of line (2) and line (3)		________(4)
Total of line (1) plus line (4)		$________(5)
Enter your **adjusted net capital loss amount**		________(6)
Maximum deduction for net capital losses of other years. Enter the lesser of line (5) and line (6)		$________(7)

Please remember

- You must claim net capital losses of earlier years before you claim net capital losses of later years. Therefore, you may not apply post-May 22, 1985 losses until pre-May 23, 1985 losses have been applied.
- If you are applying net capital losses to 1988, the amount at line (7) above is the maximum amount that you may deduct at line 253 of your 1988 return.
- If you are applying a 1988 net capital loss to 1985, 1986 or 1987, complete and attach form T1A, *Request for Loss Carry-back (Rev 1988)* to your 1988 return.

Unapplied net capital losses

If any net capital losses remain unapplied, you may use them to reduce taxable capital gains in future years. Therefore, you should keep a record of your unapplied net capital losses.

Record keeping – When net capital losses are applied in circumstances where the inclusion rate for the year in which you incurred a net capital loss is different from the inclusion rate for the year in which you apply a net capital loss, the amount by which you reduce your unapplied net capital losses is different than the amount you deducted for net capital losses of other years.

1. If you applied a 1988 net capital loss to reduce taxable capital gains in 1985, 1986 or 1987, use the following chart to calculate your remaining balance of unapplied net capital losses.

1988 net capital loss		$______(1)
1988 **adjusted net capital loss amount** available for carry-back Line (1) x 3/4		______(2)
Amount applied to 1985	$______(3)	
Amount applied to 1986	______(4)	
Amount applied to 1987	______(5)	
Total of lines (3), (4) and (5)		______(6)
1988 **adjusted net capital loss amount** unapplied Line (2) minus line (6)		$______(7)
Balance of 1988 net capital loss available for carry-forward to a future year Line (7) ______ x 4/3		$______(8)

2. If you deducted a pre-1988 net capital loss in 1988, use the following chart to calculate your remaining balance of unapplied net capital losses.

Total unapplied net capital losses incurred before 1988	$______(1)
Amount claimed at line 253 of your 1988 return	______(2)
Line (2) ______ x 3/4	______(3)
Balance of pre-1988 net capital losses available for carry-forward to a future year Line (1) minus line (3)	$______(4)

To assist with your record keeping, you should keep separate balances for unapplied net capital losses for each year.

Example

Allan reported a taxable capital gain of $4,000 at line 127 of his 1988 return. He has unapplied net capital losses totalling $13,000: a balance of $10,000 from property disposed of in 1983 and $3,000 from property disposed of in 1987. In both 1985 and 1986, Allan claimed a capital gains deduction of $1,000.

To determine the maximum amount he may deduct at line 253 on his 1988 return, Allan must first calculate both his pre-1986 capital loss balance and his adjusted net capital loss amount.

Calculation of Allan's pre-1986 capital loss balance for 1988:

Pre-1986 Capital Loss Balance for 1988

Unapplied net capital losses incurred before May 23, 1985 $ 10,000	$ 10,000 (1)
Total amount of capital gains deductions that Allan claimed **before** the year in which he is applying net capital losses (1988)	2,000 (2)
Pre-1986 capital loss balance for 1988 Line (1) minus line (2)	$ 8,000

Calculation of Allan's adjusted net capital loss amount:

Unapplied net capital losses	$13,000
Adjustment factor	× 4/3
Adjusted net capital loss amount	$17,333

Allan may now calculate the maximum amount of his "net capital losses of other years" that he may deduct at line 253 of his 1988 return.

Taxable capital gains reported at line 127 of his 1988 return		$ 4,000 (1)
	$ **2,000** (2)	
Enter his **pre-1986 capital loss balance** for 1988	8,000 (3)	
Enter the **lesser** of line (2) and line (3)		2,000 (4)
Line (1) plus line (4)		$ 6,000 (5)
Enter his **adjusted net capital loss amount**		17,333 (6)
Maximum deduction for net capital losses of other years. Enter the lesser of $ 6,000 line (5) and line (6)		$ 6,000 (7)

When he completes his 1988 income tax return, Allan may claim a $6,000 deduction for "net capital losses of other years" at line 253. For record keeping purposes, his balance of unapplied net capital losses is calculated as follows:

Total unapplied net capital losses incurred before 1988	$ 13,000 (1)
Amount claimed at line 253 of Allan's 1988 return	6,000 (2)
Line (2) $6,000 x 3/4	4,500 (3)
Balance of pre-1988 net capital losses available for carry-forward to a future year Line (1) minus line (3)	$ 8,500 (4)

As indicated above, Allan's unapplied net capital losses will then total $8,500; $5,500 for 1983 ($10,000 – $4,500) and $3,000 for 1987.

Obtain form T2088, *Capital Dispositions Supplementary Schedule – A. Net listed – Personal – Property Losses Unapplied – B. Net Capital Losses Unapplied* to record unapplied net capital losses and unapplied LPP losses.

CHAPTER 3
CAPITAL GAINS DEDUCTION

If you lived in Canada or were a deemed resident of Canada throughout 1988 and you reported a taxable capital gain at line 127 of your return, you may be able to claim a capital gains deduction at line 254. There is a limit to the total capital gains that you may deduct in your lifetime. A copy of form T657, *Calculation of Capital Gains Deduction for 1988*, is contained in this Guide to help you calculate your deduction.

Note:

If you do not file your 1988 return before April 30, 1990, you may be denied the capital gains deduction.

If you are not considered to be resident of Canada throughout 1988, refer to Chapter 9 for details on what requirements you must meet in order to qualify for the capital gains deduction.

New for 1988

Up to $500,000 in capital gains realized on the disposition of qualified farm property or qualified small business corporation shares may be tax free in your lifetime. For dispositions of all other types of capital properties, the tax free amount is $100,000.

Since the taxable portion of capital gains has increased from one-half to two-thirds in 1988, the maximum capital gains deduction that you may claim at line 254 of your 1988 return is as follows:

- Your lifetime cumulative deduction for dispositions of qualified farm property and qualified small business corporation shares is limited to $333,333 ($500,000 x 2/3); **and**
- Your lifetime cumulative deduction for dispositions of all other types of capital properties is limited to $66,667 ($100,000 x 2/3).

Note:

Your cumulative combined deductions for the 1985 to the 1988 taxation years for **all** types of capital properties cannot exceed $333,333.

You reduce your maximum 1988 deduction by 4/3 of the total deductions you claimed in previous years. This "gross-up" adjusts the one-half inclusion rate for prior year dispositions to the two-thirds inclusion rate for 1988 dispositions. See the section in this Chapter entitled "Capital gains deduction, Line 254 — T1 Return" for more details.

Deemed taxable capital gains realized on the disposition of eligible capital property qualify for the capital gains deduction. If you disposed of eligible capital property that satisfies the requirements of qualified farm property, you may be entitled to the larger capital gains deduction limit. For further information on deemed taxable capital gains on the dispositions of eligible capital property, obtain the *1988 Farming Income Tax Guide*, the *1988 Business and Professional Income Tax Guide* and the *1988 Fishing Income Tax Guide*.

You were asking...?

Q. I sold my rental property in 1988. Since I didn't claim a capital gains deduction in 1985, 1986 and 1987, can I combine the total deductions for these years with my 1988 deduction or do I lose them?

A. If the allowable capital gains deductions were not claimed in 1985, 1986 and 1987, you do not lose them. They are carried forward to form part of your cumulative lifetime deduction which is $66,667 in 1988 for property that is not qualified farm property or qualified small business corporation shares.

For more details on the calculation of your maximum 1988 capital gains deduction, see the sections "Qualified farm property," "Qualified small business corporation shares" and "Other property" in this chapter.

Capital gains deduction Line 254 — T1 Return

Qualified farm property

New for 1988

The definition of qualified farm property has changed. The revised definition is contained in "Qualified farm property" in Chapter 1.

For capital gains realized on qualified farm property, you may claim a capital gains deduction in 1988 equal to the **least** of

- your annual gains limit for 1988,
- your cumulative gains limit at the end of 1988,
- your net taxable capital gains in 1988 from the disposition of qualified farm property after 1984, **and**
- $333,333 minus the amount you obtain when your total capital gains deductions for 1985, 1986 and 1987, if any, are multiplied by 4/3.

Qualified small business corporation shares

New for 1988

You may no longer make a tax free rollover of shares of a small business corporation to your children. However, if you realized a capital gain in 1988 from the disposition of qualified small business corporation shares after June 17, 1987, you may be eligible to claim the maximum capital gains deduction of $333,333.

For a detailed definition of qualified small business corporation shares refer to "Qualified small business corporation shares" in Chapter 1.

For capital gains realized on the disposition of qualified small business corporation shares, you may claim a deduction in 1988 equal to the **least** of:

- your annual gains limit for 1988 minus any capital gains deduction you claimed for qualified farm property in 1988,
- your cumulative gains limit at the end of 1988 minus any capital gains deduction you claimed for qualified farm property in 1988,
- your net taxable capital gains in 1988 from the disposition of qualified small business corporation shares after June 17, 1987, except gains that you included in your capital gains deduction for qualified farm property, **and**
- $333,333 minus the amount you obtain when your total capital gains deductions for 1985, 1986 and 1987, if any, are multiplied by 4/3.

Other property
New for 1988
Any capital gain reserve you report as income in 1988 which relates to a disposition of capital property after 1984 qualifies for the capital gains deduction.

For capital gains realized on other property, you may claim a capital gains deduction in 1988 equal to the **least** of

- your annual gains limit for 1988 minus the total of any capital gains deduction you claimed in 1988 for qualified farm property and qualified small business corporation shares,
- your cumulative gains limit at the end of 1988 minus the total of any capital gains deductions you claimed in 1988 for qualified farm property and qualified small business corporation shares, **and**
- $66,667 minus the amount you obtain when you multiply the

total of your 1985, 1986 and 1987 capital gains deduction for other property by 4/3.

You were asking...?

Q. I sold some land in 1988 and realized a taxable capital gain of $20,000. Do I qualify for the capital gains deduction? If so, do I have to claim a deduction to offset the whole gain, or can I claim a lesser amount or no deduction at all? Even without claiming a capital gains deduction, my taxable income for 1988 is zero.

A. If you were resident in Canada throughout 1988 and had a taxable capital gain in the year, you may be eligible to claim the capital gains deduction. The amount of your allowable deduction depends on various factors. For property that is not qualified farm property or qualified small business corporation shares, the maximum deduction for 1988 is $66,667. Assuming that at least $20,000 of your maximum deduction remains unused, you may claim a capital gains deduction of $20,000 to offset the full amount of your taxable capital gain of $20,000. Since the deduction is discretionary, you may claim an amount less than your gain of $20,000 or no amount at all.

Annual gains limit for 1988
Your annual gains limit represents the extent to which your taxable capital gains for 1988 may qualify for the capital gains deduction. Basically, your annual gains limit for 1988 is your total net taxable capital gains for 1988 **minus** the total of any allowable business investment losses and net capital losses of other years that you claimed in 1988.

Use "Part 1 — Calculation of Annual Gains Limit for 1988" of form T657, *Calculation of Capital Gains Deduction for 1988*, to calculate your annual gains limit for 1988.

Cumulative gains limit for 1988
In general, your cumulative gains limit represents the extent to which the total of your taxable capital gains for the years 1985 to 1988 may qualify for the capital gains deduction.

New for 1988
Your cumulative capital gains limit will be reduced by the amount your cumulative net investment losses (CNIL) at the end of 1988. Your cumulative net investment loss for 1988 is the amount by which your 1988 "investment expenses" **exceed** your "investment income" for the year.

Investment income is income from property that you earned as income in 1988. It may include

- interest,
- grossed-up taxable dividends received from taxable Canadian corporations,
- income from property including net rental income from the renting or leasing of rental properties or multiple unit residential buildings (MURBs),
- 50% of all amounts included in income which relate to recovered exploration and development expenses, **and**
- your share of income from all partnerships of which you were a **specified member.**

Note:
*You are considered to be a **specified member** of a partnership if you are a member who is a limited partner of the partnership **or** a member who is neither actively engaged in the partnership business nor otherwise engaged in a similar business.*

Investment expenses are amounts that relate to earning investment income described above and that you deducted in computing your 1988 income from property. Investment expenses include

- interest and carrying charges relating to property acquired to earn income from property,
- interest, carrying charges and certain other expenses deducted in computing your share of income for the year from a partnership of which you were a **specified member,**
- your share of losses from a limited partnership of which you are a **specified member,** including limited partnership losses of other years that you deducted in 1988,
- all your property losses or your rental losses from the renting or leasing of rental properties or multiple unit residential buildings (MURBs),
- 50% of certain resource and exploration expenditures you deducted which were
  - incurred and renounced by a corporation, **or**
  - incurred by a partnership of which you are a **specified member, and**
- any other expenses you deducted in computing your property income such as repayments of shareholder loans and repayments of inducements.

Use "Part 7 — Calculation of Cumulative Net Investment Losses" of form T657, *Calculation of Capital Gains Deduction for 1988*, to calculate your CNIL.

Basically, your cumulative gains limit for 1988 is the total of the net taxable capital gains that you realized during the years 1985 to 1988 **minus** the total of

- any allowable capital loss you deducted from other income in 1985 (maximum $2,000),
- all allowable business investment losses you claimed in 1985, 1986, 1987 and 1988,
- all net capital losses of other years you claimed in 1985, 1986, 1987 and 1988,
- your 1988 cumulative net investment loss, **and**
- all capital gains deductions you claimed in 1985, 1986 and 1987.

Use "Part 2 — Calculation of Cumulative Gains Limit for 1988" of form T657, *Calculation of Capital Gains Deduction for 1988*, to calculate your cumulative gains limit for 1988.

Example

In 1986, Ursula had a net taxable capital gain of $10,000 which was reported on line 127 of her 1986 return. She also had an unapplied net capital loss of $15,000 which she incurred before May 23, 1985. Ursula claimed a deduction of $12,000 for net capital losses of other years at line 253 of her 1986 return: $10,000 to offset the taxable capital gain she realized in 1986 and an additional $2,000 from her pre-1986 capital loss balance. She claimed no capital gains deduction in 1985 or 1986.

In 1987, Ursula had a net taxable capital gain of $30,000, and reported this amount on line 127 of her return. On line 253, she claimed the remainder of her unapplied net capital losses of other years in the amount of $3,000 ($15,000 minus $12,000). Ursula also incurred an allowable business investment loss in 1987 of $10,000 which she claimed on line 217. She claimed a capital gains deduction of $15,000 in 1987.

In 1988, she realized a capital gain of $30,000. This means that Ursula must report a net taxable capital gain of $20,000 ($30,000 x 2/3) on line 127 of her return. She also incurred an allowable business investment loss of $5,000 in 1988 which she records on line 217.

In addition, Ursula had net rental income of $3,900 and interest income of $1,200 in 1988. She claimed carrying charges of $400 for money she borrowed to purchase Canada Savings Bonds. Ursula also received a statement from the limited partnership of which she is a member showing that her share of the partnership's loss for 1988 was $5,000.

Ursula has never disposed of any qualified farm property or qualified small business corporation shares. Therefore, to calculate her maximum capital gains deduction for 1988, Ursula should only complete Parts 1,2,5,6 and 7 of form T657, *Calculation of Capital Gains Deduction for 1988* as indicated below.

Revenue Canada Taxation — Revenu Canada Impôt

T657-E
Rev. 88

CALCULATION OF CAPITAL GAINS DEDUCTION FOR 1988

- For use by an individual who was resident in Canada throughout 1988 to compute a deduction for capital gains realized on a disposition of capital property in 1988 in accordance with section 110.6 of the Income Tax Act.
- An individual who ceased to be resident in Canada in 1988, but who was resident in Canada throughout 1987, shall be deemed for the purpose of section 110.6 to be resident in Canada throughout 1988.
- A reserve claimed in respect of a disposition of capital property after 1984 will qualify for the capital gains deduction when brought into income in a subsequent year.
- You must file an income tax return for 1988 if you have a capital disposition to report even if you have no tax payable. Failure to report a capital gain or to file an income tax return may result in the loss of the capital gains deduction in respect of that disposition.
- For details of what is considered to be qualified farm property, refer to the 1988 Farming Income Tax Guide.
- For further information on capital gains refer to the 1988 Capital Gains Tax Guide.
- Additional information may be obtained from your District Taxation Office.

NAME IN FULL (Print)	SOCIAL INSURANCE NUMBER

PART 1 — CALCULATION OF ANNUAL GAINS LIMIT FOR 1988

(For all dispositions of capital property, including reserves on dispositions after 1984, reported in 1988, complete Part 1)

	Line	Amount	Line	Total
(a) Total capital gain for 1988 (total of line 540 on Schedule 3 and line 390 on form T2017)	1	30,000		
Net Taxable capital gains (2/3 of amount at line 1 above)	2	20,000		
ADD: Taxable capital gain on disposition of eligible capital property (total of lines 543 and 544 on Schedule 3)	3	0		
Total taxable capital gains for 1988		20,000	▶ 4	20,000
(b) Net capital losses of other years (from line 253 on Page 2 of your return)	5	0		
ADD: Allowable business investment losses (from line 217 on Page 2 of your return)	6	5,000		
Total of above losses in 1988 (line 5 plus line 6)		5,000	▶ 7	5,000
ANNUAL GAINS LIMIT (subtract line 7 from line 4 — if negative, enter zero)			8	15,000

PART 2 — CALCULATION OF CUMULATIVE GAINS LIMIT FOR 1988

(For all dispositions of capital property, including reserves on dispositions after 1984, reported in 1988, complete Part 2)

	Line	Amount	Line	Total
(a) Net taxable capital gains reported after 1984 and before 1988 (do not include reserves other than reserves on qualified farm property dispositions after 1984)	9	40,000		
ADD: Total taxable capital gains reported in 1988 (line 4 in Part 1 above)	10	20,000		
Cumulative taxable capital gains reported after 1984		60,000	▶ 11	60,000
(b) **ADD:** Allowable capital loss claimed in 1985 (Maximum $2000.)	12	0		
Total allowable business investment losses after 1984 and before 1988	13	10,000		
Total net capital losses of other years claimed after 1984 and before 1988	14	15,000		
Cumulative net investment loss (line (T) in Part 7 below)	15	300		
Total losses claimed in 1988 (line 7 in Part 1 above)	16	5,000		
Cumulative loss amount claimed after 1984 (total of lines 12 to 16)	17	30,300		
ADD: Total capital gains deductions claimed after 1984 and before 1988	18	15,000		
Sub-total		45,300	▶ 19	45,300
CUMULATIVE GAINS LIMIT FOR 1988 (line 11 minus line 19 — if negative, enter zero)			20	14,700

PART 5 — CALCULATION OF CAPITAL GAINS DEDUCTION — OTHER CAPITAL PROPERTY

(Complete this part if you disposed of capital property or are reporting reserves, other than dispositions or reserves reported on qualified farm property or qualified small business corporation shares, in 1988)

	Line	Amount		Amount
Maximum capital gains deduction for 1988			26	66,667 00
Capital gains deductions claimed after 1984 and before 1988 - other capital property only	27	15,000		
ADD: Adjustment of pre-1988 other capital property capital gains deductions (1/3 of amount reported at line 27 above)		5,000		
Subtotal	28	20,000	▶	20,000
Capital gains deduction available for 1988 (line 26 minus line 28) (if negative, enter zero)			(K)	46 667
Annual gains limit (line 8 in Part 1 above)		15,000		
SUBTRACT: Farm and small business corporation shares capital gains deductions (total of line (E) in Part 3 and line (J) in Part 4 above)		Ø		
Net annual gains limit (if negative, enter zero)		15,000	▶(L)	15,000
Cumulative gains limit (line 20 in Part 2 above)		14,700		
SUBTRACT: Farm and small business corporation shares capital gains deductions (total of line (E) in Part 3 and line (J) in Part 4 above)				
Net cumulative gains limit (if negative, enter zero)		14,700	▶(M)	14,700
CAPITAL GAINS DEDUCTION ON OTHER CAPITAL PROPERTY - Enter at line (N) an amount not exceeding the least of (K), (L) and (M).			(N)	14,7000

PART 6 — CALCULATION OF CAPITAL GAINS DEDUCTION FOR 1988 - ALL PROPERTY

	Line	Amount		Amount
MAXIMUM LIFETIME DEDUCTION - ALL PROPERTY			29	333,333 00
Capital gains deductions claimed in previous years (line 18 in Part 2 above)	30	15,000		
ADD: Adjustment of total capital gains deductions claimed in previous years (1/3 of amount reported at line 30 above)		5,000		
Subtotal	31	20,000	▶	20,000
Capital gains deduction available for 1988 (line 29 minus line 31) (if negative, enter zero)			(O)	313,333
SUBTRACT: Total of amounts (E), (J) and (N) above			(P)	14,700
Capital gains deduction available for subsequent taxation years (if negative, enter zero)			(Q)	298,633 *

Enter an amount not exceeding the lesser of amounts (O) and (P) on line 254 on page 2 of your return. *If less than the amount allowable is claimed, the amount at (Q) above will increase accordingly.

PART 7 - CALCULATION OF CUMULATIVE NET INVESTMENT LOSS TO DECEMBER 31, 1988

(Complete this part if you have any "investment expenses" and/or "investment income" for 1988. These amounts must be cumulated in 1988 and combined with all such amounts in subsequent years if a capital gains deduction is to be claimed in any year. Investment income and expenses include amounts relating to taxable dividends, interest, rents, royalties, limited or non-active partnerships, exploration and development and other property as listed in Notes 1 and 2 below.)

INVESTMENT EXPENSES FOR 1988 (claimed on your 1988 return)	Amount		Amount
ADD: (a) Carrying charges and interest expenses (from line 221)	400		
(b) Net rental loss reported on Line 126			
(c) Limited or non-active partnership loss (from line 122)	5,000		
(d) Limited partnership losses of other years (1986 and 1987) (from line 251)			
(e) 50% of exploration and development expenses (from line 224)			
(f) Any other expenses claimed in 1988 to earn property income (from line 232)*			
Total investment expenses	5,400	▶(R)	5,400

INVESTMENT INCOME FOR 1988 (Reported on your 1988 return)	Amount		Amount
ADD: (a) Investment income (from lines 120 and 121)	1,200		
(b) Net rental income, including recaptured depreciation (from line 126)	3,900		
(c) Limited or non-active partnership income (from line 122)			
(d) 50% of income from the recovery of exploration and development expenses (from line 130)			
(e) Any other property income reported on line 130 **			
Total investment income	5,100	▶(S)	5,100
CUMULATIVE NET INVESTMENT LOSS (Line (R) minus line (S)) - if negative, (if income exceeds expenses) enter zero		(T)	300

As indicated, Ursula is eligible to claim a capital gains deduction of $14,700 on line 254 on her 1988 return.

Form T657, *Calculation of Capital Gains Deduction for 1988*, will help you calculate your deduction. For your convenience, two copies of this form are enclosed in this Guide.

T3 Slip — Capital gains eligible for deduction

If you are the beneficiary of a trust and you received a T3 slip with an asterisk (*) in Boxes B, C or I, contact the issuer of the slip for instructions on how to calculate your 1988 capital gains deduction unless the instructions have been attached to your slip.

If there is no asterisk (*) in Boxes B, C or I, your T3 slip may indicate that the amount of capital gains allocated to you in Box B is different from the amount of capital gains eligible for deduction indicated in Box I. If so, to determine your capital gains deduction for 1988, you should recalculate Schedule 3 to line 540. Enter the amount in Box I at line 533 of Schedule 3 and use the new line 540 amount to calculate your annual gains limit in Part 1 of form T657, *Calculation of Capital Gains Deduction for 1988*.

Note:

When Box I is blank, your capital gains eligible for deduction are equal to the capital gains reported in Box B. Therefore, a second calculation of Schedule 3 is not required.

CHAPTER 4
PRINCIPAL RESIDENCE

A capital gain from the sale of a home that was your principal residence is usually exempt from tax. This exemption is separate and distinct from the cumulative lifetime capital gains deduction. However, you may have a **taxable** capital gain if, during the period you owned your principal residence, you used any part of it to

- earn rental income, **or**
- operate a business.

Refer to "Change in use" in this chapter for additional information.

What property qualifies as a principal residence?

A principal residence generally refers to a housing unit you own and ordinarily live in. More specifically, a property will qualify as your principal residence for a year if 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,
- owned by you solely or jointly with another person, **and**
- ordinarily inhabited in the year by you, your spouse, your former spouse or any of your children. For exceptions to this requirement, see the section in this chapter entitled "Change in use to rental or business operation."

If you dispose of a residence that meets all of these conditions for each year since you acquired it, any resulting capital gain will be exempt from tax. For additional information, see "Designating your principal residence" and "Disposition of your principal residence" in this chapter.

Types of property
Your principal residence may be

- a house,
- an apartment,
- a duplex,
- a condominium,
- a trailer,
- a mobile home, **or**
- a houseboat.

In addition, land surrounding your principal residence may qualify as part of that residence if

- it is not more than one-half a hectare, **and**
- it contributes to your use and enjoyment of the residence.

Note:

Any capital gain resulting on the disposition of land surrounding your principal residence that is in excess of one-half hectare will not be exempt from tax. However, such a capital gain may qualify for the capital gains deduction discussed in Chapter 3.

Change in use

Generally, you use a residence you own either as your principal residence or as an income-producing property. In some instances, you may use part of your principal residence for income-producing purposes. You are considered to have used part or all of a property for income-producing purposes when you use it

- to earn rental income, **or**
- to operate a business.

When you begin to use your residence to earn rental income or to operate a business, you are deemed to have disposed of the property or that part of the property to which the change relates. Similarly, if you later stop using it to earn rental income or to operate a business, a further deemed disposition occurs. You must report deemed dispositions on Schedule 3 in the same manner as actual dispositions. Depending on the circumstances of each situation, a taxable capital gain may or may not result.

Change in use to rental or business operation
If you acquired a residence to use as your home and you begin to use it for income-producing purposes, you are deemed to have

- disposed of it at the time the change occurs for proceeds equal to its fair market value at that time, **and**
- immediately reacquired it at a cost equal to that fair market value.

If the property qualified as your principal residence every year since you acquired it, any capital gain you realized on the deemed disposition will be exempt from tax.

If you later stop using it as an income-producing property, but do not sell the property, another deemed disposition occurs. Your capital gain is the increase in the value of the property since the time you last changed its use.

Normally, you report the capital gain in the calendar year of the change in use. However, a special provision applies if you convert your residence to an income-producing property but you intend to use it again as your principal residence. You may elect to designate the income-producing property to be your principal residence for up to four years if, during your absence from your residence, you

- do not designate any other housing unit as your principal residence,
- do not claim any capital cost allowance on the property, **and**
- do not rescind your election.

If you temporarily changed the use of your residence in 1988, you may choose to continue treating it as your principal residence. To make this election, you should enclose with your return a signed letter which

- describes the property, **and**
- states that you are making your election under subsection 45(2) of the Income Tax Act.

You may extend the four year limitation indefinitely if

- your absence results from a relocation required by your employer or your spouse's employer,
- you and your spouse are not related to the employer,
- you return to the original house while still with the same employer or before the end of the year following the year in which such employment terminates, **and**
- the housing unit to which the time extension relates is located at least 40 kilometres (25 miles) farther than your temporary residence is from your or your spouse's new place of employment.

If you began to use your residence as an income-producing property in 1988, please obtain the *1988 Business and Professional Income Tax Guide* or the *1988 Rental Income Tax Guide* for details on reporting business or property income.

Change in use from rental or business operation

If you acquired a house to produce income and later begin to use it as your principal residence

- you are deemed to have disposed of the property at the time you changed its use, **and**
- you may elect to postpone recognition of any capital gain until there is an actual disposition of the property.

Note:

You may not make this election if you, your spouse, or a trust under which you or your spouse is a beneficiary have claimed a deduction for capital cost allowance on the property for any taxation year after 1984.

You may make this election by

- attaching a note to your return explaining the situation, **and**
- specifying that you are making the election under subsection 45(3) of the Income Tax Act.

You were asking...?

Q. **I began to use my business property as my principal residence in 1988. I understand that I am deemed to have disposed of the property at the time that I changed its use, and that the resulting capital gain is taxable. I am also aware that I may be able to elect to defer this gain. Does this gain qualify for the capital gains deduction?**

A. Yes. The capital gains deduction is normally available where a disposition of capital property results in a taxable capital gain. This is the case whether there is an actual disposition or a deemed disposition. However, you may be able to defer recognition of any taxable capital gain until you actually dispose of the property if you make an election under subsection 45(3) of the Income Tax Act.

For information on the recapture of capital cost allowance where there has been a change in the use of property, please obtain the *1988 Business and Professional Income Tax Guide* or the *1988 Rental Income Tax Guide*.

Using part of your residence for a rental or business operation

When you begin to use part of your residence to earn rental or business income, there is normally a deemed disposition of the portion to be used for income-producing purposes. If that portion was part of a property that qualified as your principal residence every year since you acquired it, any capital gain realized on the deemed disposition will be exempt from tax. Later, when you actually dispose of the whole property,

- you must split the proceeds of disposition and the adjusted cost base between the personal and the income-producing portions. This split must be made on a reasonable basis such as square footage or number of rooms, **and**
- only the capital gain relating to the portion qualifying as a principal residence is exempt from tax. Any resulting taxable capital gain may qualify for the capital gains deduction discussed in Chapter 3.

However, if

- the portion of the residence you use for income-producing purposes is minor in relation to the whole house,
- you do not make major structural changes to make the property more suitable for income-producing purposes, **and**
- you do not claim capital cost allowance on the income-producing portion, **then**
  - you will not be considered to have changed the use of the portion used for rental or business purposes,
  - the portion used for income-producing purposes will keep its status as your principal residence, **and**
  - any capital gain you realize on the actual disposition of the property may be exempt from tax.

Designating your principal residence

For taxation years **before 1982,** more than one qualifying housing unit per family may be designated as a principal residence. Therefore, it is possible for a husband and wife to designate different principal residences for these years.

For **1982 and later years,** only one qualifying housing unit per family may be designated as a principal residence per year:

(a) For any year after 1981 during which you were either married or 18 years of age or older, family includes
- you,
- your spouse, unless you were separated throughout the year pursuant to a court order or written agreement, **or**
- any child of yours who was under 18 and not married throughout the year.

(b) For any year after 1981 during which you were neither married nor 18 years of age or older, family includes
- your mother or father, **or**
- a brother or sister of yours who was under 18 and not married throughout the year.

A special rule applies if members of a family have designated more than one housing unit as a principal residence for 1981 and prior years. For further details, see Interpretation Bulletin IT-120R3, *Principal Residence* and the next section in this chapter "Disposition of your principal residence."

Disposition of your principal residence

You should complete form T2091, *Designation of a Principal Residence*, in 1988 you
- disposed of your principal residence or any part of it,
- granted an option to acquire your principal residence or any part of it, **or**
- were deemed to dispose of your principal residence or any part of it.

If a property does not qualify as your principal residence for all the years that you owned it, the instructions on the form will help you determine
- the number of years that the property is designated as your principal residence, **and**
- the portion of your capital gain that is not exempt from tax.

You must file a form T2091 with your return **only** if a taxable capital gain remains after you apply the tax-exempt provisions. Report this amount on line 530 of Schedule 3.

For more details on the principal residence exemption, obtain Interpretation Bulletins IT-120R3, *Principal Residence*, and IT-366R, *Principal Residence – Transfer to Spouse, Spouse Trust or Certain Other Individuals* and its Special Release.

Farms

If you are a farmer and in 1988 you disposed of farmland that included your principal residence, you have the choice of using one of two methods to determine the resulting capital gain. For details on these methods, please obtain the *1988 Farming Income Tax Guide*.

CHAPTER 5
RESERVES

Although you may not receive the full sales proceeds for property you sold in a year, you must still report the transaction on Schedule 3 in the normal manner. However, the taxation of any capital gain you realized may be spread over a number of years. This is done by claiming a reasonable reserve for proceeds not due until after the end of the year.

New for 1988
The taxable portion of any reserve reported as income in 1988 and relating to the disposition of property after 1984 qualifies for the capital gains deduction. For more details, refer to Chapter 3 of this Guide.

Individuals deducting a capital gains reserve must file form T2017, *Summary of Reserves on Dispositions of Capital Property* with their return. This new form is discussed in more detail later in this chapter.

A reserve claimed at the end of 1987 must be reported on line 542 of Schedule 3 in 1988. If all the proceeds are not due in 1988, you may be able to claim a new reserve by filing form T2017.

Calculating your reserve

The method you use to calculate a reserve depends on when the disposition of property occurred.

Dispositions before November 13, 1981

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

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

Note:
You may use this formula for property you sold after November 12, 1981, if the disposition occurred under the terms of an offer or agreement in writing you made or entered into before November 13, 1981.

Dispositions after November 12, 1981

Family farm property or small business corporation shares
Family farm property includes
- shares of a family farm corporation,
- an interest in a family farm partnership, **or**
- land in Canada or depreciable property in Canada used in the business of farming by you, your spouse or any of your children.

Small business corporation shares are shares in a Canadian controlled private corporation (CCPC), in which all or substantially all (90%) of the fair market value of its assets are
- used in an active business carried on primarily in Canada by the corporation or by a CCPC related to it,
- shares or debts in a connected small business corporation, **or**
- a combination of the above two categories of assets.

If you disposed of family farm property or shares of a small business corporation after November 12, 1981 to your children or grandchildren who lived in Canada at the time of the disposition, the reserve you may claim is the **lesser** of

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

and

(b) $\dfrac{\text{Capital gain}}{10} \times (9 - X)^*$

*X = the number of taxation years since the year of disposition, but not including the year of disposition.

This calculation ensures that you report a minimum of one-tenth or 10% of the gain each year until you include the full capital gain in your income.

Other property

For dispositions of **all other types of property** after November 12, 1981, you may spread the taxation of a capital gain over a maximum of five years. Your reserve in each year may not exceed the **lesser** of

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

and

(b) $\dfrac{\text{Capital gain}}{5} \times (4 - X)^*$

*X = the number of taxation years since the year of disposition, but not including the year of disposition.

This calculation ensures that you report at least one-fifth or 20% of the gain each year until you include the full capital gain in income.

You were asking...?

Q. In 1988, I sold a residential property that was not my principal residence and I realized a taxable capital gain of $50,000. I took a mortgage back on the property and plan to claim the maximum allowable reserve each year with respect to proceeds not due in 1988 and subsequent years. It is my understanding that I can claim a capital gains deduction to offset the capital gain that is taxable in 1988 and the taxable portion of the reserve which I include in income in later years. Is this correct?

A. Yes. Beginning in 1988, the taxable portion of a reserve that you include in income may qualify for the capital gains deduction if the reserve relates to a disposition of capital property after 1984. However, you may not claim a capital gains deduction that exceeds your 1988 cumulative capital gains limit of $66,667 unless you disposed of qualified farm property or qualified small business corporation shares.

Example A

Juanita sold her cottage in 1988 for $75,000. The adjusted cost base of the cottage was $50,000 and she incurred selling expenses of $5,000. Juanita received a down payment of $15,000 at the time of sale and will receive $10,000 a year for the next six years.

Juanita calculates her capital gain as follows:

Proceeds of disposition		$75,000
minus		
ACB	$50,000	
selling expenses	5,000	55,000
Capital gain		$20,000

As Juanita will not receive all the proceeds in the year of disposition, she may claim a reserve. Even though Juanita will not receive the total proceeds for six years, the taxation of her capital gain cannot be spread over more than five years.

Juanita's reserve for 1988 is the **lesser** of

(a) $\dfrac{\$20,000}{\$75,000} \times \$60,000 = \$16,000$

and

(b) $\dfrac{\$20,000}{5} \times 4^* = \$16,000$

* No taxation years have ended since the year of disposition. Therefore, Juanita does not reduce the 4 in this calculation.

When Juanita completes her 1988 return, she reports the $20,000 capital gain at line 530 on Schedule 3. She enters the reserve of $16,000 at line 388 of form T2017, *Summary of Reserves on Dispositions of Capital Property*.

Example B

Assume that Juanita disposed of the property in the above example in **1987** rather than in 1988. In that case, in 1987, she would have reported a capital gain of $20,000 and deducted a reserve of $16,000.

Since Juanita would have collected an additional $10,000 of the sale price in 1988, she must calculate a new reserve. Her reserve for 1988 is calculated as the **lesser** of

(a) $\dfrac{\$20,000}{\$75,000} \times \$50,000 = \$13,333$

and

(b) $\dfrac{\$20,000}{5} \times 3^* = \$12,000$

* As 1988 is the only taxation year that has ended since the year of disposition (1987), Juanita reduces the number 4 by 1.

When Juanita files her 1988 return, she completes form T2017, *Summary of Reserves on Dispositions of Capital Property*. She reports the 1987 reserve of $16,000 at line 386 and claims the 1988 reserve of $12,000 at line 388 of this form. Juanita enters the reduction in her reserve of $4,000 ($16,000 – $12,000) as an addition at line 542 on Schedule 3. She must file form T2017 and a Schedule 3 with her 1988 return.

For more details on reserves, obtain Interpretation Bulletin IT-236R2, *Reserves – Disposition of Capital Property*.

Form T2017

You are required to file form T2017, *Summary of Reserves on Dispositions of Capital Property* if you are claiming a reserve in 1988.

Since reserves you include in your 1988 income qualify for the capital gains deduction if they relate to dispositions after 1984, the T2017 groups reserves according to

- the type of property to which a reserve relates, **and**
- the year of disposition.

This will help you identify the amount that qualifies for the capital gains deduction.

Depending on whether your net reserve for 1988 increases or decreases your capital gains for the year, the amount calculated on form T2017 may either be an addition or a deduction at line 542 on Schedule 3.

For your convenience, two copies of form T2017 are enclosed in this Guide.

CHAPTER 6
VALUATION OF CAPITAL PROPERTY

The calculation of capital gains and losses may be different when you dispose of capital property that was acquired before 1972. This chapter discusses these different calculations.

When you dispose of capital property, you usually use the price you paid for it to determine if the disposition has resulted in a capital gain or loss. However, you may have acquired property in circumstances where you did not pay anything for it. For instance,

- when you inherit or receive property as a gift; **or**
- when you begin using personal-use property as income-producing property, or vice versa.

If you acquired property in any of these circumstances, generally, your cost is deemed to be its fair market value on the date of acquisition. Therefore, you should keep a record of the fair market value of property on the date you inherit or receive it as a gift.

Valuation Day (V-Day)

Capital gains became taxable on January 1, 1972. Therefore, to ensure that tax would not be assessed, or losses allowed, for any gain or loss that arose before that date, a starting point called Valuation Day was established for calculating capital gains and losses.

There are two Valuation Days:

- **December 22, 1971** is V-Day for publicly-traded shares (common and preferred), rights and warrants.
- **December 31, 1971** is V-Day for all other capital properties including bonds.

When you dispose of property that you held on December 31, 1971, you may elect to use its V-Day value to determine your capital gain or loss since that date.

Note:

Valuation Day is important only for property acquired before January 1, 1972. It does not apply to property acquired on or after that date.

V-Day values

V-Day will affect those who, on December 31, 1971, owned capital property including

- real estate such as cottages, land and rental property,
- personal-use property including listed personal property such as works of art, jewellery, rare folios, rare manuscripts or rare books, stamps or coins,
- investments, including shares and securities,
- land, buildings or equipment used in a business, **or**
- partnership interests.

You need to know the fair market value of these properties on V-Day to determine any capital gain or loss when you dispose of them. However, you do not have to establish or report the V-Day value of your property until you dispose of it.

Although you may not be planning to dispose of your property for several years, it is to your advantage to determine the V-Day fair market value of the property today. If you wait, the value becomes increasingly difficult to establish.

All property will eventually be disposed of for income tax purposes. Even if it is never sold or otherwise disposed of, disposal will be deemed to have occurred on the death of the owner.

Determining the V-Day value of your property

It is your responsibility to establish what the fair market value of your property was on V-Day. To avoid any possible conflict of interest, our appraisers do not establish property values for owners.

You may not need to employ a professional appraiser. If determining the value of your property is a simple matter, you may wish to do it yourself. On the other hand, the size and type of your property may mean that you need a professional appraiser.

Note:

You cannot deduct the cost of appraisal fees from your income or from any capital gain when you eventually dispose of the property.

Real estate

A professional appraiser will normally provide a fully documented appraisal with supporting data that adequately explains the investigation carried out. The appraisal should include a detailed explanation of the method used to arrive at the estimated value.

You may wish to establish the value yourself. If so, you should collect information on sales of similar properties in the same area around December 31, 1971. This will help you to arrive at the fair market value of your property. To support your valuation, you should retain documents containing the following information:

- a brief description of the property, including location, lot, building size, and date and type of construction;
- the cost and date of purchase;
- the cost of any additions or improvements, including receipts for the cost of labour or materials;
- the property assessment for municipal tax purposes; **and**
- insurance coverage.

We may require additional information for certain other types of property, such as

(a) farm property
  - the type of land (arable, bush or shrub), **and**
  - the type of farming done.

(b) rental property
  - the gross annual rental income, **and**
  - the net annual income before capital cost allowance.

(c) commercial and industrial property
  - the type of business for which the property is used,
  - the gross annual income derived from it, **and**
  - the net annual income before capital cost allowance.

Real estate data bank
We have set up a computerized Real Estate Data Bank to assist in verifying values reported in income tax returns. It contains records of real estate transactions that took place in 1971 and 1972. Properties sold during this period are listed and pertinent information such as legal description, municipal address, assessed value, lot size and other data is noted. Taxpayers who are disposing of property may obtain information from the data bank by contacting their district taxation office.

Investments
If, on December 31, 1971, you owned publicly traded shares, please obtain the booklet entitled *Valuation Day Prices of Publicly Traded Shares and Securities* from your district taxation office. Publicly traded shares are shares bought and sold through a stock exchange. This publication lists all publicly traded shares and their V-Day value (December 22, 1971) if they were traded on a recognized stock exchange in Canada. We will accept only the prices in this publication, unless you can establish another fully-documented value.

Any shares not included in this publication have a December 31, 1971 V-Day value. You should be able to determine the V-Day value of such shares by consulting published listings of transactions on stock exchanges, investment publications or investment dealers.

Establishing a V-Day value for shares in a private company may be more difficult. There is no standard formula and you must value each holding on its own particular merits. This may require professional assistance.

Business property
Capital properties used in a business are valued in the same manner as other properties. However, the following do not require valuation for capital gains purposes:

- the trading assets of a business such as inventory and accounts receivable, **and**
- eligible capital property such as the goodwill of a business. The taxation of the proceeds from the disposition of such property are subject to tax in a special manner. For information on how to calculate the taxable amount, obtain the *1988 Business and Professional Income Tax Guide*, the *1988 Farming Income Tax Guide* or the *1988 Fishing Income Tax Guide*.

Partnerships
Since January 1972, partnerships have been considered owners of property for tax purposes. Therefore, when a partnership disposes of capital property, a capital gain or loss may result at the partnership level. A V-Day value is therefore required for all capital property of the partnership at December 31, 1971. Once the partnership's taxable capital gain or allowable capital loss has been calculated, individual partners must report their share of the disposition when they file their income tax returns for the year in which the partnership's fiscal period ends. Note that the capital gains deduction is available to individual partners but not to the partnership itself.

In addition, an interest in a partnership is a capital property. A partner who withdraws from or otherwise disposes of an interest in a partnership may realize a capital gain or loss.

For more details on partnerships, obtain Interpretation Bulletins IT-338R, *Partnership Interests – Effects on Adjusted Cost Base Resulting from the Admission or Retirement of a Partner* and Correction Sheet 8, IT-353R2, *Partnership Interest – Some Adjustments to Cost Base*, and IT-378R, *Winding-up of a Partnership*. If you disposed of part or all of a partnership interest in 1988 and were a member of the partnership continuously since before 1972, obtain form T2065, *Determination of Adjusted Cost Base of a Partnership Interest*.

For general information about our role in evaluating securities, partnerships, goodwill and similar business equities, please obtain Information Circular 72-25R3, *Business Equity Valuations*.

Disposition of property owned on December 31, 1971

If you acquired property before 1972 and its actual cost is the same as its value on V-Day, this amount is its cost for capital gains purposes. However, if the actual cost and the V-Day value differ, you must use one of the following two methods to determine the cost of the property for capital gains purposes:

- you may elect to use the fair market value on V-Day as the cost of all such capital property you owned on December 31, 1971, **or**
- you may determine the cost using the "median rule."

These methods are explained below.

Tax Tip

You should carefully consider the pros and cons of both methods of valuing capital property you owned on December 31, 1971. Once you choose a method to calculate the capital gain or loss resulting from your first disposition of pre-1972 capital property, you must use that same method to report all dispositions of such property. For instance, once you use the V-Day value election, you may not change to the median rule. Nor may you use the median rule, then change and use the V-Day value on a later disposition.

Note:

These methods of determining the deemed cost of pre-1972 capital property do not apply to depreciable property or interests in a partnership.

If you dispose of depreciable or personal-use property, you may not deduct any capital loss arising from its disposal. For more details, refer to "Personal-use property" in Chapter 1 or the section entitled "Disposition of depreciable property" in Chapter 8.

The median rule

To determine the deemed cost under the median rule, three amounts are required:

- the actual cost,
- the V-Day value, **and**
- the proceeds of the disposition.

The median amount is the amount that is neither the highest nor the lowest. That amount then becomes the deemed cost in calculating the capital gain or loss. When two or more of these amounts are the same, that amount will be the median.

The following examples demonstrate the median rule:

Example A

Matt acquired a cottage lot in 1968 for $10,000. He sold it in 1988 for $50,000, realizing a total gain of $40,000. However, Matt is only required to take into account the part of the gain that arose after December 31, 1971 when computing his income.

The fair market value of the property on V-Day was $20,000. This was Matt's first disposition of a property he acquired before 1972. Applying the median rule, his deemed cost will be the median of the following three amounts:

Actual cost of acquisition	$10,000
V-Day value	$20,000
Proceeds of sale	$50,000

His deemed cost of is $20,000. This figure becomes the base from which Matt calculates his gain or loss.

Selling price	$50,000
minus	
Deemed cost	20,000
Capital gain	$30,000
Taxable capital gain for 1988 ($30,000 x 2/3)	$20,000

Using the median amount, Matt reports a taxable capital gain of $20,000 at line 127.

Example B

Assume that Matt had purchased the property for $20,000, but its fair market value on V-Day had decreased to $10,000. The facts are otherwise the same as in the above example.

When Matt applies the median rule, the result is as follows:

Actual cost of acquisition	$20,000
V-Day value	$10,000
Proceeds of sale	$50,000

The deemed cost of acquisition is the median amount or $20,000.

Selling price	$50,000
minus	
Deemed cost	20,000
Capital gain	$30,000
Taxable capital gain for 1988 ($30,000 x 2/3)	$20,000

Matt's capital gain is thus equal to his actual gain on the property.

Obtain Interpretation Bulletin IT-84, *Capital Property Owned on December 31, 1971 – Median Rule (Tax-Free Zone)*, for more details.

Valuation day value election

You may elect to use the V-Day value as the deemed cost of property owned on December 31, 1971. To make this election, you must file form T2076, *Valuation Day Value Election for Capital Properties Owned on December 31, 1971* with your return for the year in which you first dispose of pre-1972 capital property. You may postpone this election as long as your only dispositions of capital property are one or more of the following:

- capital property you disposed of for the same amount as its fair market value on V-Day;
- personal-use property other than listed personal property or real property;
- listed personal property where there was no capital gain or loss as both the proceeds of disposition and the cost were $1,000 or less;
- your principal residence, if there was no taxable capital gain;
- other personal-use property that is real property, and where there was no capital gain or loss as both proceeds and cost were $1,000 or less;
- property that you were deemed to own but did not actually own; **and**
- certain property you did not acquire in an arm's length transaction.

The following examples demonstrate the Valuation Day value election.

Example A

Assume that Esther purchased shares in 1968 for $10,000 and sold them in 1988 for $14,000. On December 31, 1971 the shares had a value of $20,000.

Using the valuation day value election, the result is as follows:

Selling price	$14,000
minus	
V-Day value (deemed cost)	20,000
Capital loss	($6,000)
Allowable capital loss for 1988 ($6,000 x 2/3)	($4,000)

Esther incurred an allowable capital loss of $4,000 in 1988. She may use this loss only to reduce taxable capital gains in 1988 and other years. Refer to "1988 Capital losses" in Chapter 2. If Esther had used the median rule, her deemed cost and proceeds would have been the same

amount ($14,000) and there would have been no taxable capital gain or allowable capital loss.

Example B

Jolene purchased a cottage in 1968 for $20,000 but its V-Day value had decreased to $12,000. She sold the property in 1988 for $15,000. Jolene had elected to use the V-Day value on previous dispositions of property owned on December 31, 1971.

When the valuation day value election is applied, the result is as follows:

Selling price	$15,000
minus	
V-Day value (deemed cost)	12,000
Capital gain	$ 3,000
Taxable capital gain for 1988 ($3,000 x 2/3)	$ 2,000

Although Jolene actually suffered a monetary loss of $5,000 ($20,000 – $15,000), she must report a taxable capital gain of $2,000 in 1988 using the valuation day value election. If she had been able to use the median rule, her deemed cost would equal her proceeds of disposition and there would be no resulting capital gain or capital loss.

For more details obtain Interpretation Bulletin IT-139R, *Capital Property Owned on December 31, 1971 – Fair Market Value*.

CHAPTER 7
ROLLOVERS

If you dispose of property to someone with whom you do not deal at arm's length and your proceeds of disposition are less than they would have been on the open market, your proceeds of disposition are deemed to be the fair market value of the property. Similarly, if you acquire property in a non-arm's length transaction and your acquisition cost is more than the fair market value of the property, you are deemed to have acquired the property at its fair market value.

Interpretation Bulletin IT-405, *Inadequate Considerations – Acquisitions and Dispositions*, contains additional information.

There are special rules that permit the transfer of property at an amount that is other than the property's fair market value. If these rules apply, you may be able to elect to defer tax on any capital gain resulting from the disposition. Some of the more common "rollovers" (transfers) are noted below.

Tax Tip

As you read through this chapter, you should keep in mind the capital gains deduction discussed in Chapter 3. You may decide that the deduction is more beneficial to you than the rollover provisions.

Farms

There are many special rules governing the treatment of capital gains arising from the disposition of farm property. In certain instances, farm property may be transferred to a farmer's child or spouse. For information on these types of rollovers and other rules applicable to farm property, refer to the *1988 Farming Income Tax Guide*.

Other rollovers

You may elect to defer the recognition of any capital gains which would otherwise be realized when property is transferred from

- an individual to a corporation. To make this election, you must file form T2057, *Election on Disposition of Property by a Taxpayer to a Taxable Canadian Corporation*. For more details, refer to Information Circular 76-19R, *Transfer of Property to a Corporation under Section 85*, and Interpretation Bulletin IT-291R, *Transfer of Property to a Corporation under Subsection 85(1)*,
- a partnership to a corporation. To make this election, you must file form T2058, *Election on the Disposition of Property by a Partnership to a Taxable Canadian Corporation*. For more details, refer to Information Circular 76-19R, *Transfer of Property to a Corporation under Section 85*, and Interpretation Bulletin IT-291R, *Transfer of Property to a Corporation under Subsection 85(1)*, **and**
- an individual to a partnership. To make this election, you must file form T2059, *Election on Disposition of Property by a Taxpayer to a Canadian Partnership*. For more details, refer to Interpretation Bulletin IT-413, *Partnership as 'Person' or 'Taxpayer' for Subsection 97(2)*.

Note:

If you elect to defer the recognition of any capital gains resulting on one of the above dispositions, you must still report the disposition on Schedule 3.

CHAPTER 8
OTHER SPECIAL RULES

Special rules for determining a capital gain or loss apply in some cases. The following are the most common situations affected by these rules:

- disposition of depreciable property,
- disposition of part of a property,
- identical properties,
- gifts,
- disposition of cultural property to designated institutions,
- replacement properties,

- mortgages and other obligations, **and**
- foreign exchange gains and losses.

Disposition of depreciable property

You may realize a capital gain on depreciable property only if you sell the property for more than its original capital cost. For property you owned on December 31, 1971, any capital gain is limited to the gain since V-Day.

Examples

	A	B	C
Original capital cost before 1972	$2,000	$2,000	$2,000
V-Day value	1,500	2,600	2,800
Proceeds of disposition	1,000	2,400	3,000
Capital gain	0	0	200

In example A, since the property was sold for less than its capital cost, there is no capital gain. In B, although the property is sold for more than its capital cost, there is no capital gain for tax purposes since the capital gain really occurred before 1972. A capital gain occurs only in example C.

For more details about the disposition of depreciable property acquired before 1972, please obtain Interpretation Bulletin IT-217, *Capital Property Owned on December 31, 1971 – Depreciable Property* and its Special Release.

Depreciable properties are grouped into classes according to the Income Tax Regulations. Generally, the **undepreciated capital cost (UCC)** of a class is the difference between

- the total original capital cost of all properties in the class, **and**
- the total capital cost allowance (CCA) claimed from the date the properties in the class were acquired to their date of disposition.

When depreciable property is disposed of for less than its original capital cost but for more than its UCC, there is no capital gain. If it is the last property in a class, a **recapture** of capital cost allowance generally results.

Also, there can be no capital loss on the disposition of depreciable property. However, under the capital cost allowance rules, there may be a **terminal loss** when the UCC of a particular class of property has a negative balance. The special rules to calculate the proceeds from the disposition of a building where the proceeds otherwise determined indicate that a loss has been sustained are discussed below.

Examples

A building was purchased for $20,000. It is the only property in its class. At the beginning of 1988, the building had a UCC of $11,000. It was sold in 1988. In each example below, assume the stated proceeds indicate the sales price allocated to the building.

	A	B	C
Proceeds	$ 8,000	$16,000	$24,000
UCC	11,000	11,000	11,000
Terminal loss	3,000	0	0
Recaptured CCA	0	5,000	9,000
Capital gain	0	0	4,000

Note:

In example C, the recaptured CCA is restricted to the difference between the UCC and the original cost. The proceeds in excess of the original cost represent the capital gain.

UCC	$11,000
Recapture	9,000
Original cost	$20,000
Capital gain	4,000
Proceeds of disposition	$24,000

For more information on recaptured CCA and terminal losses, please obtain Interpretation Bulletin IT-478, *Capital Cost Allowance – Recapture and Terminal Loss.*

The next section discusses the calculation of the deemed proceeds of disposition for a building where the actual proceeds indicate that a loss was incurred.

Disposal of a building in 1988

Cost amount

If the building disposed of was the only property in a class, its cost amount is the undepreciated capital cost (UCC) of the class before the disposal.

If there was more than one building in the same class, the cost amount of each building is calculated as follows:

$$\frac{\text{Capital cost of the building}}{\text{Capital cost of all buildings in the class}} \times \text{Undepreciated capital cost of the class} = \text{Cost amount of the building}$$

Proceeds of disposition

In certain instances, you must calculate and use a deemed proceeds of disposition amount instead of the actual proceeds of disposition. This must be done if you meet both of the following conditions:

1. You or a person with whom you do not deal at arm's length owned
   - the land on which the building was located, **or**
   - land next to and necessary for the use of the building.
2. You disposed of the building for an amount **less** than the lesser of
   - its cost amount as calculated above, **and**
   - its capital cost to you.

If you disposed of a building under these conditions, you calculate the deemed proceeds of disposition as outlined under **Calculation A,** unless you did not dispose of the land in the same year as the building. In that case, you calculate the deemed proceeds of disposition as outlined under **Calculation B.**

Calculation A

Enter the the fair market value of the building at the time of the disposition	$_______(1)	
Enter the fair market value of the land immediately before its disposition	_______(2)	
Line (1) plus line (2)		$_______(3)
Enter the vendor's ACB of the land	_______(4)	
Enter the total capital gains (determined without regard to any reserves) for		

dispositions of the land within the 3 year period before the disposition of the building by you or by a person with whom you were not dealing at arm's length to yourself or to another person with whom you were not dealing at arm's length	______(5)	
Line (4) minus line (5)	$______(6)	
Enter the **lesser** of line (2) and line (6)		______(7)
Line (3) minus line (7) (if negative, enter nil)		$______(8)
Enter the cost amount of the building	$______(9)	
Enter the capital cost to you of the building immediately before its disposition	______(10)	
Enter the **lesser** of line (9) and line (10)	______(11)	
Enter the greater of line (1) and line (11)		$______(12)
Deemed Proceeds of Disposition for the Building Enter the lesser of line (8) and line (12)		$______

The deemed proceeds of disposition for the land is calculated as the difference between

- the actual proceeds for both the land and the building, **and**
- the deemed proceeds of disposition for the building as determined above.

Calculation B

Enter the cost amount of the building immediately before disposition	$______(1)	
Enter the fair market value of the building at the time of disposition	______(2)	
Enter the **greater** of line (1) and line (2)		$______(3)
Enter the actual proceeds of disposition, if any		______(4)
Line (3) minus line (4)		$______(5)
Enter the amount at line (5) $______ × 1/3 =		$______(6)
Enter amount from line (4)		______(7)
Deemed proceeds of disposition of the building Add line (6) plus line (7)		$______

This calculation gives the same tax treatment to a loss on a building as that given to a capital loss on the sale of land. This is done by adding one-third of the terminal loss that would otherwise be allowable to the actual proceeds received for the building.

For more details on the recapture of capital cost allowance and terminal loss, obtain the *1988 Rental Income Tax Guide* or the *1988 Business and Professional Income Tax Guide.*

You can use form T2085, *Capital Dispositions Supplementary Schedule Re: Depreciable Property*, to help you calculate your gain or loss on the disposition of depreciable capital property.

Disposition of part of a property

When you only dispose of part of a property, you must divide the adjusted cost base (ACB) of the property proportionately between the part you dispose of and the part you retain. For instance, part of a property could be a portion of a parcel of land or part of an interest in a building. You must apportion the ACB on a reasonable basis.

Example

If you own 100 hectares of vacant land of equal quality and sell 25 hectares, you would normally calculate one-quarter of the total ACB as follows:

Total ACB	$100,000
minus	
ACB of part disposed of	25,000
ACB remainder	$ 75,000

You would then calculate your gain or loss using an ACB of $25,000 for the 25 hectares sold.

For more details.on the disposition of part of a property, obtain Interpretation Bulletin IT-264R, *Part Dispositions* and its Special Release.

Identical properties

Properties of a group are identical if each property in the group is identical in every material respect with every other property in the group. Shares of the same class of the capital stock of a corporation are the most common example of identical properties.

Identical properties acquired after 1971

A special situation arises when you acquire several identical properties at different prices over a period of time. To overcome the problem of which cost to use in determining a capital gain or loss, you are required to calculate the average cost of each property in the group. This amount is then considered to be the cost of each identical property acquired after 1971.

Example

Boris owned 100 common shares of a corporation. He purchased these shares for $15 per share. Boris later purchased another 150 shares of the same class of the capital stock of that corporation at a cost of $20 per share. In 1988, Boris disposed of 200 of these shares at a selling price of $24 a share.

Previously acquired shares	100 at $15		$1,500
Newly acquired shares	150 at $20		3,000
Total shares	250	Total cost	$4,500

Average cost of each share $= \frac{\$4,500}{250} = \$18$

Calculation of capital gain

Selling price of shares	(200 at $24)	$4,800
minus		
Cost of shares sold	(200 at $18)	3,600
Capital gain		$1,200
Taxable capital gain ($1,200 x 2/3)		$800

You calculate the average cost each time you acquire another identical property. Dispositions do not affect the average cost since the deemed cost of each property in the group is identical to the deemed cost of every other identical property in the group.

If, after selling the 200 shares in the corporation, Boris purchased 350 more shares which were identical properties at a cost of $21 a share, the average cost of the shares would change.

Cost of previously acquired shares (250 – 200) 50 at $18			$ 900
Cost of newly acquired shares	350 at $21		7,350
Total shares	400	Total cost	$8,250

Average cost of each share $\frac{\$8,250}{400}$ = $ 20.63

Use the same method to determine the average cost of identical bonds or debentures acquired after 1971 as you do for shares. One bond, debenture or similar debt obligation issued by a debtor is deemed to be identical to another such obligation issued by the same debtor if all rights attached to each are the same. The principal amount of the individual debt obligations is not taken into account in establishing whether they are identical properties.

Identical properties held on December 31, 1971
Identical properties owned on December 31, 1971 are treated differently since their V-Day fair market value must be taken into account in determining gains or losses. If you use the median rule you also need to know the actual cost of the properties. The actual cost of identical properties owned on December 31, 1971 is considered to be the average cost of such properties.

Refer to Chapter 6 for more information on the median rule.

Example

Purchased in 1969	200 shares at $ 5	$1,000
Purchased in 1970	100 shares at $ 8	800
Purchased in 1971	100 shares at $10	1,000
Total shares	400	Total cost $2,800

Actual (average) cost of each share $\frac{\$2,800}{400}$ = $7

Fair market value on Valuation Day — $14 per share

Sold in 1988 — 100 shares at $17

Calculation of capital gain using the median rule

Proceeds of sale	100 shares at $17	$1,700
minus		
Deemed cost per share is the median amount of		
proceeds	$17	
actual cost	$ 7	
Valuation Day value	$14	
Deemed cost	100 shares at $14	1,400
Capital gain		$ 300
Taxable capital gain ($300 x 2/3)		$ 200

Identical properties acquired before 1972 and after 1971
If you own a group of identical properties, some of which you purchased before 1972 and some after 1971, when you dispose of any or all of the properties,

- you are considered to have first disposed of those purchased before 1972.
- you do not average the cost of all of them.
- you must make a separate determination of the capital gain or loss on those purchased before 1972, and a further computation of the gain or loss on those acquired after 1971.

For more details on the disposition of identical properties, please obtain Interpretation Bulletins IT-387R, *Meaning of Identical Properties* and IT-78, *Capital Property Owned on December 31, 1971 – Identical Properties.*

Gifts

To persons other than your spouse
If you give property as a gift, you are deemed to have disposed of the property at proceeds equal to its fair market value at the time you give the gift. You must take any resulting capital gain or loss into account in calculating your income for the year the gift is given.

When you acquire property as a gift, you are deemed to have acquired the property at its fair market value on the day you receive it. There are no tax consequences to you at that time. However, if you subsequently dispose of it, you will have to take into account any resulting capital gain or loss when computing your income for the year of disposition.

Note:
If you acquired property before 1972, you need the property's V-Day fair market value to report the disposition.

To your spouse or a trust for your spouse
If you make a gift of property to your spouse or to a trust for your spouse, there will not normally be a capital gain or loss at that time. Depending on the type of property gifted, your proceeds of disposition are deemed to be equal to the

- undepreciated capital cost of depreciable property at the time of making the gift, **or**
- adjusted cost base of other property at the time of making the gift.

However, if you made a gift of property to your spouse or to a trust for your spouse in 1988, you may elect to transfer the property at its fair market value rather than have it deemed to be transferred for proceeds equal to its undepreciated capital cost or its adjusted cost base. You make the election by attaching a note to your return stipulating that you are making the election under subsection 73(1) of the Income Tax Act.

Your spouse or the trust is considered to acquire the property at the same amount as your deemed proceeds. If your spouse

or the trust subsequently disposes of the property during your lifetime, generally you must take any resulting capital gain or loss on the property into account in calculating **your** income if

- you are still a Canadian resident, **and**
- the property was not disposed of during a period when you and your spouse were living apart due to marriage breakdown.

If you owned property other than depreciable property or a partnership interest on June 18, 1971, and you gave it to your spouse after 1971, a special situation arises when your spouse disposes of the property. Provided that you have not elected to use the V-Day values of properties you owned on December 31, 1971, your spouse will be required to use the median rule to determine the capital gain or loss on the property. This rule applies even if your spouse had elected to use V-Day values on all property held on December 31, 1971. Under the median rule, your spouse will use the following amounts to determine the deemed cost of the property on December 31, 1971:

- your original cost,
- the V-Day value, **and**
- the proceeds of disposition.

If you have made the V-Day value election, your spouse will use the fair market value of the property on December 31, 1971, together with any adjustments to your adjusted cost base from 1972 to the transfer date, as the adjusted cost.

In calculating income, your spouse will take into account any capital gain or loss which occurs after 1971 on gifts of property received from you before January 1, 1972.

Refer to Chapter 6 for more information on V-Day value and the median rule.

For more details on transfers of property to a spouse, obtain Interpretation Bulletins IT-209R, *Inter-vivos Gifts of Capital Property to Individuals Directly or Through Trusts*, IT-511, *Interspousal Transfers and Loans of Property made after May 22, 1985* and IT-258R2, *Transfer of Property to a Spouse* and its Special Release.

Inherited property

Generally, when you inherit property, your cost is deemed to be the property's fair market value on the date you acquired it. There are no tax consequences to you at that time. However, if you subsequently dispose of it, a capital gain or loss could result. You must take any resulting capital gain or loss into account in calculating your income for the year of disposition.

Property inherited by a spouse may not be subject to this treatment. Please refer to the *1988 Deceased Persons' Income Tax Guide* for further information.

Disposition of cultural property to designated institutions

If you sell or donate certified cultural property to an institution or public authority that is designated by the Minister of Communications at the time of the disposition, any capital gain you realize is exempt from taxation. This exemption is in addition to the lifetime capital gains deduction. The Canadian Cultural Property Export Review Board is responsible for the certification of cultural property and the provision of certificates for tax purposes.

If you incur a capital loss on the disposition of a certified cultural property to a designated institution, you may deduct the loss within the limits described in Chapter 2. For instance, you may not deduct losses arising on the disposition of personal-use property that you donate to a designated institution unless the property donated was listed personal property. In addition, you can only offset losses on dispositions resulting from donations of listed personal property against gains on listed personal property.

This special treatment relates only to capital gains and not to profits or losses on dispositions by dealers and traders.

For more details, please obtain Interpretation Bulletin IT-407R2, *Disposition of Canadian Cultural Property*.

Election to defer capital gain on disposal of property

You may defer the recognition of a capital gain and the recapture of capital cost allowance resulting from the voluntary disposition of some business properties and from certain involuntary dispositions if you satisfy the requirements stated below.

Replacement property — involuntary dispositions
You may elect to defer all or part of what would have been your capital gain or recapture of capital cost allowance on property that was stolen, destroyed or expropriated, if you

- received or were entitled to receive compensation;
- acquire the replacement property within two years from the end of the year in which you were entitled to receive compensation;
- elect in your return for the year you acquired the replacement property;
- use the replacement property in a manner similar to that of the former property. If you had used the former property in a business, you must have acquired the replacement property for use in the same or similar business. The replacement property must generally be of the same physical description as the former property such as land for land, building for building, etc.; **and**
- replace a depreciable property with another depreciable property to defer a recapture of capital cost allowance.

Note:
Compensation is generally deemed to be receivable on the earliest of:

- *the day the amount of full compensation is agreed to, or is finally determined by a tribunal or court,*
- *two years after the day of the loss, if proceedings have not been taken before a tribunal or court,* ***and***
- *the date you die or cease to be a resident of Canada.*

Replacement property — voluntary dispositions
Voluntary dispositions refer to dispositions of property where the property was **not** stolen, destroyed or expropriated. You may elect to defer all of the capital gain or recapture of capital cost allowance realized on a voluntary disposition if:

- you received or were entitled to receive compensation,

- the property involved is land or buildings used primarily to earn income from a business and not for rental purposes, **and**
- you acquire the replacement land or building within one year from the end of the year in which you disposed of the former land or building.

Voluntary or involuntary dispositions
Whether you elect with respect to a voluntary or an involuntary disposition of property, please note the following:

- You will realize a capital gain only to the extent that the cost of the replacement property is less than the proceeds of disposition of the former property. You may defer the realization of this gain when a portion of the proceeds of disposition is not due until a subsequent year. See Chapter 5 for information on reserves.
- If you elect to defer recognition of recapture of capital cost allowance, you may reduce the proceeds of disposition by the amount that would otherwise be recaptured. Consequently, you will not include the recapture in income in the year. Instead, the recapture will reduce the undepreciated capital cost of the class of depreciable property containing the replacement property.
- If you elect to defer the recognition of either the capital gain or recapture of capital cost allowance, you are considered to have elected to defer both.
- If you do not acquire a replacement property until a taxation year that is later than the year that the property was disposed of, you must report any recaptured capital cost allowance or taxable capital gain in the year of disposal.
- If you acquire a replacement property in a taxation year after the year of disposition, but within the specified time limit, you must
  - make the election to defer your capital gain or recapture in your return for the year you acquired the replacement property, **and**
  - request an adjustment to your return for the year of disposal to delete the portion of the capital gain or recapture you are deferring. Refer to the "Changing your return after you mail it" section in the *1988 General Tax Guide* for instructions on how to request an adjustment to your return.

For more details on the above elections and what constitutes replacement property, obtain Interpretation Bulletins IT-259R2, *Exchanges of Property* and its Special Release, and IT-491, *Former Business Property*.

Mortgages and other obligations

Mortgages and conditional sales agreements
The holder of a mortgage on a property is referred to as the mortgagee while a mortgagor is the person who owes the money to the mortgagee.

Mortgagee
As a mortgagee, you may take possession of the property securing a mortgage because of a default on the part of the mortgagor. In such cases, you are generally deemed to have reacquired the mortgaged property for

- the amount owing to you on account of principal under the mortgage

  minus
- any reserve that you deducted in the preceding year for amounts not due until later years.

As the adjusted cost base of the mortgage itself is deemed to be zero, you will not be able to deduct a capital loss by reason of the repossession. Therefore, there are no capital gain or loss implications at that time. Any capital gain or loss is deferred until you dispose of the repossessed property.

In computing your income for the year of repossession, you are not required to take into account any reserve claimed in the preceding year for amounts not due on the mortgage. Note, however, you may not deduct any reserve for bad or doubtful debts related to the claim in the year of repossession or any subsequent year.

Mortgagor
As a mortgagor who has lost property through repossession by the mortgagee, generally, you would incur a capital loss in an amount equal to the difference between the

- principal amount owing by you under the mortgage, **and**
- the cost to you of the forfeited property.

This loss could also be a terminal loss if the property is depreciable property. However, if the property is personal-use property, the loss is deemed to be zero.

The mortgagor is also entitled to treat any amount paid to the mortgagee after repossession to satisfy the claim as a loss from the disposition of the property for the year in which the payment is made.

You may realize a capital gain as a result of repossession. For instance, if property you owned before December 31, 1971 is mortgaged in 1982, the amount of money borrowed could be in excess of the property's adjusted cost base (V-Day value). A repossession could result in the proceeds of disposition being in excess of the adjusted cost base of the property. This situation would generate a capital gain. However, such gains may qualify for the capital gains deduction discussed in Chapter 3 and do not attract minimum tax.

These rules do not apply to mortgaged property when the mortgagee does not acquire or reacquire beneficial ownership of the property as a result of the mortgagor's default. For instance, the property might be sold directly to a third party under a power of sale provision in the agreement. In such a case, your proceeds of disposition as a mortgagor are equal to the amount by which your liability is reduced as a result of the sale, plus any excess amount you received out of the sale proceeds.

Example

Suzanne sold land to Brian in 1987. The selling price was $110,000, consisting of a $20,000 down payment and a three-year mortgage payable in annual instalments of $30,000. In 1987, Brian made the $20,000 down payment but was unable to pay his annual instalment. Suzanne was forced to take possession of the property in 1988. At the time of repossession, the mortgage principal outstanding was $90,000. Suzanne did not claim a reserve for the unpaid proceeds in the preceding year. The tax consequences of the repossession are as follows:

Brian (mortgagor)

Proceeds of disposition (principal of the mortgage)	$ 90,000
minus	
Cost of the property	110,000
Capital loss	($ 20,000)

Suzanne is deemed to have acquired the property for the amount of principal owing under the mortgage at the time of reacquisition, or $90,000. As the ACB of the mortgage is deemed to be zero, she is not able to deduct a capital loss because of the repossession. The recognition of any capital gain or loss is deferred until Suzanne again disposes of the property.

The above rules also apply when property is repossessed under a conditional sales contract as a result of the purchaser's failure to pay all or any part of an amount owing under the agreement.

For additional information, refer to Interpretation Bulletin IT-505, *Mortgage Foreclosures and Conditional Sales Repossessions.*

Other capital debts

When you have a receivable capital debt, other than a debt or right under a mortgage or a conditional sales agreement, and the debt becomes uncollectible, you will generally have a capital loss equal to the principal amount of the debt. The loss is not a deductible loss unless you acquired the debt

- to gain or produce income from a business or property, **or**
- as consideration for a disposition of capital property in an arm's length situation.

If the amount receivable arises from the disposition of a personal-use property, you may claim a capital loss in the year you establish the debt to be bad. However, this capital loss may not exceed the capital gain previously reported on the sale of the property which created the debt.

For more information about capital debts, obtain Interpretation Bulletins IT-159R2, *Capital Debts Established to be Bad Debts*, and IT-239R2, *Deductibility of Capital Losses from Guaranteeing Loans for Inadequate Consideration and from Loaning Funds at less than a Reasonable Rate of Interest in Non-arm's Length Circumstances.*

Foreign exchange gains and losses

Foreign exchange gains or losses that result from capital transactions in foreign currencies are treated as capital gains or losses for tax purposes. However, only the amount of your net gain or loss for the year from transactions in foreign currency which exceeds $200 is taxable or deductible as a capital gain or loss. Record this amount on line 528 of Schedule 3. If the net amount is $200 or less

- there is no capital gain or loss, **and**
- you are not required to report the transaction(s) on your return.

Form T2087, *Capital Dispositions Supplementary Schedule Re: Foreign Exchange Transactions*, is available to help you calculate your gains or losses from foreign exchange transactions. For more details about the nature of capital transactions resulting in foreign exchange gains or losses, obtain Interpretation Bulletin IT-95R, *Foreign Exchange Gains and Losses.*

CHAPTER 9
NON-RESIDENTS

Ceasing to be a resident of Canada

If you leave Canada to reside in another country, you are deemed to dispose of all of your capital property **except**

- taxable Canadian property which includes
  - real property situated in Canada,
  - shares of Canadian private corporations,
  - capital property used in carrying on a business in Canada,
  - certain shares of public corporations,
  - capital interests in Canadian trusts except certain mutual fund trusts, **and**
  - interests in certain partnerships.

and

- rights to receive certain Canadian source payments such as
  - Old Age Security payments, Canada Pension Plan payments and most other pensions,
  - social benefits including Unemployment Insurance payments, workers' compensation and social assistance,
  - retiring allowances, **and**
  - IAAC, RRSP and RRIF payments.

The properties listed above continue to be subject to Canadian tax even when you are not a resident of Canada.

All other capital property is deemed to be disposed of at its fair market value at the time of your departure. You must take into account any resulting capital gain or loss in computing your income for the year in which you ceased to be a resident. You may elect to pay any tax in up to six annual instalments if you

- provide acceptable security, **and**
- file form T2074, *Election Under Subsection 159(4) to Defer Payment of Income Tax on the Deemed Disposition of Property.*

Other Options

When you cease to be a resident of Canada, you may want to consider the following two options.

1. You may elect to be deemed to have disposed of your taxable Canadian property immediately before emigrating from Canada. This enables you to take advantage of the capital gains deduction for any capital gains that have accrued on such property to the time of

your departure. To make the election and to take advantage of the capital gains deduction,

- report the deemed disposition of the property on Schedule 3, *Summary of Dispositions of Capital Property in 1988*,
- complete form T657, *Calculation of Capital Gains Deduction for 1988*, **and**
- include both items with your return for the year of departure.

OR

2. You may elect to treat any or all of your capital properties as not having been disposed of at the time of your departure. Such property is then deemed to be taxable Canadian property. Therefore, you will not realize any capital gain until the property to which the election relates is
   - actually disposed of, **or**
   - otherwise deemed to have been disposed of such as when you give property as a gift.

   To make this election, you
   - complete form T2061, *Election by an Emigrant to Defer Deemed Disposition of Property and Capital Gains Thereon*, **and**
   - furnish acceptable security for payment of any tax deferred by the election.

   This election will defer realization of the capital gain or loss on any or all of the property you own at the time you leave Canada until you actually dispose of the property.

Becoming a resident of Canada

Individuals from other countries are deemed to acquire their capital property at its fair market value on the date they become resident of Canada. Therefore, upon becoming a resident of Canada,

- prepare a list of all properties you own, **and**
- note the fair market value of each property at that time.

For the purpose of determining any capital gain or loss on a subsequent disposal of such property, the cost of each property will be its fair market value at the time you became a Canadian resident.

Capital gains deduction

You may only claim the capital gains deduction in computing taxable income if you were resident in Canada throughout the entire taxation year in question. However, you are deemed to have been resident in Canada throughout a particular taxation year if you were a resident at any time in the particular year and

- throughout the immediately preceding year, **or**
- throughout the immediately following year.

The capital gains deduction applies to capital gains realized on actual and deemed dispositions.

The following illustrates the availability of the capital gains deduction for individuals immigrating to and emigrating from Canada:

- If you emigrated from Canada in 1988, the capital gains deduction would be available to you if you were a resident of Canada at any time in 1988 **and** throughout 1987.
- If you immigrated to Canada in 1988, but were not resident here for the entire year, the capital gains deduction will not be available to you until you have lived in Canada **throughout** 1989.
- Immigrants who arrived in Canada in 1987 **and** were resident throughout 1988 may now claim the deduction for the 1987 taxation year. If you are in this position and wish to claim this deduction on your 1987 return, please refer to "Changing your return after you mail it" in the *1988 General Tax Guide*.

You were asking...?

Q. I immigrated to Canada from another country in May 1987. Later in 1987, I sold some shares and realized a capital gain which I reported on my return for the year. I knew that I didn't qualify for the capital gains deduction at that time. However, I have heard that since I now qualify for the deduction I can have my 1987 return adjusted. Is this correct?

A. If you continued to be resident in Canada throughout 1988, you are deemed to have been a resident throughout 1987 for the purpose of claiming the capital gains deduction. Please refer to the section entitled "Changing your return after you mail it" in the *1988 General Tax Guide*, for instructions on how to request an adjustment to your 1987 return.

Chapter 3 of this Guide contains more information on the capital gains deduction.

For more information on the treatment of property when a person enters or leaves Canada, please obtain the *1988 Immigrants' and Emigrants' Tax Guide* and Interpretation Bulletin IT-451R, *Deemed Disposition and Acquisition on Ceasing to be or Becoming Resident in Canada*.

REFERENCES

The Department issues a number of forms, guides and other publications for use by the public. A complete listing of these publications is contained in Information Circular 88-1.

Listed below are several of these publications which may be of assistance to you. Complete the order form located on the inside back cover of this Guide. You may order by phone, mail, or in person at your district taxation office.

Forms

T1A	Request for Loss Carry-back
T123	Election on Disposition of Canadian Securities
T657	Calculation of Capital Gains Deduction for 1988
T2017	Summary of Reserves on Dispositions of Capital Property for 1988
T2057	Election on Disposition of Property by a Taxpayer to a Taxable Canadian Corporation
T2058	Election on Disposition of Property by a Partnership to a Taxable Canadian Corporation
T2059	Election on Disposition of Property by a Taxpayer to a Canadian Partnership
T2061	Election by an Emigrant to Defer Deemed Disposition of Property and Capital Gains Thereon
T2065	Determination of Adjusted Cost Base of a Partnership Interest
T2074	Election Under Subsection 159(4) to Defer Payment of Income Tax on the Deemed Disposition of Property
T2076	Valuation Day Value Election for Capital Properties Owned on December 31, 1971
T2080	Personal-Use Property (other than listed personal property and principal residence)
T2081	Listed Personal Property
T2082	Shares
T2083	Real Estate (except principal residence, other personal-use property and depreciable property)
T2084	Bonds and Other Obligations
T2085	Depreciable Property
T2087	Foreign Exchange Transactions
T2088	A. Net Listed-Personal-Property Losses – Unapplied — B. Net Capital Losses – Unapplied
T2089	Information Slips
T2090	Election Available to Farmers Disposing of Farmland
T2091	Designation of a Principal Residence
T2211	Calculation of Deemed Proceeds and Capital Gain Deferral on Disposition of Shares of a Small Business Corporation

Information Circulars

72-25R3	Business Equity Valuations
76-19R	Transfer of Property to a Corporation under Section 85
78-10R	Books and Records Retention/Destruction
88-1	List of Forms and Publications Available For Use by the Public

Interpretation Bulletins

IT-73R3	Income from an Active Business
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-95R	Foreign Exchange Gains and Losses
IT-96R4	Options Granted by Corporations to Acquire Shares, Bonds or Debentures
IT-113R3	Benefits to Employees — Stock Options
IT-114	Discounts, Premiums and Bonuses on Debt Obligations
IT-120R3	Principal Residence
IT-123R4	Disposition of and Transactions Involving Eligible Capital Property
IT-125R3	Dispositions of Resource Properties
IT-128R	Capital Cost Allowance — Depreciable Property
IT-139R	Capital Property Owned on December 31, 1971 — Fair Market Value
IT-143R2	Meaning of Eligible Capital Expenditure
IT-159R2	Capital Debts Established to be Bad Debts
IT-209R	Inter-vivos Gifts of Capital Property to Individuals Directly or Through Trusts
IT-213R	Prizes from Lottery Schemes, Pool System Betting and Giveaway Contests
IT-217	Capital Property Owned on December 31, 1971 — Depreciable Property, and Special Release dated September 13, 1982
IT-218R	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-232R2	Non-Capital Losses, Net Capital Losses, Restricted Farm Losses and Limited Partnership Losses — Their Composition and Deductibility in Computing Taxable Income
IT-236R2	Reserves — Disposition of Capital Property
IT-239R2	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-258R2	Transfer of Property to a Spouse, and Special Release dated December 30, 1987
IT-259R2	Exchanges of Property, and Special Release dated November 7, 1986
IT-264R	Part Dispositions, and Special Release dated October 19, 1984
IT-291R	Transfer of Property to a Corporation under Subsection 85(1)
IT-332R	Personal-Use Property
IT-338R	Partnership Interests — Effects on Adjusted Cost Base Resulting from the Admission or Retirement of a Partner, and correction sheet 8
IT-346R	Commodity Futures and Certain Commodities
IT-353R2	Partnership Interest — Some Adjustments to Cost Base
IT-366R	Principal Residence — Transfer to Spouse, Spouse Trust or Certain Other Individuals, and Special Release dated May 8, 1987
IT-378R	Winding-up of a Partnership
IT-387R	Meaning of "Identical Properties"
IT-405	Inadequate Considerations — Acquisitions and Dispositions
IT-407R2	Disposition of Canadian Cultural Property
IT-413	Partnership as 'Person' or 'Taxpayer' for Subsection 97(2)
IT-451R	Deemed Disposition and Acquisition on Ceasing to Be or Becoming Resident in Canada

IT-456 Capital Property — Some Adjustments to Cost Base
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-479R Transactions in Securities, and Special Release dated February 21, 1985
IT-484 Business Investment Losses
IT-486R Intergenerational Transfers of Shares of a Small Business Corporation
IT-491 Former Business Property
IT-505 Mortgage Foreclosures and Conditional Sales Repossessions
IT-511 Interspousal Transfers and Loans of Property made after May 22, 1985

Guides and Other Publications

1988 Farming Income Tax Guide
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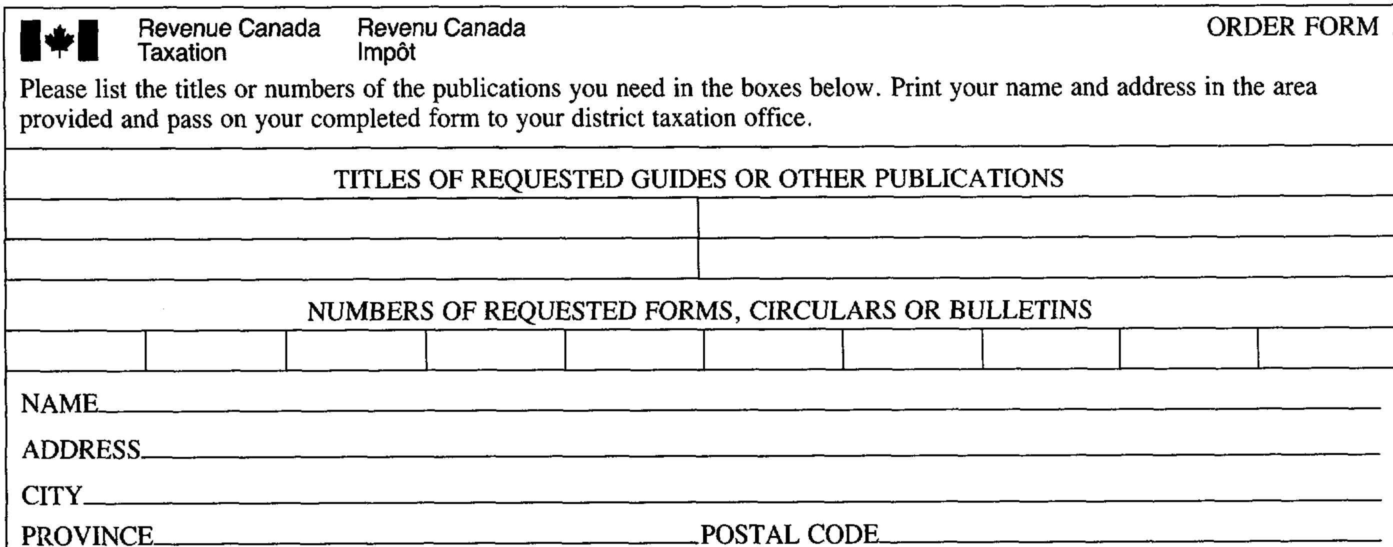

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