NATIONAL POST
FINANCIAL POST

DECEMBER 7, 2011

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Make the most of your tax losses

Prudent planning can make a big difference

'Tis the season to be jolly, but it's also time for prudent tax planning and wise investors have already combed their portfolios for tax loss selling opportunities.

If capital gains have been realized in non-registered investments, investors may choose to make use of tax losses. By selling losing positions, investors have the potential to offset capital gains and reduce their tax bill. After applying losses against capital gains in the current year, capital losses can be applied three years back (2010, 2009, or 2008) or carried forward indefinitely.

Investors must abide by the superficial loss rules, which prevent taxpayers from realizing losses without actually disposing of the assets. In order to crystallize a capital loss, investors must wait 30 days before repurchasing the investment. Those needing to trigger a loss, but also wishing to remain invested, can buy a sector-focused exchange-traded fund (ETF) or shares of a different company in the same sector.

For instance, if an investor wanted to show a loss on Research In Motion (TSX: RIM), but wished to maintain exposure to the technology sector, they could purchase an ETF such as the iShares S&P/TSX Capped Information Technology Index (TSX: XIT).

The majority of tax loss selling tends to occur during the end of November and the first half of December, and it creates volatility. Adding to it is the fact that this is also when mutual fund asset managers trigger losses in order to avoid reporting them in year-end reports. According to Canaccord Genuity analysts, this window dressing can be particularly troublesome for stocks that are trading near their 52-week lows.

The stocks to monitor are at the extreme ends of the range – the worst performing and the best performing – as they will be the most actively traded. For instance, the TSX Venture Index is down significantly this year and many of the junior companies are likely to be easy targets for tax loss sellers. Some have traded down over 80 percent this year.

Many large companies have also significantly underperformed this year, including Yellow Media Inc (TSX: YLO), Research In Motion, and Air Canada (TSX: AC.B). It's quite likely they could fall further with tax loss selling.

At the other end of the performance range, some good quality companies will have their share prices artificially driven down because of the selling activity, and they will present good buying opportunities.

When reviewing your choices, don't sell a stock simply to show a tax loss. All investment

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decisions must be based on careful analysis and thorough evaluation. If an investment is going to be sold, there should be a reason. If the future looks bright for the investment in question, the tax loss benefits may not outweigh the potential upside.

Tax loss selling is not simple and, before embarking on it, investors should consult with their accountants to ensure any decisions are right for their particular situation.

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