

# TODAY'S ISSUES



*TODAY'S ISSUES is produced three times a year by Personal Wealth Strategies. It is a commentary on important taxation, business and economic matters of interest to clients and business associates of Personal Wealth Strategies.* ed.11/08

## TAX TACTICS IN A DOWN MARKET

Good management of your portfolio is the dual responsibility of your investment and tax advisors. Obviously the investment advisor takes the lead but good tax advice is an essential ingredient. Portfolio tax implications depend on many things such as types of income, timing of income inclusion, deductibility of costs associated with your portfolio, your strategy to split income among family members and tax rules that determine the deductibility or non deductibility of capital losses.

The stock market will be a bumpy ride for awhile – at least until after the US election and probably beyond. Having said that, there are incredible values in the market today and good investment choices at this time could easily double or triple in a year or two. The market has unduly driven down the value of good stocks as well as the bad ones. Your broker may have reasons to advise you to hold in but your tax advisor may see opportunities to sell in order to trigger losses for tax benefits. Both positions are compelling so your advisors are going to have to get together and thrash out a plan to your best advantage.

### Tax Loss Selling

The bashing of portfolio values recently provides investors with a chance to recoup income taxes (past, present and future) by using an effective tax loss selling strategy that fits within the many complex tax rules. Normally, tax loss selling is done in December but the likelihood of a prolonged downturn in the market means that the strategy can start now and continue for some time. In fact, tax loss selling should be a permanent fixture of tax planning at any time. Since the market threatens to stay in neutral or decline for awhile, creating tax losses at this time is not as risky as normal.

### The Complexities of Investing

Everyone's portfolio is affected by the many influences of today's marketplace which were less in play ten or twenty years ago. Canadians are more inclined to invest internationally and so volatile exchange rates are more of an issue. The participation of developing countries in the new global economy creates a demand for materials and natural resources beyond current production capabilities and makes prices of oil, potash and other materials more volatile. Investment choices are affected by arbitrage, speculation, banking policies, geopolitical influences and the current unchecked use of credit around the world. Unless you are guided by good investment and tax advice, playing in the market can be a crap shoot.



## Cash from Tax Losses

If you sell stocks and realize losses, the Income Tax Act allows you to use them immediately or carry them back three years and forward indefinitely to offset against gains of other years. It's conceivable that larger portfolios could have \$100,000 or more of capital losses at this very moment. If you had the same \$100,000 in gains between 2005 to 2007, realizing \$100,000 of losses by the end of December would give you a \$25,000 tax refund when you file your tax return in April 2009. Not bad! If you sell a stock and generate a capital loss, you or your wife cannot buy the same stock back within thirty days of selling it or the loss is denied. The denied loss is added to the cost of the newly purchased shares. However, you can buy a similar stock to replace the one you sold to avoid the loss denial and that will allow you to participate in gains should shares go up in value in the 30 day period.

If you do not have gains in the previous three years, you can carry capital losses forward against future capital gains - forever. Building up losses now to apply strategically against gains in years ahead can smooth income and avoid high tax rates—a good strategy. You don't have to use losses until you want to and can apply them to gains only as needed – as little or as much as you want each year.

## Dangers from a Quick Recovery – Not too Likely

What happens if by chance the stock you sold recovers shortly after you sell it? You have to understand that there are risks in doing a tax loss strategy but that can be controlled. December will put even more pressure on stocks to go down as traditional year end tax loss selling switches into high gear and broadens your window of opportunity. If some of the beaten down stocks are a bargain today, it is a no brainer to take losses and buy them back after 30 days to participate in the move up as market jitters abate.

## Targeted Tax Strategies

Specific rules in the Income Tax Act can be used to your advantage – sometimes in conjunction with other family members. Some specific situations are as follows:

- ◆ Husband has accumulated unrealized capital losses in his portfolio and wife has accumulated unrealized capital gains in hers but has no offsetting capital losses. Husband sells his loser stocks and wife buys the same stocks in her portfolio within 30 days. Husband's loss is denied but the tax rules provide that his denied loss is added to the cost of his wife's securities. Later on she sells the securities at a loss and offsets her loss against gains in her portfolio.
- ◆ A by-product of selling securities with losses is to generate cash. Consider using the cash to pay off debt with *non deductible* interest and then borrow to buy new stocks. The interest on the new debt should be tax deductible.
- ◆ Gift your loser stocks to your children and claim a capital loss. When the stocks now owned by your children go up, they will have a gain. The strategy reduces your estate and spreads future capital gains amongst other family members
- ◆ If you have stocks in your portfolio with unrealized gains and it is time to sell them, the gains will obviously cause you to pay income tax. Why not also sell your loser stocks at the same time so the losses can be offset against the gains and reduce or eliminate income tax.
- ◆ Donating stocks that have decreased in value to a charity will provide a capital loss (and reduced taxes) and you will also get a charitable donation receipt for the value of the stock – a double dip.

## Bulk Up On Cash

A byproduct of selling stocks to generate tax refunds is to produce cash. Hold on to it and let your investment advisor plan a comprehensive strategy to put your money back in play– take it easy, there's no hurry to reinvest.

It used to be that the cash component of a portfolio was say 5% of a portfolio – maybe 10% at most. That was when people held Ma Bell for twenty five years. No more! With the added complexity of uneven sector performance, geopolitical influence and vastly changing market forces, volatility has been bumped a way up. To cope with such fast changing targets, it's important at times to keep more cash than ever before. And with today's downturn, cash will be your best friend – cash will be King. You should not shy at 25% to 30% at this time.

## Conclusion

Stock loss selling will make you money. You may not profit from the tax benefits immediately but eventually you will be able to apply losses to reduce your taxes or the taxes of someone in your family. Life is a risk but everything you do is a risk. This one is definitely worth taking and the odds for tax savings are better than doing nothing. So do your homework, take some action and make some dough. *This Today's Issues was first written as an article for the MoneySaver magazine.*

*J. E. Arbuckle Financial Services Inc.  
30 Dupont St. E., Suite 205, Waterloo, Ontario N2J 2G9  
Phone: 519-884-7087 Fax: 519-884-5741  
Email: [info@finplans.net](mailto:info@finplans.net)*

