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Many families suffered significant losses in 2008. In addition to job losses, the decline in equity markets has altered retirement plans and various lifestyle decisions. The income tax act allows taxpayers to use many of these losses to offset gains from other sources. In this edition of the Canadian Tax Planners Newsletter, we shall review the tax treatment of various types of losses.

### Tax Planning for Losses

We shall review tax planning tips and traps related to the following types of losses:

- non-capital losses
- capital losses
- losses related to a deceased's final tax return
- transactions with spouses
- non-arm's length transactions
- housing losses
- personal use property
- depreciable property

### Non-capital Losses

A non-capital loss arises from a loss in a business. The losses can be used to offset income from other sources, such as employment income or investments. These losses can be carried back three years and forward twenty years. In 2006, the loss carryforward period was extended from ten years to twenty years.

**Rental Losses** – A rental loss is a non-capital loss, thus they can be carried back three years and forward twenty years. However, there are two caveats. A loss cannot be created or increased by claiming capital cost allowance. This provision effectively eliminates many of the losses from rental properties. Secondly, if rent is received from a non-arm's length person, such as a child, the rental loss may be disallowed if the rent received was less than fair market value.

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## Capital losses

If a transaction creates a capital loss, 50% of the loss is known as an “allowable capital loss” and can be used to offset taxable capital gains. Such losses can be carried back three years and forward indefinitely. There are a number of tax planning tips related to capital losses.

**Interest on Loss Carrybacks** – If a loss is carried back to a prior year, it will result in a tax refund. In effect, the individuals have overpaid their taxes and therefore are entitled to receive interest on the overpayment. CRA must pay interest as of the latest of these five dates:

- the date when the return for the loss year was filed
- the first day following the loss year
- the date the taxpayer makes a written request to CRA to recalculate the tax liability based on the loss carry back
- if the taxpayer files an amended return, the date of filing
- the date the taxpayer files a T1A form advising of the loss carry back

Since it is the date that CRA is contacted that determines the start of the interest period, it is important to advise CRA as early as possible. Amounts owed by CRA are calculated as the prescribed rate of interest that is set quarterly plus 2%.

**Order of Losses** – The rules are very flexible concerning how losses are applied. For example, if taxpayers have losses from different sources, they can select which losses will be utilized and which can be saved for a later date. Rather than carry capital losses to one of the previous three years, assuming capital gains were available, the taxpayer may decide not to make such a claim and these losses can be carried forward to future years. It is normally prudent to apply the capital losses to previous years, but if the taxpayer had a lower marginal tax rate in the year of the gain, there may be a net saving by deferring the claim to a future year when the tax rate is expected to be higher.

**Transfers to a RRSP** – Individuals with a self-directed RRSP have the option of contributing cash or investments to their RRSP. If the decision is made to transfer stocks from an investment portfolio to a registered retirement savings plan, consider the capital gains implications of such a transfer.

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