

# The Navigator

RBC WEALTH MANAGEMENT SERVICES

## Actual or Deemed Dispositions

### List of events outside a sale that may trigger taxable capital gains/losses

Typically, you realize a capital gain or loss when you sell securities on a secondary market for cash. If the cash proceeds on the sale of your security are greater or smaller than its adjusted cost base (ACB), a taxable capital gain or loss will result. However, there are other events outside a sale that may trigger an actual or deemed disposition of your securities or other assets for Canadian tax purposes. Therefore, it is important for you to recognize when an actual or deemed disposition may result.

#### What events will trigger an actual or deemed disposition?

Under certain circumstances the Canadian tax rules may require that you report your assets as having been sold in the same manner as you would treat an actual sale of those assets for cash. An actual or deemed taxable disposition of assets may result from an event that is not the actual sale of the assets. Therefore, even if you do not receive cash or some other form of consideration for your assets, you may trigger a disposition that you must report on your tax return, and you may have to pay the resulting tax liability.

Here is a non-exhaustive list of common events outside a

sale that may trigger an actual or deemed disposition for tax purposes resulting in taxable capital gains or losses:

*(Note: The term “spouse” used in this article also refers to common-law partner or same-sex partner.)*

#### Transfer of assets from a non-registered account to a registered account

When securities are transferred in-kind from your non-registered investment account to a registered account such as a Registered Retirement Savings Plan (RRSP), Registered Education Savings Plan (RESP), Registered Disability Savings Account (RDSP), Tax-Free Savings Account (TFSA) or Registered

Retirement Income Fund (RRIF), you are deemed to have disposed of the securities for proceeds equal to the fair market value (FMV) of the securities at the time of the transfer to the registered account. A transfer may trigger a capital gain or loss.

Note that if a capital loss is triggered as a result of the in-kind transfer to a registered account, the capital loss will be deemed to be nil and lost forever. A better strategy to use if your security is in a loss position is to sell it first for cash and then contribute the cash to the registered account. If you intend to repurchase the same security, remember to wait 30 days from the settlement date of the sale to avoid the superficial loss rules.



RBC Wealth Management

---

Note that if a capital loss is triggered as a result of the in-kind transfer to a registered account, the capital loss will be deemed to be nil and lost forever.

---

### **Transfer of securities to an inter-vivos trust**

If you, as the settlor, transfer securities in-kind to a trust (e.g. a family trust or a trust account for a minor), a disposition at FMV will occur. You must report a capital gain or loss on the transfer of the securities. The adjusted cost base (ACB) of the securities transferred to the trust is the FMV on the date of the transfer. Where a disposition results in a capital loss, the loss may be denied under the superficial loss rules if you or your spouse has a majority interest beneficiary of the trust. There are certain exceptions that allow you to transfer assets to a spousal trust, alter-ego trust or joint partner trust without triggering a capital gain or loss. You should consult with your tax advisor to determine whether a disposition will occur and if the superficial loss rules will apply. You should also consider whether the income attribution rules will apply after the transfer.

### **Transfers from a shareholder to their corporation or from a corporation to a shareholder**

If you transfer a security to your corporation, you may trigger a capital gain or loss. If the securities you transfer are in a gain position, a joint income tax election may be available to allow the transfer to be made at an amount that is less than the FMV. It may also be possible to elect an amount, which would result in a complete tax-deferred rollover to your corporation at the ACB.

If these securities are in a loss position, the superficial loss rules prohibit you as the shareholder from claiming a capital loss on the transfer of the securities to a corporation controlled by you or your spouse. When the loss is denied on the transfer of securities, the loss is added to the corporation's ACB of the securities.

A distribution of portfolio securities from a corporation such as a holding company to a shareholder is a taxable disposition and is reported at FMV. The shareholder's ACB will be the FMV of the securities on the date of the distribution. Where the securities are in a loss position, the stop-loss rules will prohibit the corporation from claiming the capital loss until the shareholder ultimately disposes of the securities to an unaffiliated person.

### **Corporate reorganizations (investments in other corporations)**

If your corporation reorganizes, for example through a merger or takeover, you as a shareholder may be considered to have disposed of

your shares, resulting in a capital gain or loss. Sometimes the Canadian tax rules allow a tax-deferred rollover or allow you to file a joint tax election with the corporation to allow a tax-deferred rollover at the ACB or some other elected amount that is less than the FMV.

### **Transfers to an individual other than your spouse**

If you gift securities in-kind to anyone other than your spouse, you are considered to have sold the securities for FMV, and you may trigger a capital gain or loss as a result. If you gift property to your spouse or another non-arm's length individual (i.e. individual related by blood), you should consider whether the income attribution rules will apply. For example, the income attribution rules require you to report income earned on gifts made to your spouse or minor child.

If a loss is triggered, the superficial loss rules should also be considered. The transfer of securities in a loss position to your spouse will trigger the superficial loss rules, which will deny you the loss and add the denied loss to the ACB of the securities transferred to your spouse.

### **Changing ownership of investment accounts from sole to joint ownership**

When there is a change in ownership structure of a non-registered investment account from sole ownership to joint ownership with someone other than your spouse and there is a change in legal and beneficial ownership, you are considered to have disposed of a pro-rata share of the account for FMV, which may trigger a capital gain or loss. You should also consider whether the income attribution rules or superficial loss rules apply.

A deemed disposition does not occur when someone other than your spouse is added to a joint account if the intention is to transfer only the right of survivorship and you maintain beneficial ownership. For example, it is possible for a parent to add an adult child to an investment account with the intention of transferring the right of survivorship upon death while the parent retains beneficial interest in the assets during their lifetime. If the parent maintains beneficial ownership of the account, there is no deemed disposition until death, at which point the assets are automatically transferred to the surviving joint tenant (adult child) with no probate required. Further information on this issue is available in the article titled, "Creating Joint Tenancy with Right of Survivorship Accounts Between Parents and Adult Children."

---

If you gift securities in-kind to anyone other than your spouse, you are considered to have sold the securities for FMV, and you may trigger a capital gain or loss as a result.

---

---

A deemed disposition does not occur when someone other than your spouse is added to a joint account if the intention is to transfer only the right of survivorship and you maintain beneficial ownership.

---

### **Changing ownership of investment accounts from joint to sole ownership**

When there is a change in ownership structure of a non-registered investment account from joint ownership with someone other than your spouse, to sole ownership, and there is a change in legal and beneficial ownership, you may be considered to have disposed of a pro-rata share of the account at FMV, which may trigger a capital gain or loss.

Where a joint non-registered investment account is divided amongst the non-spouse owners in a way such that each owner receives his or her pro-rata share of each security in the account, a disposition will not occur. However, if the joint non-registered investment account is divided in a manner where each owner receives his or her pro-rata share of the total value and does not receive his or her share of each security, a deemed disposition will occur. In this scenario, the owner will be deemed to have disposed of his or her share of each security and a capital gain or loss may be triggered.

For example, assume a situation in which two individuals equally own a joint account which contains 10 shares of Company X with a fair market value of \$10 per share and a book value of \$8 per share, and 20 shares of Company Y with a fair market value of \$5 per share and a book value of \$2 per share. The account's total fair market value is \$200 and book value is \$120. If both individuals decide to transfer their investments to separate sole accounts such that the first individual received all the shares of Company X (fair market value of \$100) and the second individual received all the shares of Company Y (fair market value of \$100), there would be a resultant capital gain taxable to both individuals. To separate the account such that there is no resultant taxable capital gain on the deemed disposition, each individual would have to receive 5 shares of Company X and 10 shares of Company Y.

### **Change in use of property**

Due to the Canadian tax rules referred to as "change in use" rules, when the use of property changes from personal use to business or investment use, or vice versa, the property is deemed to be sold at FMV. An example is when your principal residence is converted to a rental property, or your rental property is converted to a principal residence. In certain cases you can make an election to have the change in use rules not apply and thus defer the capital gain that would otherwise be triggered. Alternatively, if you qualify, you may choose to apply the principal

residence exemption to offset the capital gain. This area of taxation and planning should be reviewed and discussed with your own personal tax advisor.

### **Return of capital**

A security you own may under certain circumstance have a return of capital distribution that is in excess of the ACB at the end of the year. As a result, the distribution amount less the ACB of your security will be negative, resulting in a capital gain equal to the negative ACB amount.

### **Worthless securities**

Under Canadian tax rules, if at the end of the year a security you own is considered worthless, you may elect to report a deemed disposition of that worthless security on your tax return. You are deemed for tax purposes to have reacquired this security immediately after the year-end. The proceeds of the deemed disposition are zero. This means the amount of the capital loss is equal to the ACB of the worthless security.

### **Ceasing Canadian residency**

If you ceased to be a resident of Canada for tax purposes, you are deemed to have disposed of your property. Therefore, you may incur a tax liability even though you did not actually sell this property. These deemed disposition rules ensure you pay tax on the appreciated value of your property while you were a resident of Canada. There are certain exceptions to the rules and certain property that is excluded. In some cases where capital gains are triggered, your tax liability may be delayed until the property is actually sold, provided adequate security is posted with approval from the Canada Revenue Agency (CRA).

### **Upon death**

When an individual dies, all of their capital property is deemed to have been sold immediately prior to death, unless that property is left to a spouse or spousal trust. Therefore, you may be considered to have disposed of the securities held in your non-registered account for proceeds equal to FMV, and thus, trigger a capital gain or loss even though the property was not actually sold. There are exceptions to these deemed disposition rules where farm property is left to children. There are also special rules concerning the use of capital losses triggered on death.

---

Due to the Canadian tax rules referred to as “change in use” rules, when the use of property changes from personal use to business or investment use, or vice versa, the property is deemed to be sold at FMV.

---

## Summary

The events discussed in this article are examples of situations where an actual or deemed disposition may be triggered resulting in tax implications to you. Since other consequences could result, such as the application of the income attribution rules, the superficial loss rules, possible tax elections that can be made to avoid immediate tax consequences or reduce the tax liability, it is always advisable to speak to your advisor and your tax advisor regarding how these events could apply to you.

---

When an individual dies, all of their capital property is deemed to have been sold immediately prior to death, unless that property is left to a spouse or spousal trust

---

› Please contact us for more information.

This document has been prepared for use by the RBC Wealth Management member companies, RBC Dominion Securities Inc. (RBC DS)\*, RBC Phillips, Hager & North Investment Counsel Inc. (RBC PH&N IC), RBC Global Asset Management Inc. (RBC GAM), Royal Trust Corporation of Canada and The Royal Trust Company (collectively, the "Companies") and their affiliates, RBC Direct Investing Inc. (RBC DI) \*, RBC Wealth Management Financial Services Inc. (RBC WM FS) and Royal Mutual Funds Inc. (RMFI). Each of the Companies, their affiliates and the Royal Bank of Canada are separate corporate entities which are affiliated. \*Members-Canadian Investor Protection Fund. "RBC advisor" refers to Private Bankers who are employees of Royal Bank of Canada and licensed representatives of RMFI, Investment Counsellors who are employees of RBC PH&N IC and the private client division of RBC GAM, Senior Trust Advisors and Trust Officers who are employees of The Royal Trust Company or Royal Trust Corporation of Canada, or Investment Advisors who are employees of RBC DS. In Quebec, financial planning services are provided by RMFI or RBC WM FS and each is licensed as a financial services firm in that province. In the rest of Canada, financial planning services are available through RMFI, Royal Trust Corporation of Canada, The Royal Trust Company, or RBC DS. Estate and trust services are provided by Royal Trust Corporation of Canada and The Royal Trust Company. If specific products or services are not offered by one of the Companies or RMFI, clients may request a referral to another RBC partner. Insurance products are offered through RBC WM FS, a subsidiary of RBC DS. When providing life insurance products in all provinces except Quebec, Investment Advisors are acting as Insurance Representatives of RBC WM FS. In Quebec, Investment Advisors are acting as Financial Security Advisors of RBC WM FS. The strategies, advice and technical content in this publication are provided for the general guidance and benefit of our clients, based on information believed to be accurate and complete, but we cannot guarantee its accuracy or completeness. This publication is not intended as nor does it constitute tax or legal advice. Readers should consult a qualified legal, tax or other professional advisor when planning to implement a strategy. This will ensure that their individual circumstances have been considered properly and that action is taken on the latest available information. Interest rates, market conditions, tax rules, and other investment factors are subject to change. This information is not investment advice and should only be used in conjunction with a discussion with your RBC advisor. None of the Companies, RMFI, RBC WM FS, RBC DI, Royal Bank of Canada or any of its affiliates or any other person accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or the information contained herein. © Registered trademarks of Royal Bank of Canada. Used under license. © 2012 Royal Bank of Canada. All rights reserved. NAV0061 (10/2012)